# How to Build Your Own Stock-Screening Tool Using a 3-Factor Strategy

## Description

Not all investors have portfolio managers, but those who do may be aware of the ranking tools they use. What these tools do is to screen stock performance using specially weighted indices. You'll find very basic versions of the same thing on some stock market advice websites, although usually the inner workings of these tools are the hidden domain of financial advisors.



Below is a rough, jargon-free approximation of these sorts of tools based on three main factors used to assess individual stocks in determining whether they are improving or deteriorating. Let's take a look at the hidden trends of the TSX and see how to calculate the true worth of a stock.

### Value

To build a basic tool, the first objective should be ease of use. To make things simple, each of the three factors used will be split into three subsections. Let's assign a 33-point weighting to each factor, so that it's possible to calculate a total score out of 100. Each subsection will be scored out of 11 so that they'll add up easily.

To come up with a value weighting, let's use price to earnings (P/E), price to book (P/B), and dividend yield. Quality investment usually takes into consideration a stock's value and its growth. However, for the purposes of our stock-screening tool, we're going to give quality its own weighting based on a company's ability to grow.

### Quality

Let's use return on equity (ROE) as an indicator of quality, since it's a reliable measure of a company's ability to reinvest in itself to generate growth, as well as to make acquisitions in order to expand or repay earnings to its shareholders either in the form of dividends or share buybacks. We can also use earnings per share (EPS) and expected growth in earnings as our other two subsections.

### Momentum

Price momentum over time is the most obvious subsection here. This can be calculated over 10 days, or five, or however long an investor deems appropriate to test whether a stock's price has momentum. In this strategy we'll use five days.

Price volatility will also be assessed, based on a stock's beta, which is a measure of an asset's variability relative to the market (which has a default value of one). Lastly, let's use valuation based on a share's current price comparative to its future cash flow value.

**Practical example**

Let's take a look at a popular tech stock, **Constellation Software Inc.** (TSX:CSU), and see how it fares with our basic screening tool.

Value: Constellation Software has two very bad multiples in its P/E of 64.4 times earnings and P/B of 26.7 times book. Add in a low dividend yield of 0.48%, and this stock gets 5/33, mainly for trying.

Quality: Constellation Software's ROE of 41% is nice and high, while its EPS of $12.6 shows excellent growth. Throw in a 17.5% expected annual growth in earnings, and we have a score of 28/33.

Momentum: Despite Constellation Software's year-long climb, this stock has now lost upward momentum and is in free fall, having shed -4.44% in the last five days. Its beta of 0.48 shows low volatility, and its share price is overvalued by 6% compared to its future cash flow value. This gives a score of 14/33.



**What's the verdict?**

Altogether, Constellation Software gets 47%. That's a pretty solid hold signal, and it correlates with current analyst calls, which shows that our simple tool might be fit for purpose! While other stock-screening tools go into more detail than the one we've built here, using this three-factor strategy gives a quick and fairly accurate reading for any given stock.

**CATEGORY**

1. Investing
2. Stocks for Beginners
3. Tech Stocks

**TICKERS GLOBAL**

1. TSX:CSU (Constellation Software Inc.)

**PARTNER-FEEDS**

1. Msn
2. Newscred
3. Sharewise
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