

AlphaScreens: the might of momentum

7 July 2022

Banks seemingly the bold bet for analysts

Our screens focus on share price momentum and the direction of travel in profit forecast upgrades for companies. These barometers of investor and analyst sentiment are highlighting an eclectic mix of companies in the UK and US markets this month.

- Momentum investing can get badly caught out when market regimes change and the economy shifts into a new cycle. The two things don't happen perfectly in step of course, the stock market is typically a lead indicator. Our earnings upgrade screen should in theory bridge the gap – analysts' expectations of real world profits ought to inform the prices paid for shares today. The trouble is, consensus on macro-economic outlooks can sour rapidly and earnings forecast momentum can reverse like price momentum.
- Banks and financial stocks again do well this month, but there is the nagging doubt that recession risk is underpriced. Banks will do better in a rising interest rate environment with the backdrop of a relatively soft landing for the economy as policy decisions to rein in inflation bite. But if there is a recession the potential for greater loan impairments can counteract that.
- Utilities shares traditionally have defensive properties and **Centrica (CNA)** scores well on earnings forecast momentum. However, the share price has moved sideways for the past couple of months and much of the expected profits growth seems to have been priced in then.
- Revealingly, some companies with quite negative share price momentum are passing our tests because, although they've declined in value, that fall has been less bad than the median share price fall for stocks in the index over the period.
- In the case of some companies with high quality earnings, share price falls are partly due to the ongoing adjustment to valuations in response to higher inflation and interest rate rises. In short, these markets aren't conducive to blindly following momentum as there are simply too many changes afoot.

Building on great expectations

Momentum shares, those that have seen the biggest share price gains in a recent period, have frequently been observed to outperform in the subsequent period. Whether that's down to initial underreaction to good news (Jegadeesh and Titman), or simply animal spirits, it's a well attested to phenomenon.

Yet there are drawbacks: when momentum fails, it has done horribly. Peak-to-trough drawdowns (high to low mark-to-market losses) have been as much as 50 per cent. Few investors have nerves stern enough to ride out that sort of drop and keep faith with the intensive trading to maintain the strategy.

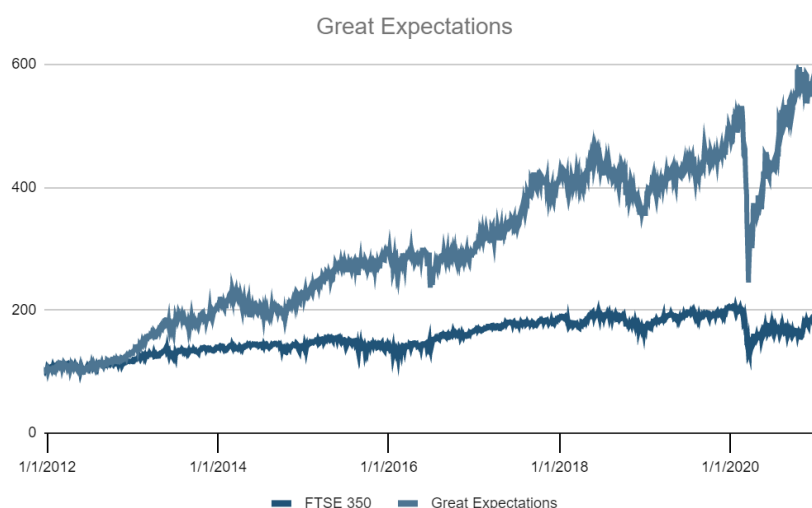
On a practical level, charges for churning between momentum stocks on a quarterly, or even half-yearly, basis would rack up costs. So, even when momentum works, charges seriously eat into the return premium.

Shifting the focus to earnings

Being selective about individual momentum stocks is difficult and it reintroduces the element of decision-making (with all the mental short-cuts and cognitive biases that entails), which a mechanical strategy like momentum should eliminate. Moving the emphasis from pure share price momentum to optimism about profitability and analysts' upgrade cycles is by no means a flawless approach, but it certainly provides a more useful starting point in terms of idea generation for individual shares.

Over time the Investors' Chronicle methodology of looking not only at earnings forecast momentum, but also at the momentum in the pattern of analysts' upgrades has proved hugely successful. Fewer companies meet the criteria of forecast upgrades and the momentum in the sentiment behind the upgrades (the latter factor being a compulsory test in our screen), so it's a system that can be followed more easily. Although, as some pretty horrendous losses at times demonstrate, the screens are best employed as a source of potential ideas, not as a strategy to be followed exactly.

Performance statistics for the "Great Expectations" screen Investors' Chronicle has run for years against the FTSE All-Share index, demonstrate the potential of the system, but note the shocking falls in early 2020 when the coronavirus pandemic hit.



Source: Refinitiv, Investors' Chronicle

Methodology and some tweaks to allow for the pandemic

- **Earnings upgrade momentum:** EPS upgrades over the past 12 months of at least 10 per cent for the next financial year (in normal years, this test must be passed for the current financial year, too – see below).
- **Earnings momentum:** Forecast EPS growth of at least 10 per cent in the current financial year and next financial year.
- **Price momentum:** Studies have found that the longer price momentum has persisted the more likely it is to be 'stale' and set to reverse. The Alpha momentum screen tests for strong share price performance over four different periods, which helps check price momentum remains fresh. Companies are tested whether they are in the top quartile of shares based on trailing 12-month share price momentum and whether they are above the index median for trailing six-month, three-month and one-month share price momentum.

Companies must pass the earnings upgrade momentum test(s). Those that do are listed by the total number of tests they pass – out of seven (eight in normal years) – and within that a combined ranking score of earnings upgrade and three-month share price momentum.

The core test for our Great Expectations screen is for analysts to have upgraded their view of a company's earnings outlook in the last year. Before the pandemic, this test had to be passed for the current and next financial years. Thanks to the exceptional rebounds expected for the current year (with businesses reopening after lockdowns), momentum in upgrades is a given. Therefore, for the next 12 months, we are dropping one of the tests – we're only interested if analysts are getting more excited about the prospects for profits

growing in the following year, a measure of sentiment less likely to appear distorted by the restart. This is also a test that shows up the companies analysts are expecting to do well in the more inflationary environment.

New indices, a tighter set of ideas

The Alpha earnings momentum screens have run the Great Expectations tests against the FTSE All-Share index (for 'large-cap' companies); the FTSE All Small Companies index (for main market 'small-cap' companies); and the FTSE Aim All-Share index for the junior market. Where this has fallen down in the past is that a lot of the companies in the FTSE All-Share index are mid-to-small caps, so few genuine large-caps were appearing on the momentum ranking tests (especially price tests) that were comparing the medians and percentiles for an index containing many small companies.

Going forward, we're switching to screening in an equities universe inspired by the Numis family of UK indices. The aim is to give investors a true overview of the genuine large-cap; mid-cap and small-cap companies that are exciting analysts and the markets.

We will also be excluding investment trusts from results. The purpose of these screens is to highlight individual companies that are worth investigating further. Including closed-end funds in the universe skews the results and distracts from that objective. Investment trusts are given their own, far more detailed, analysis in the regular Alpha Investment Trust report.

Breakdown of the Numis indices we have been inspired by:

Numis Large-Cap index (excluding investment companies/trusts): This includes the top 80 per cent of companies by market capitalisation that are listed on the UK main market. The lower size cut-off for 2022 is **£4.12bn** market cap.

Numis Mid-Cap index (excluding investment companies/trusts): This includes the 15 per cent of UK main market listed companies below the top 80 per cent but above the bottom five per cent by market capitalisation. The upper size cut-off is **£4.12bn** and the lower cut-off is **£880mn** market cap.

NSCI (Numis Small Companies Index), version excluding investment trusts: This includes the bottom 10 per cent of the UK main market by market capitalisation

(so there is overlap with the Numis Mid Cap index). The upper size cut-off is **£1.64bn** market cap.

NSCI plus Aim, version excluding investment trusts: This adds all Aim companies below the **£1.64bn** market cap cut-off to the NSCI.

How the AlphaScreens will be guided by the Numis indices

The Numis index family is rebalanced at the end of the calendar year, but we will be taking elements of their methodology to update the universe of companies we look at every time we run the screens. Our cut-off points will move around and our screens will capture the impact of mergers and acquisitions, de-listings and initial public offerings on the UK equity universe throughout the year.

Large Cap – This will copy and refresh the Numis Large-Cap (excl ITs) index methodology. Top 80 per cent of main market companies by size.

Mid Cap – This will copy and refresh the Numis Mid-Cap (excl ITs) index methodology, plus we will add in the Aim-listed companies that are within the size parameters of the main market index. Bottom 20 per cent (excluding bottom five per cent) of main market companies; plus all Aim companies that also have a market cap within this size range.

Small Cap – This will copy and refresh the NSCI plus Aim (excl ITs) index methodology. Bottom 10 per cent of main market companies and all Aim companies that also have a market cap below the cut-off size.

Performance tracking

Clearly, we won't be able to claim the back-tested performance of the Investors' Chronicle Great Expectations screen, which is based on all the companies in the FTSE All-Share. The deconstructed performance of momentum shares selected from that universe will be attributable to a different set of size and beta factors to the ones we will be exposed to.

Back-testing in general is a very dangerous tool. One needs to guard against survivorship bias in an index and look-ahead bias (factoring in data that although it relates to a period, wouldn't have been known at the time). Therefore this is year zero for the performance tracking of the screens. Finally,

it is worth reiterating the purpose is to flag ideas. What the screens do not do is generate off-the-shelf portfolios.

American adventure

One no-brainer addition to the Alpha screens is to add American companies to the mix. We've run our methodology against the S&P 500 and there are so many companies ranking well on the criteria we are only showing those that get full marks.

July 2022 results

UK large-cap momentum shares (passing at least 6 out of 7 tests)

Name	Ticker	Share price (last close)	Mkt cap (£mn)	Fwd 12-mth PE	Trailing 12-mth DY	Next year 12-mth EPS upgrade	Fwd EPS grwth cur FY	Fwd EPS grwth next FY	3-mth share price mom	Net cash (£mn)	Tests passed (out of 7)	Tests failed
Standard Chartered	STAN	592	17570	6.6	0.0%	31%	38.7%	30.7%	18%	-	7	na
HSBC	HSBA	523.1	104858	8.0	3.6%	36%	10.6%	23.3%	-1%	-	7	na
Centrica	CNA	76	4490	6.0	0.0%	86%	170.4%	28.4%	-5%	-12916.0	7	na
AstraZeneca	AZN	10800	167344	17.7	1.9%	16%	44.1%	17.1%	5%	-11957.6	7	na
Compass	CPG	1688	29933	22.4	1.4%	6%	101.4%	35.4%	3%	-3387.0	7	na
Diageo	DGE	3507	79966	21.5	2.1%	13%	21.3%	14.5%	-12%	-4272.0	7	na
Airtel Africa	AAF	134.7	5062	7.6	2.9%	82%	28.0%	26.1%	-3%	-1172.7	6	/1mthMom/
SSE	SSE	1671	17841	14.4	5.1%	21%	21.4%	1.8%	-7%	-3525.1	6	/>10% EPSgrth FY+2/

Source: FactSet, Numis Large Cap, Investors' Chronicle

UK mid-cap momentum shares (passing at least 6 out of 7 tests)

Name	Ticker	Share price (last close)	Mkt cap (£mn)	Fwd 12-mth PE	Trailing 12-mth DY	Next year 12-mth EPS Upgrade	Fwd EPS grwth cur FY	Fwd EPS grwth next FY	3-mth share price mom	Net cash (£mn)	Tests passed (out of 7)	Tests failed
Telecom Plus	TEP	1962	1553	25.0	2.9%	18%	20.7%	12.3%	26%	-129.5	7	na
Mediclinic Int'l	MDC	446	3288	15.7	0.7%	13%	21.4%	13.7%	27%	-283.0	7	na
Indivior	INDV	299.4	2091	15.2	0.0%	20%	32.4%	23.9%	-1%	220.0	7	na
ContourGlobal	GLO	251.5	1651	22.7	5.2%	78%	68.7%	1.5%	30%	-626.2	6	/>10% EPSgrth FY+2/
TBC Bank	TBCG	1200	662	2.6	7.9%	52%	29.2%	10.4%	8%	-	6	/1mthMom/
Vivo Energy	VVO	147.8	1873	13.0	3.0%	21%	32.1%	7.7%	7%	-1032.9	6	/>10% EPSgrth FY+2/
Spirent Comm.	SPT	241.8	1479	15.9	2.1%	21%	16.8%	8.2%	0%	-1.3	6	/>10% EPSgrth FY+2/
Hays	HAS	109	1797	11.3	10.2%	33%	139.8%	15.7%	-9%	-412.4	6	/1yrMom/
Playtech	PTC	542.5	1662	16.0	0.0%	29%	4.0%	13.9%	-12%	-218.0	6	/>10% EPSgrth FY+1/
Centamin	CEY	78.1	904	9.1	8.8%	23%	21.2%	18.0%	-15%	93.9	6	/1yrMom/
Drax	DRX	637	2553	6.8	3.0%	58%	215.0%	76.1%	-23%	-1915.5	6	/3mthMom/

Source: FactSet, Numis Mid Cap, Investors' Chronicle

UK main market and Aim small-cap momentum shares (passing at least 6 out of 7 tests)

Name	Ticker	Share price (last close)	Mkt cap (£mn)	Fwd 12-mth PE	Trailing 12-mth DY	Next year 12-mth EPS upgrade	Fwd EPS grwth cu FY	Fwd EPS grwth next FY	3-mth share price mom	Net cash (£mn)	Tests passed (out of 7)	Tests failed
Cerillion	CER	940.0	277	28.2	0.8%	94%	10.8%	23.3%	24%	2.8	7	na
Crestchic	LOAD	192.5	54	13.1	0.5%	54%	111.4%	10.3%	11%	-7.4	7	na
Telecom Plus	TEP	1962.0	1553	25.0	2.9%	18%	20.7%	12.3%	26%	-129.5	7	na
Galliford Try	GFRD	167.0	185	10.3	3.4%	23%	46.0%	17.1%	-1%	-276.5	7	na
CentralNic	CNIC	114.5	331	8.6	0.0%	66%	46.4%	13.3%	-7%	-59.8	7	na
Contour Global	GLO	251.5	1651	22.7	5.2%	78%	68.7%	1.5%	30%	-626.2	6	>10% EPSgrth FY+2/
PetroTal Corp.	PTAL	46.0	382	1.7	0.0%	316%	275.2%	25.4%	15%	-12.0	6	/1mthMom/
Judges Scientific	JDG	7400.0	470	24.3	0.9%	46%	21.4%	13.5%	12%	-8.2	6	/1mthMom/
MJ Hudson	MJH	37.0	64	12.2	0.3%	8%	83.3%	26.7%	14%	-	6	/1yrMom/
Videndum	VID	1270.0	587	13.7	2.8%	23%	21.7%	17.5%	-6%	-105.4	6	/1yrMom/
M&C Saatchi	SAA	149.0	182	10.1	0.0%	108%	24.3%	34.4%	-12%	-130.1	6	/1mthMom/
A.G. BARR	BAG	504.0	565	16.3	2.4%	17%	25.0%	2.3%	-7%	10.9	6	>10% EPSgrth FY+2/
Medica Group	MGP	148.0	181	14.2	1.8%	13%	25.9%	13.7%	-9%	-12.2	6	/1yrMom/
FD Technologies	FDP	2015.0	563	44.5	0.0%	6%	25.7%	32.7%	-8%	-30.0	6	/1yrMom/
Blanco Technology	BLTG	198.0	150	25.6	0.0%	15%	15.1%	20.2%	-12%	2.0	6	/1yrMom/
Centamin	CEY	78.1	904	9.1	8.8%	23%	21.2%	18.0%	-15%	93.9	6	/1yrMom/
Springfield Properties	SPR	131.5	156	6.5	4.5%	11%	14.6%	22.6%	-13%	-71.5	6	/1yrMom/
Pan African Resources	PAF	19.3	429	3.6	4.4%	17%	71.4%	11.2%	-18%	-51.3	6	/3mthMom/
Digitalbox	DBOX	10.0	12	10.7	0.0%	33%	141.8%	30.9%	-22%	1.1	6	/3mthMom/
Xaar	XAR	196.0	154	13.3	0.0%	-153%	585.2%	274.1%	-28%	2.1	6	/3mthMom/

Source: FactSet, NSCI plus Aim, Investors' Chronicle

US large-cap momentum shares (passing all 7 tests)

Name	Ticker (All US)	Share price \$ (last close)	Mkt cap (\$mn)	Fwd 12-mth PE	Trailing 12-mth DY	Next year 12-mth EPS Upgrade	Fwd EPS grwth cur FY	Fwd EPS grwth next FY	3-mth share price mom	Net cash (\$mn)	Tests passed (out of 7)	Tests failed	GICS sector
W.R. Berkley	WRB	67.81	17983	15.9	0.5%	28%	18.2%	12.3%	2%	-	7	na	Financials
Dollar Tree	DLTR	164.84	37016	19.0	0.0%	20%	41.4%	13.7%	6%	-3191.7	7	na	Consumer Disc.
Arthur J. Gallagher	AJG	166.07	34811	20.1	1.2%	44%	42.1%	11.7%	-5%	-	7	na	Financials
Quanta Services	PWR	127.25	18287	19.2	0.2%	26%	27.9%	10.2%	-2%	-2934.0	7	na	Industrials
Republic Services	RSG	129.56	40927	26.1	1.4%	11%	12.5%	11.2%	-3%	-2386.6	7	na	Industrials
Enphase Energy	ENPH	192.59	26005	49.0	0.0%	27%	45.3%	24.1%	-9%	576.9	7	na	Information Tech
Cadence Design Sys	CDNS	151.64	41816	36.4	0.0%	17%	19.2%	12.3%	-7%	117.7	7	na	Information Tech
Synopsys	SNPS	302.91	46336	32.4	0.0%	17%	24.6%	14.3%	-8%	-831.1	7	na	Information Tech
Everest Re	RE	277.42	10941	7.3	2.2%	14%	18.0%	20.5%	-7%	-	7	na	Financials
Chubb Limited	CB	193.14	81836	12.0	1.7%	19%	20.6%	12.3%	-9%	-	7	na	Financials
Marsh & McLennan Cos	MMC	156.2	78399	21.7	1.4%	11%	10.6%	10.4%	-8%	-	7	na	Financials

Source: FactSet, S&P 500, Investors' Chronicle

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