ABACUS
FCF Advisors

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Free Cash Flow Leaders:

Turn The Promise of Quality Investing Into Measurable Results

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Executive Summary

Abacus FCF Leaders Strategy provides a systematic, data-driven approach to quality investing through its proprietary Free Cash Flow Return on Invested Capital (FCF-ROIC) framework.

Key Insights:

- **FCF-ROIC as a Superior Alpha Indicator**: Combines cash generation and capital efficiency to identify high quality companies that historically outperform.
- **Enhanced Stock Selection**: Decompose FCF-ROIC into 4 alpha drivers: Prudent Capex, Low Accruals, High Cash Flow Margins, and Strong Asset Turnover.
- **Risk-Aware Conviction Weighting**: Balances market exposure, alpha-factor tilts, and stock-specific risks through dynamic portfolio construction.
- **Adaptive Business Cycle Adjustments**: Integrates leading economic indicators seeking to optimize risk exposure during different stages of business cycle.

Available through the **Abacus FCF Leaders ETF (ABFL)**, the strategy merges academic rigor, disciplined design, and systematic implementation seeking to turn quality investing into measurable outcomes.

Introduction: The Quest for Quality in U.S. Equities

For decades, investors have sought to identify and capitalize on the 'quality' factor in U.S. equities, driven by the widely held belief that high-quality businesses generate superior long-term returns. However, a significant challenge persists: the lack of a universally accepted and rigorously defined measure of 'quality.' While various metrics have been proposed -- ranging from return on equity (ROE) and profit margins to earnings stability and credit ratings -- each offers only a partial and potentially misleading view of a company's true economic health.

Relying solely on earnings-based metrics, for example, can be problematic. Despite accounting standards designed to promote transparency, management retains considerable discretion in revenue recognition, expense capitalization, and asset valuation, potentially distorting reported earnings. Similarly, balance sheet ratios, while useful, may not fully capture a company's operational efficiency, capital allocation discipline, or ability to adapt to changing market conditions.

As a result, investors face a critical question: How can we effectively identify and measure the characteristics that truly define a high-quality business, and construct portfolios that consistently capture the benefits of this elusive factor? This whitepaper presents our solution: the Abacus FCF Leaders strategy, which employs Free Cash Flow Return on Invested Capital (FCF-ROIC) as its primary quality indicator.

Defining and Measuring Quality: The Power of FCF-ROIC

While the concept of "quality" remains subjective, a more rigorous and data-driven approach is essential for identifying companies with the greatest potential for sustainable value creation. One metric that has gained increasing attention in recent years is Free Cash Flow Return on Invested Capital (FCF-ROIC).

What is FCF-ROIC?

FCF-ROIC offers a comprehensive view of a company's economic performance by combining two critical elements:

Free Cash Flow (FCF): Free cash flow represents the cash a company generates from its core operations after accounting for all cash outflows required to support those operations and maintain its capital assets. Unlike net income, which can be heavily influenced by accounting choices, FCF provides a *more transparent and reliable measure of a company's true earnings power*.

FCF = Cash Flow from Operations - Capital Expenditures

Invested Capital: Represents the total capital invested in the business, including both debt and equity financing.

Invested Capital = Total Assets - Non-Interest-Bearing Current Liabilities - Excess Cash

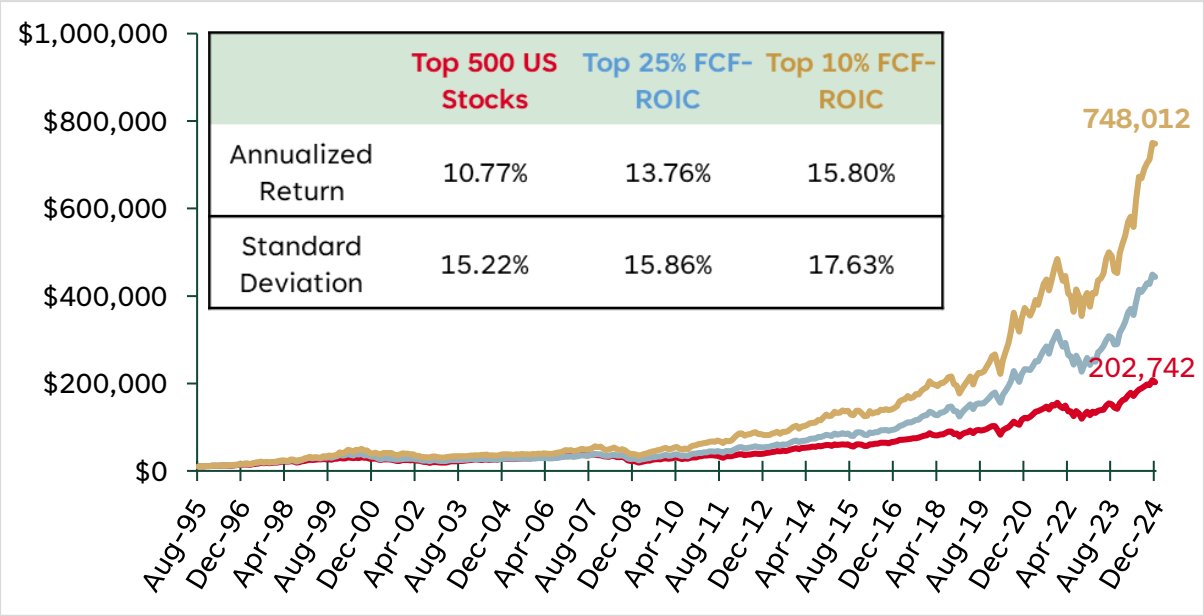
FCF-ROIC Calculation:

FCF-ROIC = Free Cash Flow / Invested Capital

Historical Performance of FCF-ROIC

Our research demonstrates that companies with high FCF-ROIC have consistently outperformed the broader market over time. Figure 1 below shows the cumulative returns of hypothetical portfolios comprising the top 10% and top 25% of stocks by FCF-ROIC within the largest 500 U.S. companies from 1995 to 2025.

Figure 1. Top 10% and Top 25% FCF-ROIC Historical Returns
08/31/1995 to 12/31/2024, Top 500 US Companies



Source: Abacus FCF Advisors. The hypothetical portfolios are constructed in a market cap weighted, quarterly rebalanced approach. They do not represent actual fund or portfolio performance. FCF-ROIC is free cash flow divided by invested capital in the last twelve month. Top 25% and Top 10% portfolio include stocks above that percentile when we rank all stocks by FCF-ROIC. For financial institutions and real estate, net income and funds from operations are used instead of free cash flow. Past performance does not guarantee future returns. It is not possible to invest directly in an index. The Abacus FCF Leaders ETF (ABFL) has expenses of 0.49% and if that was calculated into the tables the returns would be reduced.

Why FCF-ROIC?

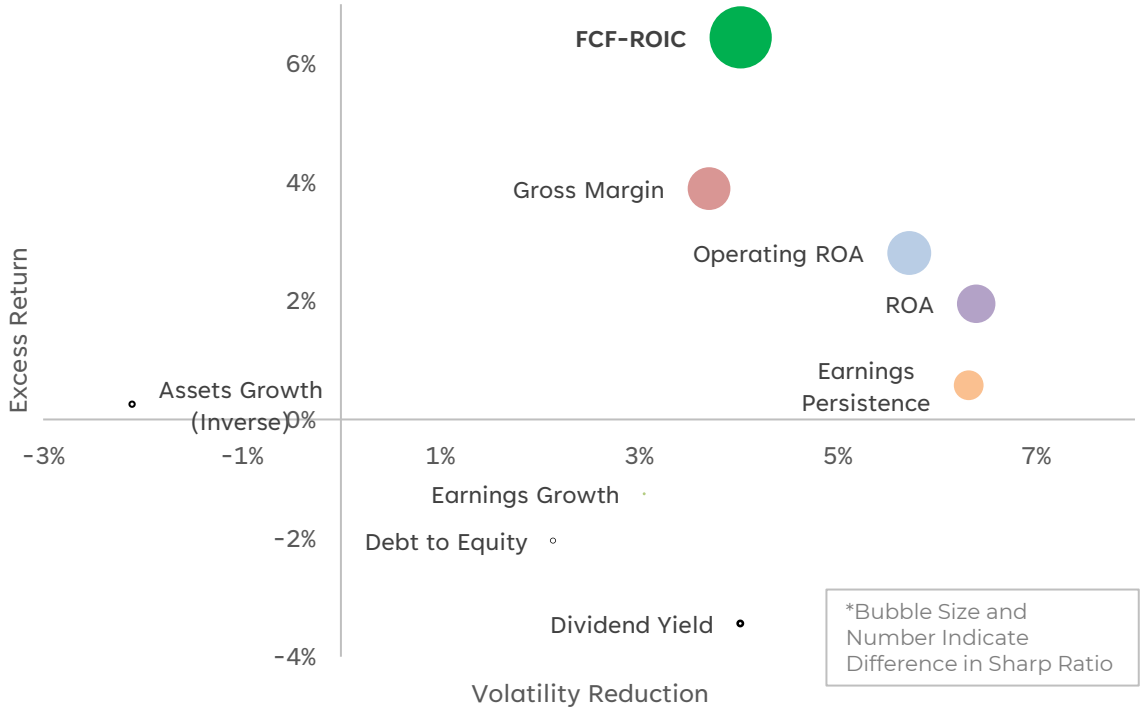
FCF-ROIC offers several key advantages over traditional profitability metrics, making it a superior tool for identifying high-quality companies:

Less Susceptible to Manipulation: Unlike earnings, which can be heavily influenced by accounting choices, free cash flow is far less open to management manipulation. While companies retain some discretion over capital expenditures, FCF provides a more transparent and reliable measure of a company's true economic performance.

Focus on Cash Generation: FCF-ROIC places a premium on companies that generate real cash flow, not just paper profits. This is particularly important because cash flow is the lifeblood of any business, providing the resources needed to fund growth initiatives, pay dividends, and weather economic downturns.

Alignment of Incentives: A focus on FCF-ROIC can help align management incentives with shareholder value creation. Companies that are focused on maximizing FCF-ROIC are more likely to make disciplined capital allocation decisions that benefit long-term shareholders.

Figure 2. Comparing Top Minus Bottom Quartile Factor Risk-adjusted Returns 08/31/1996 to 12/31/2024, Top 500 US Stocks



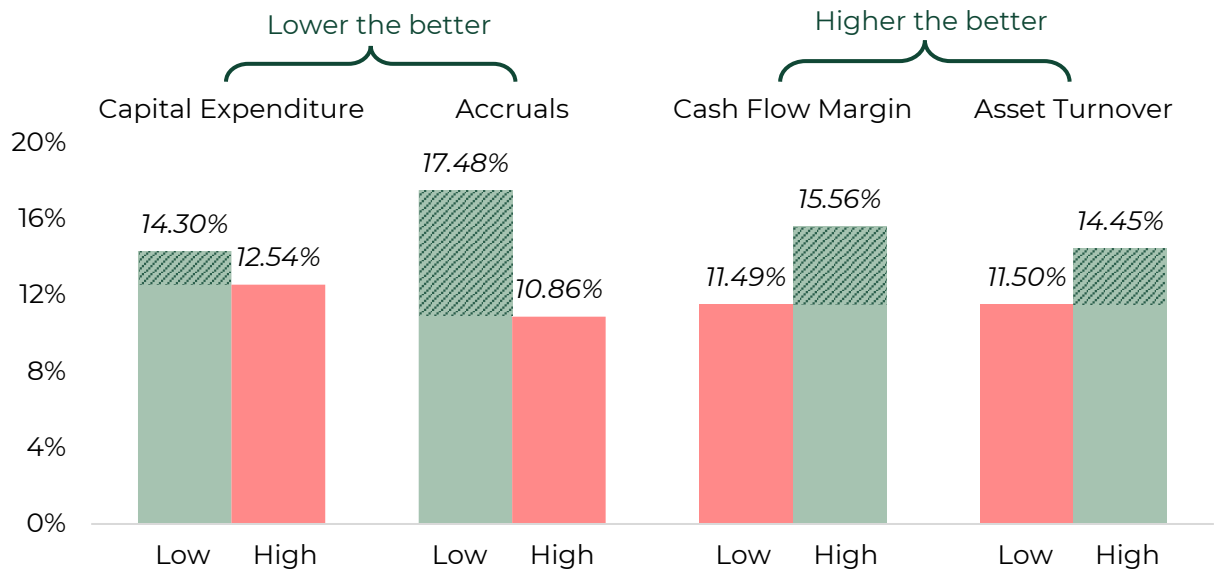
Factor	Excess Return	Volatility Reduction
FCF-ROIC	6.44%	4.03%
Gross Margin	3.89%	3.71%
Return on Assets	1.95%	6.40%
Operating ROA	2.81%	5.73%
Debt to Equity	-2.04%	2.14%
Earnings Growth	-1.25%	3.06%
Earnings Persistence	0.58%	6.32%
Dividend Yield	-3.44%	4.02%
Assets Growth (Inverse)	0.26%	-2.10%

Source: Abacus FCF Advisors. Returns from September 1996 to December 2024. Each metric represents a hypothetical portfolio of the top minus bottom quartile of top 500 large-cap U.S. stocks in market cap ranked by that measure, rebalanced monthly. Past performance does not guarantee future results. It is not possible to invest directly in an index. The Abacus FCF Leaders ETF (ABFL) has expenses of 0.49% and if that was calculated into the tables the returns would be reduced.

Beyond FCF-ROIC: Abacus FCF Leaders Score

While FCF-ROIC serves as a strong foundation for identifying high-quality companies, the Abacus FCF Leaders Model enhances this analysis by decomposing FCF-ROIC into four key sub-components. This granular approach provides a more comprehensive view of a company's financial efficiency, allowing for a more precise screening process. As shown in ***Figure 3***, each sub-component captures a distinct aspect of value creation and aligns with established factor risk premia, contributing to alpha generation and the sustainability of long-term returns.

Figure 3. Top Factor Risk Premium of Individual Components of FCF-ROIC
08/31/1995 to 12/31/2024, Top 500 US Stocks



Source: Abacus FCF Advisors. Returns from September 1996 to December 2024. Each metric represents a hypothetical portfolio of the top minus bottom quartile of top 500 large-cap U.S. stocks in market cap ranked by that measure, rebalanced monthly. Past performance does not guarantee future results. It is not possible to invest directly in an index. The Abacus FCF Leaders ETF (ABFL) has expenses of 0.49% and if that was calculated into the tables the returns would be reduced.

Prudent Capital Expenditures (CapEx)

The Model prioritizes firms that demonstrate disciplined CapEx management—investing in high-return projects while avoiding wasteful or speculative spending. Companies with excessive CapEx often suffer from value destruction due to managerial inefficiencies and agency problems.

Academic Support: Titman, Wei, & Xie (2004) show that firms with disciplined capital investment policies generate superior long-term returns, whereas excessive CapEx leads to underperformance. Jensen (1986) introduces the "agency costs of free cash flow" hypothesis, arguing that firms with excess cash often engage in low-return investments, destroying shareholder value.

Low Accruals (Cash-Backed Earnings)

The Model favors companies whose earnings are supported by real cash flow rather than aggressive accounting practices or accrual-based adjustments. High accruals signal potential earnings management and lower earnings quality, increasing the risk of future underperformance.

Academic Support: Sloan (1996) identifies the "accrual anomaly," showing that firms with high accruals tend to underperform due to subsequent earnings reversals. Richardson et al. (2005) further link accruals to earnings manipulation risks, reinforcing the reliability of cash-based earnings as a stronger indicator of financial health.

High Cash Flow Margins (Operational Efficiency & Profitability)

Companies with strong cash flow margins exhibit superior operational efficiency and an enhanced ability to convert sales into cash. This metric serves as a robust profitability measure that outperforms traditional earnings-based indicators.

Academic Support: Novy-Marx (2013) introduces the "gross profitability premium," demonstrating that profitability measures based on cash flows and gross margins predict future returns better than traditional accounting earnings. Dechow (1994) finds that cash flow-based profitability metrics are more reliable predictors of future cash flows than accrual-based earnings.

Strong Asset Turnover

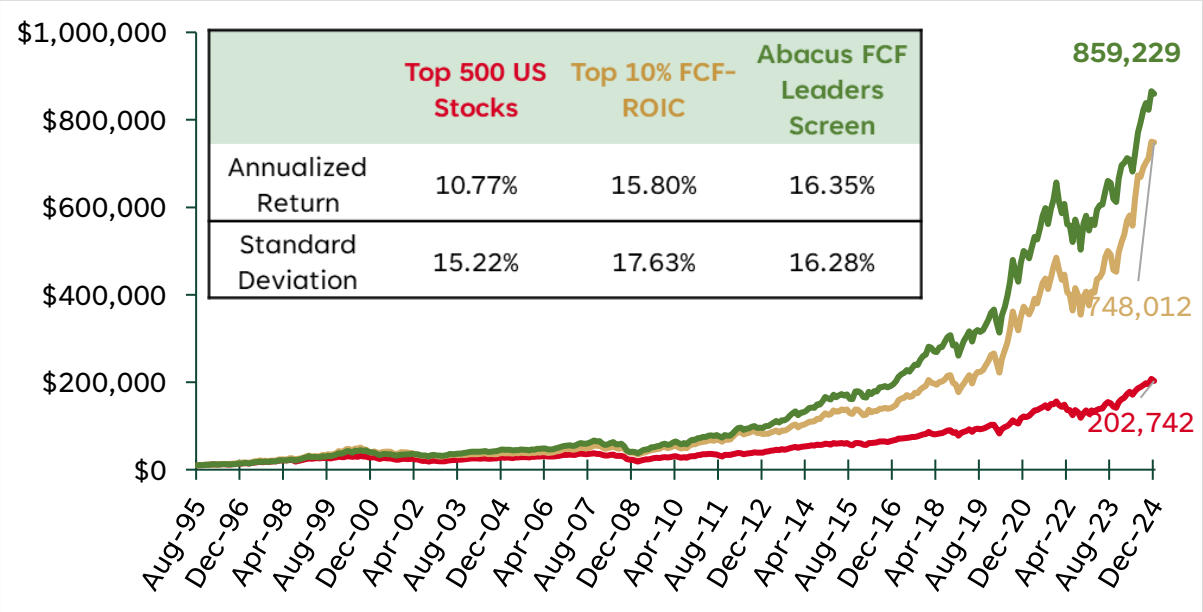
The Model emphasizes companies that efficiently utilize their assets to generate revenue, as measured by asset turnover. High asset turnover reflects effective management and a lean, productive business model.

Academic Support: Soliman (2008) establishes asset turnover as a key component of ROIC and a predictor of future stock returns. Fairfield & Yohn (2001) find that improvements in asset turnover correlate with future profitability gains, reinforcing its role in financial screening models.

Empricail Results of Abacus FCF Leaders Score (Capital Efficiency & Revenue Generation)

Figure 4 highlights the superior performance of the Abacus FCF Leaders selection methodology when constructing a market cap-weighted portfolio. Compared to a straightforward screening approach that selects only the top 10% of FCF-ROIC stocks, the Abacus methodology delivers stronger long-term growth with enhanced risk-adjusted returns, demonstrating its effectiveness in identifying high-quality investment opportunities.

Figure 4: Histrocial Performance of Portfolio Screened for Abacus FCF Leaders Score 08/31/1995 to 12/31/2024, Top 500 US Stocks



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Risk-Adjusted Conviction Active Weight Portfolio Construction

This section explains our proprietary portfolio construction methodology that seeks to enhance returns while controlling for multiple risk dimensions. We'll explore why traditional weighting approaches fall short, how our risk-adjusted conviction model works, and the step-by-step process we use to determine optimal portfolio weights.

Why This Weighting Approach Matters

Traditional portfolio construction methods often sacrifice either risk management or alpha capture. Our approach addresses these limitations by:

Capturing the FCF-ROIC Premium More Effectively

- Strong FCF-ROIC stocks demonstrably outperform, but only when properly weighted.
- Simple screening approaches fail to account for varying degrees of quality and risk.
- Our weighting methodology amplifies exposure to the highest-quality companies while managing risk.

Avoiding Concentration Pitfalls

- *Market-cap weighting* alone can lead to over-concentration in mega-caps.
- *Equal weighting* dilutes high conviction factor benefits and increases exposure to smaller, volatile stocks.
- Our combined approach maintains diversification while emphasizing high conviction opportunities.

Balancing Risk and Return

- Idiosyncratic volatility often signals underlying company issues that pure factor models miss.
- By explicitly adjusting for volatility, we seek to reduce downside risk without sacrificing upside potential.
- This balanced approach has historically delivered superior risk-adjusted returns.

Portfolio Weight Construction Process

Initial Market-Cap Weight: We begin with each stock's market capitalization weight within the investment universe. This serves as our baseline to ensure liquidity and tradability.

Active Weight Determination: For each stock, we calculate an active weight adjustment that reflects our conviction.

The active weight is derived from:

- The Abacus FCF Leaders Score

- A idiosyncratic volatility adjustment factor
  - We measure each stock's 252-day trailing return volatility.
  - Stocks with higher volatility receive a downward adjustment to their active weight.
  - This penalizes stocks with greater company-specific risk without eliminating them entirely.

Final Weight Calculation

Final Weight = Market-Cap Weight + Active Weight

Where, *Active Weight = f(FCF Leaders Score - Volatility Penalty)*

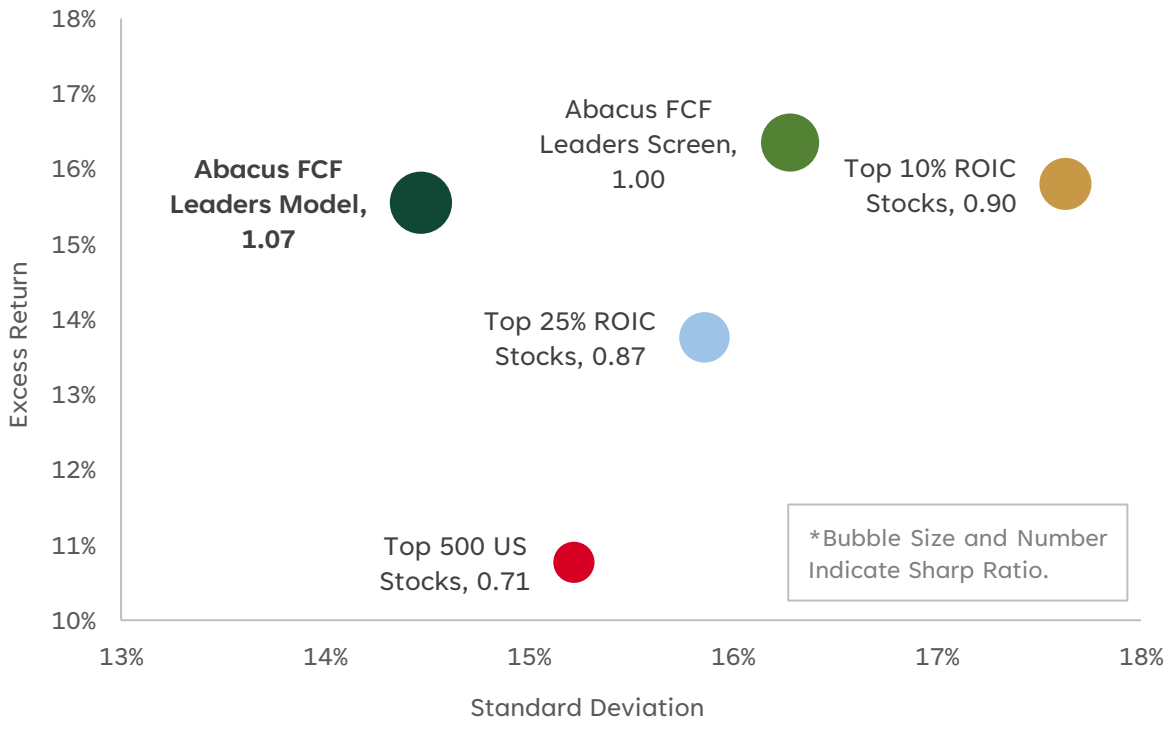
Weights are normalized to ensure they sum to 100%

Rebalancing: The portfolio is rebalanced monthly to maintain target weights, although large rebalance happens during earnings seasons quarterly. Stocks that fall below our FCF-ROIC thresholds are removed and replaced with new qualifiers.

Emprical Results of Applying the Portfolio Construction

Figure 5 shows the historical performance of applying the portfolio construction method in addition to the FCF Leaders Score Selection. Furthermore, as demonstrated in ***Figure 6***, applying this selection framework to top 3000 US stocks yields even more attractive risk-adjusted returns, highlighting the model's versatility and the potential alpha generation opportunity available through the inclusion of mid and small-cap equities.

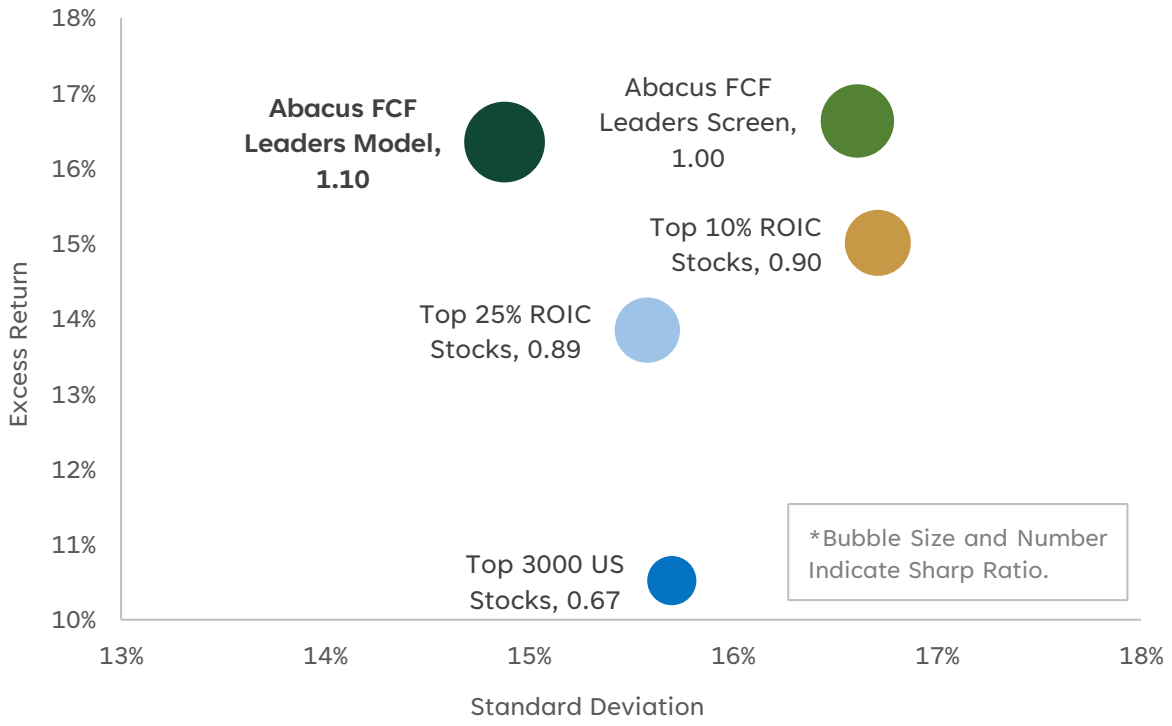
Figure 5: Histroical Performance of Abacus FCF Leaders Screen Applying Risk-Adjusted Conviction Active Weight Portfolio Construction
08/31/1995 to 12/31/2024, Top 500 US Stocks



Source: Abacus FCF Advisors. *The Top 10% and Top 25% FCF-ROIC (Top 500 Stocks) and Abacus FCF Leaders Screen portfolios are market cap-weighted and rebalanced quarterly. The Abacus FCF Leaders Model applies a proprietary risk-adjusted conviction-weighting approach to the Leaders Screen. FCF-ROIC is calculated as free cash flow divided by invested capital over the last 12 months. For financials and real estate, net income and funds from operations replace free cash flow. Top 25% and Top 10% portfolios consist of stocks ranking in those percentiles by FCF-ROIC. Past performance does not guarantee future returns. It is not possible to invest directly in an index. The Abacus FCF Leaders ETF (ABFL) has expenses of 0.49% and if that was calculated into the tables the returns would be reduced.*

Expanding the investment universe to the top 3000 U.S. stocks offers significant advantages for investors, ensuring better long-term capital appreciation while maintaining a stable risk profile. This broader approach enhances flexibility, allowing investments at any time without being restricted by market timing or stock availability. It also strengthens diversification and optimizes portfolio performance by capturing a wider range of high-quality opportunities.

Figure 6: Histroical Performance of Abacus FCF Leaders Screen Applying Risk-Adjusted Conviction Active Weight Portfolio Construction
08/31/1995 to 12/31/2024, Russell 3000 US Stocks



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Benefits of Using the Top 3000 U.S. Stocks:

- **Greater Accessibility & Liquidity** – Investors can allocate capital at any time without being constrained by a limited stock pool.

- **Enhanced Diversification** – Reduces concentration risk and increases exposure to a broader set of high-quality companies.
- **Improved Risk-Adjusted Returns** – Expanding the universe maintains a strong Sharpe ratio while optimizing return potential.
- **Flexibility in Market Conditions** – Allows efficient capital deployment across different economic cycles, reducing timing risks.

Adaptive Risk Management: Navigating the Business Cycle

While the Abacus FCF Leaders Model identifies high-quality companies, the Abacus FCF Leaders ETF (ABFL) seeks to enhance this approach with adaptive risk management to navigate the business cycle. This overlay helps capture upside during expansions and mitigate risk in downturns.

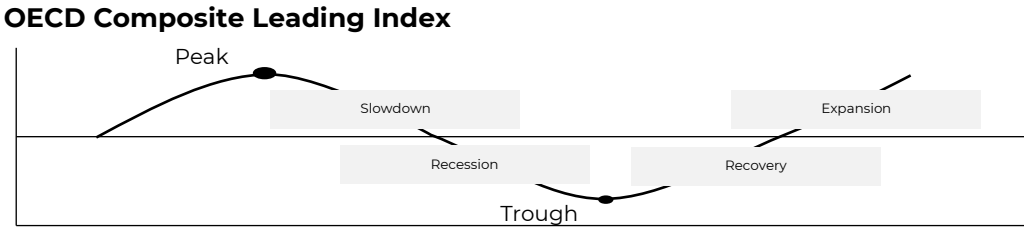
The Business Cycle Framework: A Quantitative Approach

The adaptive risk management process is grounded in a quantitative business cycle framework, leveraging OECD Composite Leading Indicators (CLI) to identify prevailing economic phases.

OECD Composite Leading Indicators (CLI):
ABFL leverages the OECD Composite Leading Indicators (CLI) to classify economic conditions and adjust portfolio exposure accordingly.

- Expansion – Strong GDP growth, rising employment, and corporate earnings.
- Slowdown – Early signs of weakening demand and profitability.
- Downturn – Falling GDP, rising unemployment, and contracting earnings.
- Recovery – Signs of stabilization and renewed growth.

Figure 7. OECD CLI Business Cycle Indicator



Dynamic Risk Adjustment:
Based on the identified economic phase, the portfolio's risk-adjustment parameters are dynamically recalibrated on a monthly basis. The following figure illustrates how the Abacus FCF Leaders Model adaptively adjusts its risk exposure based on the prevailing economic phase:

Figure 8. Business Cycle Phases and Portfolio Adjustments

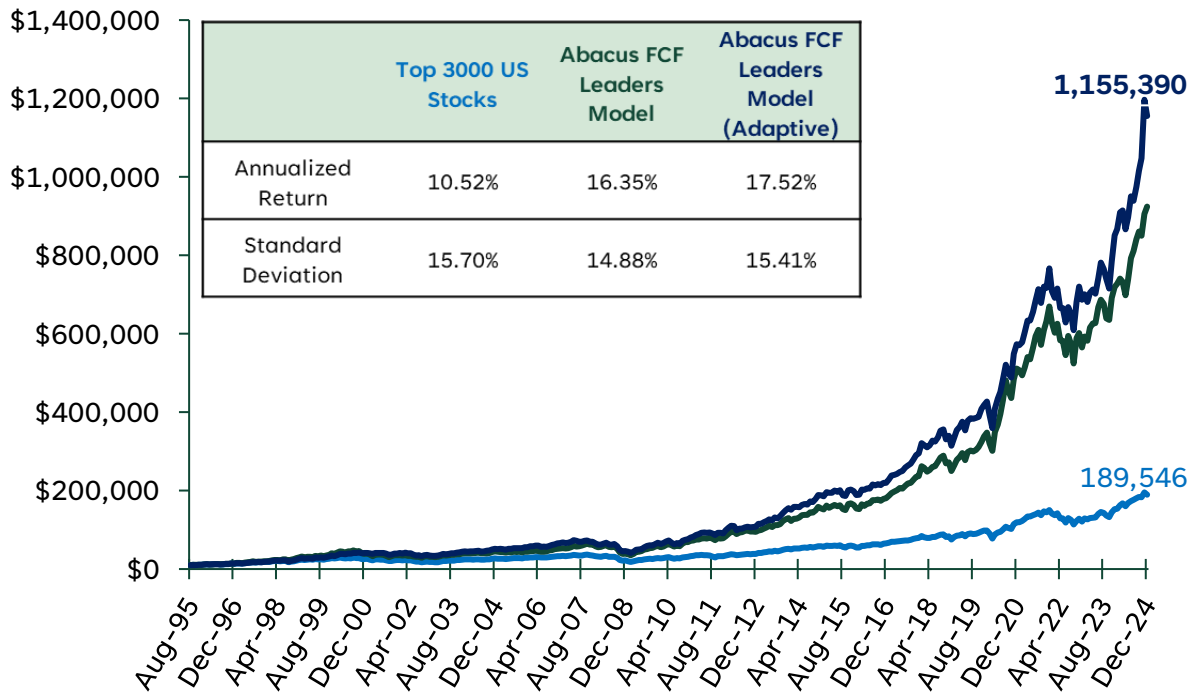
Economic Phase	Risk Appetite	OECD CLI Threshold	Risk Appetite Adjustments
Expansion	High	>100 & Growing	Increase to market beta, overweight high quality cyclicals
Slowdown	Low	>100 & Declining	Reduce volatility exposure, increase quality factor tilt
Downturn	Lowest	<100 & Declining	Maximize defensive, quality factor tilts
Recovery	Highest	<100 & Growing	Maximize cyclical exposure, seek high-beta quality stocks

Benefits of Adaptive Risk Management

Empricail results are shown in ***Figure 9***. The integration of a business cycle framework into the Abacus FCF Leaders ETF offers several key benefits.

- **Enhanced Upside Capture**: During economic expansions, the portfolio increases its exposure to high-quality, high-beta stocks, maximizing participation in rallies.
- **Downside Mitigation**: In downturns, the portfolio shifts toward defensive sectors and low-volatility stocks, reducing drawdowns and preserving capital.
- **Improved Risk-Adjusted Returns**: By dynamically adjusting risk exposure based on the economic environment, the portfolio aims to deliver superior risk-adjusted returns across all phases of the business cycle.
- **Resilience Across Market Conditions**: The adaptive approach ensures the portfolio remains well-positioned to navigate both favorable and challenging market environments, enhancing long-term performance consistency.

Figure 9. HIstroical Performance of Models Adopting Business Cycle Risk Management 08/31/1995 to 12/31/2024, Top 3000 US Stocks



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Conclusion: Long-Term Capital Appreciation with FCF Leaders

The Abacus FCF Leaders strategy represents a significant advancement in quality investing, offering a systematic, transparent approach to identifying companies with superior economic fundamentals. By focusing on Free Cash Flow Return on Invested Capital (FCF-ROIC) and its four key components, the strategy targets businesses that generate real cash, deploy capital efficiently, and create sustainable shareholder value.

Figure 10 highlights a systematic progress on how an adaptive Abacus FCF Leaders Model enhances risk-adjusted returns through superior stock selection, portfolio construction, and business cycle risk overlay.

Figure 10. Performance and Risk Statistics for Different Models
08/31/1995 to 12/31/2024, Top 3000 US Stocks

Performance Measure	Top 3000 US Stocks	Top 10% FCF-ROIC (Top 3000 Stocks)	Abacus FCF Leaders Screen	Abacus FCF Leaders Model	Abacus FCF Leaders Model (Adaptive)
Annualized Return	10.52%	15.01%	16.63%	16.35%	**17.52%**
Standard Deviation	15.70%	16.71%	16.61%	**14.88%**	15.41%
Sharpe Ratio	0.67	0.90	1	1.1	**1.14**
Sortino Ratio	0.93	1.44	1.62	1.59	**1.75**
Alpha	-	5.03%	6.18%	6.41%	**7.35%**
Beta	-	0.93	0.96	0.90	0.92
Information Ratio	-	55.60%	87.80%	113.95%	**122.07%**

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Key takeaways from this whitepaper include:

1. FCF-ROIC as a Superior Quality Metric: Our research demonstrates that FCF-ROIC provides a more reliable indicator of business quality than traditional accounting-based metrics, capturing both operational excellence and capital allocation discipline.
2. Multi-factor Advantage: By decomposing FCF-ROIC into four alpha-generating components (Prudent Capex, Low Accruals, High Cash Flow Margins, and Strong Asset Turnover), the strategy creates a more robust quality signal that has consistently outperformed simpler screening approaches.
3. Risk-Aware Portfolio Construction: The strategy's sophisticated weighting methodology, which balances market, factor, and idiosyncratic risks, has delivered superior risk-adjusted returns compared to traditional market-cap weighted and equal-weighted alternatives.
4. Adaptive Risk Management: For investors seeking enhanced downside protection, the Abacus FCF Leaders ETF (ABFL) incorporates a business cycle overlay that dynamically adjusts risk exposure based on prevailing economic conditions.
5. Consistent Performance: The strategy has demonstrated remarkable consistency across various market environments, economic cycles, and inflation regimes, making it a valuable core holding for long-term investors.

In today's increasingly complex and volatile market environment, the quest for quality has never been more important. The Abacus FCF Leaders strategy provides investors with a disciplined, research-driven approach to identifying companies with the financial strength, operational excellence, and capital discipline needed to thrive in any market condition.

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Important Information

Investing involves risk. Principal loss is possible.

Before investing you should carefully consider the Fund's investment objectives, risks, charges and expenses. This and other information is in the statutory and summary prospectuses, a copy of which may be obtained by visiting the Fund's website at www.abacusfcf.com/ABFL. Please read the prospectus carefully before you invest.

Opinions expressed are subject to change at any time, are not guaranteed and should not be considered investment advice.

Fund holdings are subject to change and should not be considered a recommendation to buy or sell any security. Please click here for top holdings and standardized performance.

There is no guarantee that ABFL will achieve its investment objective. Investing involves risk, including the possible loss of principal. Because the Fund is an ETF (rather than a mutual fund), shares are bought and sold at market price (not NAV), may trade at a discount or premium to NAV, and are not individually redeemable. Owners of the shares may acquire those shares from the Fund and tender those shares for redemption to the Fund in Creation Unit aggregations only, consisting of 25,000 shares. Brokerage commissions will reduce returns.

Investments in the Fund include risks associated with small- and mid-cap securities, which involve limited liquidity and greater volatility than large-cap securities. The evaluation of ESG ratings may expose the Fund's portfolio to certain issuers or industries and may not work as intended. There is no guarantee that screening the Fund's portfolio or individual securities based on their ESG ratings will increase the Fund's performance.

The Russell 3000® Index measures the performance of the 3,000 largest publicly traded U.S. companies, based on market capitalization. The Index measures the performance of approximately 98% of the total market capitalization of the publicly traded U.S. equity market. It is not possible to invest directly in an index.

Alpha is a measure of the active return on an investment, the performance of that investment compared with a suitable market index.

Capex (Capital Expenditures) refers to funds a company spends on acquiring, upgrading, or maintaining physical assets such as property, buildings, technology, or equipment to improve operations or expand the business.

Return on Equity (ROE) is calculated by dividing net income by average shareholders' equity. It measures how efficiently a company generates profits from its shareholders' investments.

Standard deviation measures the volatility or risk of an investment by quantifying the dispersion of its returns from the average.

Return on Assets (ROA) measures how efficiently a company generates profit from its total assets by dividing net income by total assets.

Dividend yield is the annual dividend income a stock pays as a percentage of its current price, indicating the return from dividends.

The Sharpe ratio measures the risk-adjusted return of an investment by dividing the difference between the asset's return and the risk-free rate by its standard deviation.

Beta measures a stock's or portfolio's volatility relative to the overall market, indicating its sensitivity to market movements.

FCF-ROIC (Free Cash Flow Return on Invested Capital) is a financial metric that measures how efficiently a company generates free cash flow relative to the capital invested in its business. Free Cash Flow (FCF): Operating cash flow minus capital expenditures. Invested Capital: Total equity plus interest-bearing debt minus excess cash.