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Investment Newsletter – June 2026

Executive Summary

I launched a Quantitative Equity Strategy that I expect to produce better returns with less risk over the long run than the S&P 500 index.

The new Claude Cowork artificial intelligence application introduced this year is a fantastic tool for building financial analysis software and should enhance the productivity and value of expert investment advisors.

Introducing the 2026 Quantitative Equity Strategy

My new strategy is aimed at providing a way to do as well as the headline market returns without suffering the same valuation driven drawdown risks as the market. On a gross basis (before fees) my trading simulation shows this strategy outperformed the S&P 500 by 33.3% cumulatively over the 94-month backtest period. More importantly, since the end of the 2021 speculative craze, backtest results show a gross cumulative return of 139% for this strategy versus 69% for the S&P 500. That is a 70% advantage, which is 9.3% annually before fees.

I cannot predict the future, but the evidence I have indicates this strategy will likely perform at least as well as the market over the long run and with less risk. Therefore, it may be appropriate for clients who want equity market exposure.

Equity Investing in an Expensive Market

As investors our central problem to solve is how to capture the largest possible portion of returns available in the market while holding our risk of loss at an acceptable level. This newsletter introduces a quantitatively driven stock investment strategy with a goal to earn higher returns per unit of risk than the benchmark S&P 500 index.

This Quantitative Equity strategy is designed to optimize a measure of return per unit of risk called the Sharpe Ratio. This measures the additional returns earned in excess of the risk-free interest rate – divided by the volatility of returns. (It is not a perfect measure of risk because most

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investors care more about drawdowns and permanent loss than normal month-to-month volatility, but it is useful for comparing strategies over the same period).

For example, the Sharpe ratio for the S&P 500 stock index for the period 7/30/2018 to 6/1/2026 was .67¹. The strategy's annual excess return was 1.5% higher and its volatility was lower compared to the S&P 500. This specific period was chosen because this is the period for which I have data to test the strategy. Over this period the new strategy beat the S&P 500 by achieving a Sharpe ratio of .77.

A Response to the Risks of Growth Stock Over-Valuation

In recent years the market index has been driven by a small group of stocks that have reached extreme valuations relative to revenues and earnings. Waves of speculation resemble past stock price bubbles. When such valuations revert to normal historical levels, the drawdown from the high can be too large for most investors to withstand. From the height of the internet bubble in 2000 the NASDAQ dropped 77% before bottoming out. The ARK Innovation ETF fell 75% from its 2021 peak by 2022, and NVIDIA fell 65% in 2022.

In 2026, market indices have become very concentrated in a small group of large technology companies that are selling for very high valuation multiples relative to historical norms. The chart below, showing stock prices relative to revenues, puts things in perspective.



Notice the chart above is on a logarithmic scale. A decline to the 2019 price-to-revenue ratio of 5 (which was already the highest since the internet bubble) would imply price declines of more than 50%. The silver lining of

¹ S&P 500 Sharpe Ratio = $(15.31\% - 2.71\%) / 18.86\% = .67$

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this concentration in the market is that we are free to construct a different sort of portfolio that has lower risk of reversion in valuation multiples.

My goal in developing this new strategy is so clients can earn returns in line with the market index over the long term but with smaller declines in down markets driven by valuation concerns. In order to achieve this, the new Quantitative Equity Strategy uses a rules-based stock selection process built around a broad multi-factor ranking system. Rather than relying on a single valuation measure or a subjective forecast, the system evaluates thousands of stocks across many fundamental and market-based criteria. These include:

- projected earnings growth and sales acceleration,
- multiple measures of value (price-to-sales, gross profit to enterprise value, unlevered free cash flow, and economic value added relative to market cap),
- dividend quality,
- free cash flow return on assets,
- gross margin relative to industry peers,
- accounting indicators such as low accruals and cash conversion stability,
- low share turnover,
- stable operating margins,
- low short interest, and
- active share buybacks.

These are characteristics of financial discipline and lower downside risk.

Each stock is ranked on a 0-to-100 scale. The strategy buys only stocks that score 99 or 100 — the top two percent of all ranked companies. A company can be growing rapidly and still rank poorly if it is overpriced relative to its earnings, carries unstable accounting, or generates weak free cash flow. This disciplined, multi-factor approach is what gives the strategy its structural advantage in environments where those valuations eventually come under pressure.

Since the beginning of 2022, I've used the ranking system to buy relatively illiquid small capitalization stocks for my own account. Through the end of May 2026 my portfolio has outperformed the S&P 500 index ETF (SPY) by an annualized rate of 6.4%. While my portfolio uses different stocks and different trading rules, this performance confirms the ranking system's predictive value.

For client portfolios, the strategy will apply this ranking system to larger, more liquid stocks, with portfolio rules designed to make the approach practical for real-world implementation. The idea is to build an equity portfolio that emphasizes reasonably valued companies with favorable

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fundamentals, improving business trends, and stronger risk characteristics, while avoiding excessive dependence on the most expensive mega-cap growth stocks that dominate the S&P 500. The strategy will not outperform in every market environment, but its disciplined, valuation-sensitive process is intended to improve the long-term balance between return potential and drawdown risk.

Backtesting Analysis of Drawdown Risk

Because I have previously not used this system to trade more liquid stocks, I created an algorithm to simulate what would have happened if I had followed my trading rules for these stocks starting from 7/30/2018. The results that follow are calculated from market data but do not represent actual live trades. In these backtests, the strategy generally has lower drawdowns than the S&P 500. Because it avoids speculative, high-valuation names, it has performed better in past periods where rising interest rates forced valuations back to earth. This is what we want in a world where higher interest rates going forward could punish growth stock investors. The chart below shows the four major market declines during the backtest period.

Period	Primary Trigger	Maximum Drawdown			Market Action
		S&P 500 (SPY)	Quant Strategy	Quant Strategy vs S&P	
Q4 2018 Oct–Dec 2018	Fed tightening + US-China trade war	-19.2%	-10.4%	+8.8%	Slowdown fears drove sell-off concentrated in large-cap tech & momentum stocks.
COVID Crash Feb– Mar 2020	Pandemic fear / global liquidity crisis	-33.4%	-29.5%	+3.9%	All stocks decline due to expected recession and rush for liquidity: correlations spike.
2022 Bear Market Jan–Oct 2022	Fed rate hike cycle / valuation compression	-23.8%	-15.2%	+8.6%	Stock valuation multiples contracting as rates rise and slowdown anticipated
2025 Tariff Shock Mar–Apr 2025	US tariff escalation / trade policy uncertainty	-17.3%	-17.2%	+0.1%	All stocks decline due to expected tariff driven earnings decline. Fear increases stock correlations.

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As can be seen in the table, the Quantitative Strategy is especially useful when interest rates rise and stock valuation multiples contract towards long run norms.

Strategy Returns are Excellent over the Long Run

Over the full 7.8 years in the backtest period, the Quantitative Strategy had a cumulative return of 238.8% compared to 205.5% for the S&P 500 index (as implemented in the SPY exchange traded fund). Thus, the Quantitative Strategy delivered an annualized return of 16.8% before fees. Also, since the new strategy has lower volatility than the S&P 500, its return per unit of risk (the Sharpe Ratio) is much higher at .77 compared to .67 for the benchmark. Assuming fees at 1% of assets, the annualized return for the backtest after fees for the strategy would be 15.8% and the cumulative net return would be 216.7%.

Short Term Relative Performance depends on the Market Environment

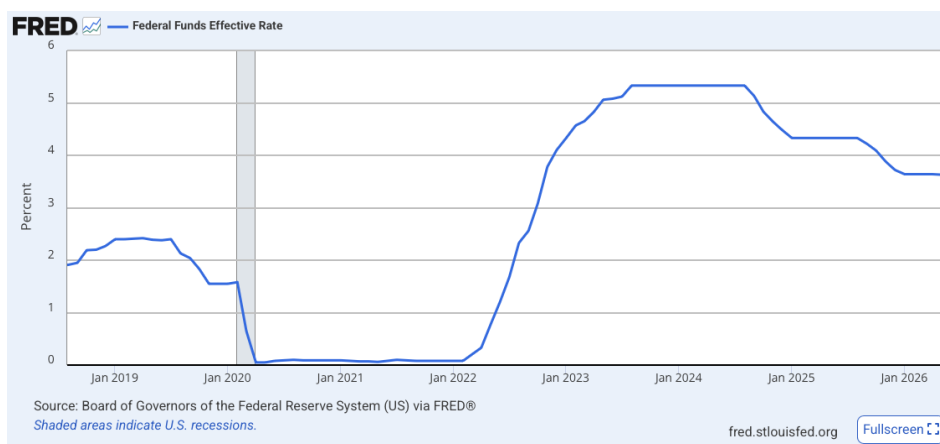
This strategy will not always outperform the S&P 500. Because the S&P 500 is mostly driven by a few large growth stocks, certain market environments that favor technology growth stocks will cause our strategy to underperform the index. In particular, periods of declining interest rates, above average growth, and intense investor optimism will favor the highest growth stocks. The table below shows the large variances across sub-periods of the backtest.

Period	Months in Period	Total Return before fees		
		Quant Strategy	S&P 500	Quant - S&P 500
End of 2018	5	-2.4%	-9.8%	7.4%
2019 to 2021	36	45.3%	100.9%	-55.6%
2022	12	0.4%	-18.8%	19.2%
23 to mid 24	18	32.9%	46.1%	-13.2%
mid 24 to May 2026	23	79.0%	42.0%	37.0%
Full backtest gross returns	94	238.8%	205.5%	33.3%
Full Backtest Returns Net of 1% fee rate:	94	216.7%	205.5%	11.2%

The table above shows that the strategy lagged the S&P 500 by a lot from 2019 to 2021 despite earning an annualized gross return of 13.3% over the 3-year period. This outperformance by large growth stocks from 2019 to 2021 seems to have been driven by the outlook for lower interest rates over the period (along with the speculative risk seeking market sentiment of 2021). Here’s the Federal Reserve interest rate policy over the backtest period:

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The S&P 500 also outperformed while rates were still rising in the first part of 2023. I attribute this to the artificial-intelligence-driven market excitement after the launch of ChatGPT in late 2022. The Quantitative Strategy did manage to outperform even with rates slightly declining after August 2024 thanks to the system identifying unusually undervalued positions that appreciated substantially.

While we cannot always count on finding particularly undervalued stocks with the Quantitative Strategy, we can expect good relative performance when interest rates are no longer expected to drop.

This Strategy's Role in Client Portfolios

Compared to the other strategies used for client accounts, this strategy has higher risks and may not be appropriate for all clients. For clients with higher risk tolerance, I will evaluate the impact of allocation changes to make sure overall portfolio risk remains within tolerance. This may require reducing risk elsewhere in your portfolio depending upon current allocations and market conditions.

Important Disclosures about Methodology and Results

Since 2018 I have subscribed to the quantitative stock ranking system that rates stocks from 0 to 100 by combining a large set of characteristics for each stock. I have used the ranking system very successfully for trading smaller, less liquid, stocks. It has been my goal to test whether this system of stock picking could outperform the market using larger, more liquid, stocks so that I could offer it to my clients. This year, I built a complete trading simulator which incorporates all aspects of real time trading, including bid-ask spreads, dividends, interest, and cash management.

Using my new backtesting system, my new large stock quantitative strategy was tested by using several portfolio management rules to simulate weekly trades over the period 7/30/18 to 6/1/26. The stocks selected are ranked either 99 or 100 and bid-ask spreads are .05% or less. The strategy also screens out stocks that trigger accounting manipulation warnings. By

design the portfolio can hold no more than 50 stocks and may hold as few as 12 in the first month.

The Quantitative Equity Strategy results are thus backtested and hypothetical. They were not achieved by any client account. These returns are gross, meaning client results would be lower because fees would be deducted. I have been careful to include realistic pricing and spreads in my tests but results may not reflect actual trading, taxes, or future market conditions. Past performance, including hypothetical or backtested performance, does not guarantee future results.

Conclusion

It is worth using the Quantitative Strategy for the U.S. equity market because it has been designed to deliver higher returns with lower risk than the overall stock market. This is especially true whenever markets run up to extreme valuations as they are now.

An Update on Artificial Intelligence Tools in Finance

In 2026 artificial intelligence applications are now creating the opportunity for much greater productivity for financial experts. Consequently, someone with the expertise to properly supervise these new software agents, can create very sophisticated systems for researching and evaluating investment strategies.

Easier-to-Use AI Agents let Non-Engineers Safely Build Software

Early this year Anthropic launched a new Claude application that incorporates 3 functions in one: Chat, Claude Code, and a new interface called Claude Cowork. This simplifies the process of setting things up securely so Claude cannot damage your computer. Claude gets its own dedicated virtual machine already built into the software and has severely limited network access. It can, however, use a Chrome browser to do some limited online tasks. This setup is important because these agents still make mistakes and you need to make sure they cannot delete your files or corrupt your computer systems.

Claude Cowork is a Massive Productivity Multiplier

Using Claude Cowork (and Claude Code) I can build sophisticated custom financial applications through careful prompting. Previously, only large financial firms had the resources to build such software. Also, the separation of software engineers from financial analysts created barriers to building such applications. Using this new tool I easily and quickly built a large financial database — 14 connected tables containing roughly one million rows of data. Consequently, I can analyze investment strategies at a far more granular level than previously possible, and thus identify those strategies with superior risk and return characteristics.

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The strength of Claude Cowork is writing database scripts and python computer code – both key for financial applications. In a few weeks I had it write 43 database scripts (4400 lines) and 17 programs (13,800 lines). Needless to say, this would have taken months for a human.

Expert Humans Still Required

None of this is flawless, however. Although current AI models make fewer mistakes than earlier versions, Claude very much needs human supervision to point out errors and redirect to more useful approaches when it goes in the wrong direction. It is much like an enthusiastic, but careless, human analyst – it does not stop to consider if the numbers make sense. It does not audit results or point out issues unless you tell it exactly what to check. For example, it won't notice if two pieces of similar data are on a different scale (by a factor of 100). Nor will it identify gaps in data unless you explicitly tell it to check this. On the other hand, it is quite good at fixing software bugs and correcting data problems once they are pointed out by the human coworker (i.e. me).

Safety Precautions: Controlling AI

One thing to keep in mind in using Claude is that if it gets off track, it will burn through your compute allowance very fast. I learned how to keep my sessions very efficient after hitting my limit multiple times. Some corporate users (e.g. Uber) are blowing through their annual compute budgets in a few months – likely because no one is paying attention to the efficiency of usage. The Financial Times ran an article titled “We created a monster: companies rein in AI usage as costs strain budgets” in which they report big companies trying to limit AI spending.

Some users report letting Claude Code work for hours making its own decisions about what to do. I am not comfortable with allowing such autonomy to an AI on my computer. In my setup, Claude Cowork cannot execute code directly on my Mac operating system. Instead, I review and run the code myself. By limiting Cowork's permissions, the possibility of misbehavior is minimized. When I used Antigravity (from Google) last year, and also Claude Code more recently, I installed these on a virtual machine. A virtual machine is a separate, isolated computer environment running inside the main computer. In this setup I let the AI execute commands and I only require my approval for a subset of the AI's commands. This makes fixing software bugs more automatic, but you would not want to run such a setup without the virtual machine between the AI and your real computer.

Bottom Line for AI in Investing

AI is not a substitute for financial judgment. It does not know whether an analysis is sensible unless a human analyst defines the problem, checks the data, and challenges the output.

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In my opinion Anthropic has created a tool with the right balance between security and automation for financial application building. Although Claude is still not a great financial analyst, it enables us humans to be super analysts by greatly simplifying the building of complex analysis systems. I expect this new capability to increase the value of expert investment advisors who can combine financial judgment with disciplined use of AI tools.

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