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History of Momentum Investing

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Momentum investing is a strategy seeking to capitalize on existing trends in the stock market. In a way, it is similar to Newton's Law "that a body in motion tends to remain in motion". The momentum strategy starts with identifying and then buying stocks that have posted high price gains over the trailing three to twelve months. It uses a strict set of rules with defined market entry and exit points for each security. Portfolio turnover is high using the momentum approach as momentum trends are constantly in flux.

1965 Sam Eisenstadt at Value Line creates the first quantitative stock ranking system using earnings metrics (momentum) without regard to valuations or P/E. He arranges all 1,600 Value Line stocks into quintiles ranked 1 to 5 for the purpose of examining forward 6-month performance. He finds that Rank 1 stocks, considered to have the highest potential, far outperform those contained in the lower ranks during 1967-2009. Moreover, the Rank 1 group beat the Dow Jones Index by a ratio of 15:1 during this period according to the Hulbert Digest. Eisenstadt could arguably be called the father of "momentum investing".

1971 Jim Stowers introduces Twentieth Century Growth Fund which uses an earnings momentum model based on earnings acceleration with no consideration of P/E. Next, Twentieth Century Select is introduced in 1972, then Twentieth Century Ultra in 1982, all based on the same momentum approach. For many years, the Twentieth Century Funds rank among the best performing funds. These funds still exist today, but under the American Century name.

1978 Robert Zuccaro is appointed manager of the Axe Houghton Stock Fund and is quick to adopt a quantitative strategy given the poor recommendations of his 9-man research department. He creates a "fractional earnings" approach which is applied stocks with earnings growth of 25% or higher seeking to buy stocks with high growth rates at a low P/E, or at a fraction of its growth rate. He pioneers in another facet of momentum investing by identifying growth stocks followed by Wall Street with earnings estimates that seem too low. Wall Street has always been conservative in their earnings estimates for companies with rapidly growing earnings. This represents an investment opportunity for those who take notice. At the end of each year, he runs a post-mortem study to evaluate each stock in the fund and finds a high correlation between respective earnings growth rates and price gains each year.

1978 Benjamin Zacks, a graduate of MIT with a PHD, comes along and coins the terms "positive and negative earnings surprises". Surprises are defined as the difference between the latest quarterly earnings report and same quarter estimate. Zacks Investment Survey takes the lead in earnings surprise research and expands its coverage to momentum stocks.

1978 J Wells Wilder introduces the first relative price index using a scale of 0-100 in his book "New Concepts in Technical Trading Systems".

1983 Zuccaro forms Target Investors and starts out with his quantitative approach used at Axe which incorporates his "fractional earnings" methodology that is integrated with his positive surprise work. Additional research reveals that many stocks reporting positive earnings surprises of at least 5% tend to move faster than the stock market and persist over several quarters.

1983 William O'Neil introduces Investor's Business Daily (IBD), a financial newspaper. IBD is the outgrowth of his study which examined 30 stock variables during 1953-1982. He concludes in the study that earnings momentum and price momentum are the two most important variables of the 30 in predicting future stock price behavior. Keying off Wilder's work on a relative price scale, O'Neil creates a relative earnings growth index and relative price index. One year later, Zuccaro becomes aware of and a user of the IBD tables in managing institutional money.

1992 Zuccaro creates his first quant model using IBD data published in the Weekly Review. After compiling performance data on the model for 8 years, he calls IBD in 2000 to inquire about the performance of stocks listed in their Weekly Review and finds out that IBD never bothered to investigate Weekly Review performance, nor do they keep daily papers archived. However, Zuccaro has been archiving the Weekly Review since 1992 which provides the grist to undertake a multitude of momentum studies using data that is no longer publicly available.

1993 The groundbreaking study by Jegadeesh and Titman becomes the first academic work on "momentum" strategies. The study covers the period 1965-1989 and appears in the Journal or Finance in 1993 in the same year. In total, the two researchers undertake 16 studies. The best strategy among the many studies finds that stocks possessing the strongest "price strength" or "price momentum" over the latest 12 months go on to outperform the market averages over the following 3 months before a falloff takes place. The best strategy produced an aggregate return that exceeded the S&P 500 return by two percentage points on average for each year.

1995 David Zanoni picks up on the work of the Jegadeesh/Titman and concludes that portfolios containing 100 or more stocks can put a damper on

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returns. He goes on to stress that investors with strong confidence in their picks should choose a concentrated portfolio of 10 stocks to obtain high returns. For others with a lower risk profile, he suggests using a portfolio of 15 to 20 stocks. Concentrated portfolios, often called focus funds, start to become an accepted approach in money management. Meanwhile, Zuccaro has been using a concentrated portfolio of 20 stocks since 1978.

2001 Investor's Business Daily introduces their first momentum index built with all Weekly Review stocks after the Zuccaro telephone call several months earlier.

2000-2002 The S&P 500 declines 52% while the NASDAQ Composite plummets 78% in the worst bear market since the Great Depression. Momentum funds get crushed and many close their doors. Only 2 momentum funds can be found by the end of 2003.

2003 IBD introduces its second momentum index called the IBD 100. In 2011, IBD shortens the 100 Index to the IBD 50 because the stocks in the top half are producing better returns than those in the bottom half. As Eisenstadt discovered, this phenomenon is at the heart of every worthwhile stock ranking system.

2005 CANGX, the CAN SLIM Select Growth Fund, is introduced to follow IBD's methodology in purchasing growth stocks using momentum and fundamental factors. CAN SLIM is an anacronym for seven screens used in stock selection.

2015 The momentum style re-emerges with the introduction of new momentum ETFs. Goldman Sachs and Morgan Stanley jump into the fray with their own momentum products. FFTY, an ETF modeled after the IBD 50, is introduced and its returns correlate closely to the IBD 50 Index in its first three years.

2016 Zuccaro creates a momentum matrix comprised of 10 momentum mutual funds and ETFs to measure performance against his two momentum funds.

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