

AlphaScreens: the might of momentum

28 April 2022

The market's call on shares that will thrive

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.

- Our UK large-cap screen is topped by pharmaceutical giant **Astrazeneca (AZN)**, with drinks and brands business **Diageo (DGE)** – a stalwart of many portfolios that favour quality-style shares – also ranking highly. Oil & gas behemoth **Shell (SHEL)** has had plenty of positive momentum as investors reappraise the role of energy majors in light of the supply issues and a new appreciation that a more nuanced approach will be needed towards the transition to low-carbon fuels. Then there is also a very high position in the large-cap screen for technology and communications play **Airtel Africa (AAF)**. This eclectic mix of companies only serves to highlight that in uncertain times and with interest rates headed upwards, it is really becoming a stockpickers' market.
- Mid- sized UK shares that still rank well include **Drax Group (DRX)**, which has also scored well against our growth at a reasonable price (GARP) screen. Sticking with the energy theme, **Harbour Energy (HBR)** scores highly. Another interesting firm that has had the distraction of mooted takeover offers last year is **Sanne Group (SNN)**, a provider of outsourced alternative asset and corporate business services.
- Large American companies included in the S&P 500 index that score highly include insurance firms **W.R. Berkley (WRB:US)** and **Arthur J. Gallagher & Co (AJG:US)**, with the cost of living and inflation crisis feeding into a narrative that favours discount retailers **Dollar Tree (DLTR:US)** and **CostCo (COST:US)**.

James Norrington

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.

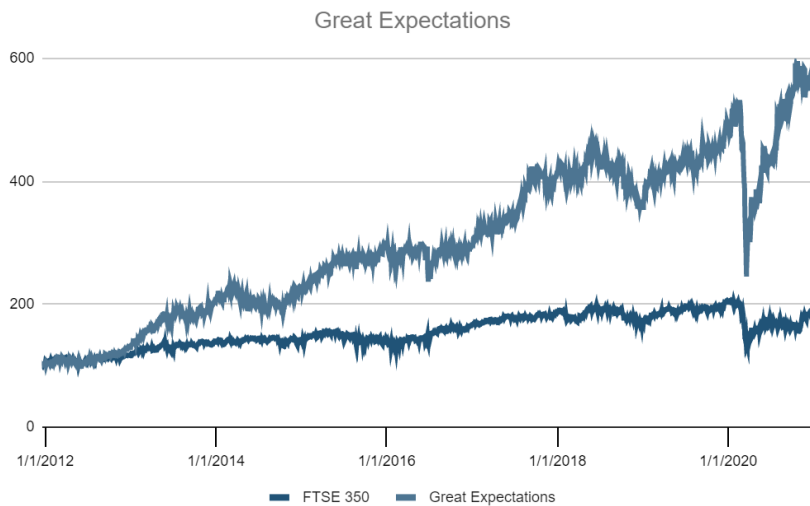
On a practical level, charges for churning between momentum stocks on a quarterly, or even half-yearly, basis would rack up costs. So, even when momentum works, charges seriously eat into the return premium.

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 both 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.

April 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 gwth cur FY	Fwd EPS gwth next FY	3-mth share price mom.	Net cash (£mn)	Tests passed (out of 7)	Tests failed
AstraZeneca	AZN	10,332	160,090	18.5	2.0%	12%	36.3%	17.9%	22%	-11,957.6	7	na
Airtel Africa	AAF	143.5	5,393	9.3	2.3%	88%	118.4%	19.0%	-4%	-1,427.1	7	na
Diageo	DGE	3,972	91,406	25.7	1.9%	13%	20.0%	12.0%	9%	-4,272.0	7	na
Segro	SGRO	1,361	16,365	39.2	1.8%	10%	13.6%	16.0%	6%	-	7	na
Shell	SHEL	2,124	159,628	6.2	3.1%	88%	90.1%	-3.9%	11%	-42,322.7	6	/>10% EPSgrth FY+2/
Centrica	CNA	78.9	4,650	8.5	0.0%	37%	108.3%	26.6%	9%	-12,916.0	6	/1mthMom/
InterContinental Hotels	IHG	5,072	9,333	23.1	1.3%	16%	88.1%	25.3%	5%	-127.0	6	/1yrMom/
SSE	SSE	1,834	19,581	16.4	4.5%	8%	2.5%	24.8%	19%	-1,906.3	6	/>10% EPSgrth FY+1/
DCC	DCC	5,896	5816	12.5	2.8%	11%	10.2%	10.1%	-4%	-1,209.5	6	/1yrMom/

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 gwth cur FY	Fwd EPS gwth next FY	3-mth share price mom.	Net cash (£mn)	Tests passed (out of 7)	Tests failed
Drax	DRX	794.5	3,181	10.1	2.4%	59%	204.5%	64.0%	33%	-1,915.5	7	na
Sanne	SNN	906	1,469	23.8	0.0%	22%	27.1%	39.9%	-1%	-142.3	7	na
Harbour Energy	HBR	494.4	4,576	4.6	1.7%	154%	1,149.5%	-10.3%	35%	-2,482.3	6	/>10% EPSgrth FY+2/
Coats	COA	67.1	975	10.4	2.4%	31%	20.3%	14.7%	4%	-257.8	6	/1mthMom/
Safestore	SAFE	1,301	2,743	27.5	1.9%	29%	12.0%	8.5%	5%	-	6	/>10% EPSgrth FY+2/
Serco	SRP	149.7	1,810	13.5	1.6%	13%	-15.3%	13.3%	13%	-678.9	6	/>10% EPSgrth FY+1/
Big Yellow	BYG	1,494	2,748	26.6	2.5%	17%	23.1%	7.2%	1%	-26.9	6	/>10% EPSgrth FY+2/
Biffa	BIFF	326.4	998	13.9	0.7%	25%	154.7%	19.0%	-2%	-317.0	6	/6mthMom/
Centamin	CEY	91.6	1,059	11.5	7.5%	16%	15.0%	18.8%	2%	93.9	6	/1yrMom/
OSB	OSB	561.5	2,508	6.6	4.6%	18%	-4.7%	10.9%	0%	-	6	/>10% EPSgrth FY+1/
Energiean	ENOG	1,179	2,099	7.6	0.0%	-2%	-	363.2%	25%	258.9	6	/>10% EPSgrth FY+1/
Hiscox	HSX	914.2	3,167	13.8	2.9%	1%	29.2%	78.7%	-4%	-	6	/1mthMom/

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 gwth cur FY	Fwd EPS gwth next FY	3-mth share price mom.	Net cash (£mn)	Tests passed (out of 7)	Tests failed
Next Fifteen Comms	NFC	1,310	1,276	17.3	0.9%	51%	22.3%	16.4%	17%	-122.0	7	na
Northbridge Ind. Svcs	NBI	186	53	14.9	0.5%	64%	83.3%	11.0%	12%	-7.4	7	na
H&T	HAT	347	138	9.9	3.5%	6%	54.8%	26.7%	26%	3.9	7	na
Midwich	MIDW	660	587	20.1	1.7%	26%	23.2%	13.3%	3%	-168.3	7	na
CentralNic	CNIC	125	361	10.6	0.0%	44%	32.6%	14.1%	-2%	-59.8	7	na
Cerillion	CER	800	236	23.8	0.9%	104%	11.4%	32.0%	-4%	2.8	7	na
EnQuest	ENQ	32	600	1.6	0.0%	70%	117.9%	-3.7%	46%	-520.2	6	/>10% EPSgrth FY+2/
Gem Diamonds	GEMD	62	87	4.4	3.4%	45%	36.4%	11.1%	24%	3.7	6	/1yrMom/
Savannah Energy	SAVE	31	400	4.5	0.0%	139%	-	355.0%	15%	-108.1	6	/>10% EPSgrth FY+1/
Digitalbox	DBOX	14	16	15.2	0.0%	33%	141.8%	30.9%	26%	1.1	6	/1mthMom/
Kenmare Resources	KMR	502	477	3.8	5.0%	90%	56.0%	-20.2%	14%	-34.2	6	/>10% EPSgrth FY+2/
Capital	CAPD	101	193	6.7	2.7%	68%	-0.8%	18.2%	15%	11.2	6	/>10% EPSgrth FY+1/
Gulf Keystone Petrol.	GKP	249	532	2.7	20.6%	157%	86.6%	-30.2%	11%	52.5	6	/>10% EPSgrth FY+2/
Base Resources	BSE	18	217	4.4	21.3%	168%	560.8%	-9.6%	9%	-1.8	6	/>10% EPSgrth FY+2/
Lok'nStore	LOK	1,020	306	31.6	1.5%	83%	194.1%	-1.7%	2%	2.2	6	/>10% EPSgrth FY+2/
Bloomsbury Publishing	BMV	383	313	15.3	4.9%	36%	28.2%	3.8%	4%	-22.7	6	/>10% EPSgrth FY+2/
Colefax	CFX	655	52	12.8	0.0%	74%	102.9%	-44.6%	2%	-3.0	6	/>10% EPSgrth FY+2/
Coats	COA	67	975	10.4	2.4%	31%	20.3%	14.7%	4%	-257.8	6	/1mthMom/
M&C Saatchi	SAA	180	220	15.4	0.0%	162%	24.7%	20.2%	0%	-101.1	6	/1mthMom/
Elixirr International	ELIX	750	346	25.5	0.0%	30%	17.8%	9.8%	3%	17.7	6	/>10% EPSgrth FY+2/
tinyBuild	TBLD	183	372	25.3	0.0%	24%	12.6%	16.6%	2%	26.5	6	/1yrMom/
Sanderson Design	SDG	167	119	11.3	0.4%	76%	70.4%	9.0%	-2%	-8.0	6	/>10% EPSgrth FY+2/
Gateley	GTLY	220	271	13.8	4.8%	30%	5.6%	14.6%	0%	-13.4	6	/>10% EPSgrth FY+1/
Centamin	CEY	92	1,059	11.5	7.5%	16%	15.0%	18.8%	2%	93.9	6	/1yrMom/
Sanne	SNN	906	1,469	23.8	0.0%	22%	27.1%	39.9%	-1%	-142.3	6	/1mthMom/
Ten Entertainment	TEG	255	174	10.5	0.0%	47%	297.5%	10.7%	-5%	-18.7	6	/1yrMom/
Galliford Try	GFRD	175	194	10.9	3.3%	8%	46.8%	18.2%	0%	-276.5	6	/1mthMom/
Marlowe	MRL	838	803	16.9	0.0%	29%	49.4%	34.3%	-5%	-37.4	6	/1yrMom/
Sureserve	SUR	87	144	10.2	0.0%	25%	14.9%	7.7%	-5%	-36.4	6	/>10% EPSgrth FY+2/
Town Centre Secs	TOWN	153	80	17.5	2.8%	12%	1,238.1%	10.1%	-6%	-	6	/1mthMom/
Ocean Outdoor	OOUT	808	436	21.8	0.0%	-125%	-	190.6%	6%	-102.7	6	/>10% EPSgrth FY+1/

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 gwth cur FY	Fwd EPS gwth next FY	3-mth share price mom.	Net cash (\$mn)	Tests passed (out of 7)	Tests failed	GICS sector
W.R. Berkley	WRB	67.29	18,624	16.3	0.5%	31%	16.8%	12.5%	23%	-	7	na	Financials
Arthur J. Gallagher	AJG	173.52	36,372	21.8	1.1%	50%	39.9%	12.2%	13%	-	7	na	Financials
Dollar Tree, Inc.	DLTR	168.24	37,873	20.5	0.0%	17%	37.3%	13.2%	32%	-3,191.7	7	na	Consumer Discretionary
Costco Wholesale	COST	553.76	245,440	39.7	0.6%	19%	18.3%	10.1%	15%	-17,266.0	7	na	Consumer Staples
Marriott Intl Class A	MAR	177.25	58,006	29.5	0.0%	21%	72.8%	27.8%	12%	-5,014.0	7	na	Consumer Discretionary
Corteva	CTVA	56.63	41,157	21.7	1.0%	10%	14.1%	20.2%	23%	-4,636.0	7	na	Materials
Marsh & McLennan	MMC	168.38	84,646	23.9	1.3%	16%	10.4%	10.3%	9%	-	7	na	Financials
W.W. Grainger	GWV	492.13	25,149	19.2	1.3%	17%	24.6%	12.1%	2%	-1,287.0	7	na	Industrials
Republic Services	RSG	134.98	42,625	28.3	1.3%	12%	10.7%	10.7%	8%	-2,386.6	7	na	Industrials
FactSet Research Sys.	FDS	416.87	15,798	29.8	0.8%	12%	16.4%	11.0%	2%	402.1	7	na	Financials

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

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