Investors' Chronicle | Alpha

Alpha Editor: James Norrington
Alpha Production Editor: Sameera Hai Baig

AlphaScreens: the might of momentum

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Are momentum strategies on the turn?

Momentum investing has some periods where it can become badly unstuck and one of the most dangerous times is in bear market rallies. Our screen relies on EPS forecast upgrades and earnings upgrade momentum to try and head off some of these pitfalls and investors must look into the idiosyncratic strengths driving positive ratings to avoid getting caught on the turn.

- No UK-listed large cap company has seen a bigger upgrade to its median current full year earnings forecast (according to FactSet data) than resources miner and marketer **Glencore (GLEN)**. Following from this, there are a few reasons for optimism to continue, not least the announcement on 5 December that the company had reached an $180mn agreement over issues surrounding its past conduct (that had been subject to investigation by the US Department of Justice "DOJ") in the Democratic Republic of Congo. This positive news comes on the back of a growing expectation among analysts that the ongoing sensitivities around energy supply today and materials needed for a low carbon transition will play to the company's strengths. Earnings per share growth for the next full year is expected to be negative (the only one of our tests Glencore fails) but the company is not valued on a hugely demanding forward multiple of earnings per share.
- Share price momentum is starting to reverse for some companies that have done well on this screen in recent months. This has been the case with big banks like **HSBC (HSBA)**, **NatWest Group (NWG)** and **Standard Chartered (STAN)**, as although the rising interest rates have been good for banks' net interest margins, the increased likelihood of a longer, tougher period for the UK economy is giving investors food for thought perhaps getting ahead of analysts making estimates. China ending its zero Covid policies would be good news for HSBC and Standard Chartered with their Asia Pacific interests but second guessing the Chinese Communist Party is a fraught task.
- On our US screen, we're seeing more evidence of the volatility in markets as several companies demonstrate negative one month share price momentum. Fears the Federal Reserve won't be swayed from its tough path on interest rates are again surfacing. Macro factors are ruling markets to a great extent so it could pay to focus more on the idiosyncratic issues that have driven companies' momentum. On Semiconductor (US:ON) for example, operates in an in demand strategic industry. It doesn't just fit a narrative, the relative newcomer to the S&P

500 index has been streamlining operations, recently announcing the sale of a Japanese plant as part of its drive to lower fixed costs.

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.

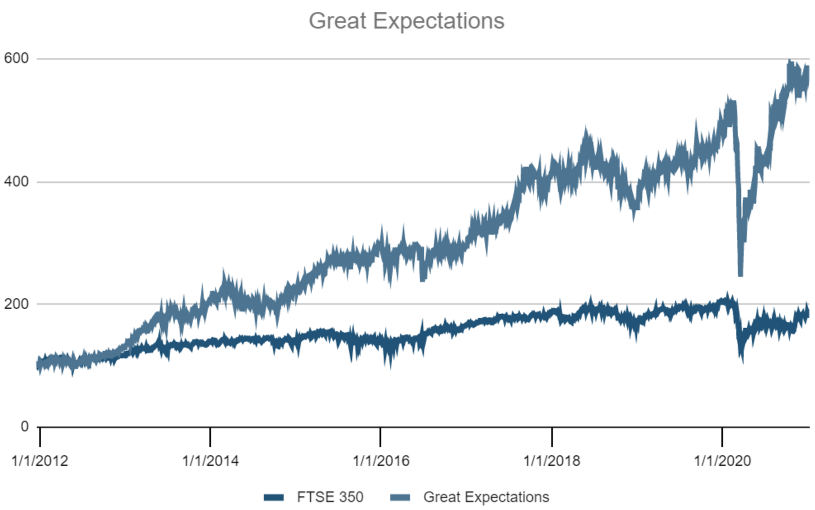
Yet there are drawbacks, when momentum fails, it has done horribly. Few investors have nerves stern enough to keep faith in these down spells, especially given the intensive trading to maintain such a strategy is very expensive.

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 to momentum, 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 crucially, also at the momentum in the pattern of analysts' upgrades, has proved hugely successful. Fewer companies meet the criteria of forecast and forecast momentum upgrades which are compulsory tests 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, rather than 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).
- **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 twelve 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.

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 them 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 (although we do not copy their methodology exactly). 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 screen against the S&P 500 for large and mega-cap US companies.

Investors' Chronicle UK screening cut-offs:

Large Cap: The top 80 per cent of the UK main market's market capitalisation.

Mid cap: The next 15 per cent of UK main market capitalisation (80th to 95th percentile)

Small Cap: The bottom five per cent of the main market by capitalisation with a £35mn lower cut-off.

Aim: We cut off the Alternative market by excluding all companies below £35mn market cap.

Momentum screen results are below

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UK large-cap momentum selection (passing at least 5 out of 7 tests)

Name	Ticker	Share price (last close)	Mkt cap (£mn)	Fwd 12-mth PE	Trailing 12-mth DY	Next yr 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
Glencore	GLEN	558.3	71867	6.4	5.5%	131%	138.3%	-31.5%	23%	-33776.8	6	/>10% EPSgrth FY+2/
Burberry	BRBY	2164	8323	17.7	2.4%	19%	26.8%	4.0%	26%	418.0	6	/>10% EPSgrth FY+2/
Pearson	PSON	951.4	6829	16.7	2.2%	31%	40.4%	19.0%	7%	-641.0	6	/1mthMom/
Wise Class A	WISE	657.8	6740	54.6	0.0%	28%	207.0%	34.8%	37%	202.1	5	/1yrMom/1mthMom/
BP	BP	480.9	87324	5.1	3.9%	113%	161.2%	-25.8%	6%	-36417.7	5	/>10% EPSgrth FY+2/1mthMom/
Imperial Brands	IMB	2100	19774	7.0	6.7%	13%	11.7%	8.6%	11%	-9289.0	5	/>10% EPSgrth FY+2/1mthMom/
NatWest	NWG	261.9	25310	6.2	11.4%	62%	27.4%	32.4%	4%	-	5	/1yrMom/3mthMom/
BAE Systems	BA	813.2	25114	14.0	3.1%	8%	12.3%	10.0%	6%	-5585.0	5	/>10% EPSgrth FY+2/1mthMom/
Compass	CPG	1875	32943	21.6	1.2%	18%	34.3%	14.7%	2%	-3387.0	5	/3mthMom/1mthMom/
Standard Chartered	STAN	592.6	17154	6.3	1.8%	32%	53.1%	11.5%	-2%	-	5	/6mthMom/3mthMom/
HSBC	HSBA	498.5	99542	6.5	4.3%	44%	22.7%	20.1%	-7%	-	5	/6mthMom/3mthMom/

Source: FactSet, Investors' Chronicle

UK mid-cap momentum selection (passing at least 5 out of 7 tests)

Name	Ticker	Share price (last close)	Mkt cap (£mn)	Fwd 12-mth PE	Trailing 12-mth DY	Next yr 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	2410	1913	23.2	2.7%	41%	52.9%	11.8%	27%	-129.5	7	na
Centrica	CNA	95	5595	5.1	1.1%	155%	421.1%	-14.3%	21%	-12916.0	6	/>10% EPSgrth FY+2/
Bank of Georgia	BGEO	2585	1230	4.4	4.8%	62%	65.3%	-3.3%	25%	-	6	/>10% EPSgrth FY+2/
Investec	INVP	485.1	3377	7.0	5.7%	30%	25.9%	10.7%	16%	-	6	/1mthMom/
Frasers	FRAS	888	4240	11.7	0.0%	100%	31.6%	4.8%	11%	-486.9	6	/>10% EPSgrth FY+2/
Lancashire Hldgs	LRE	593.5	1448	7.3	2.1%	-22%	-	419.2%	24%	-	6	/>10% EPSgrth FY+1/
Plus500 Ltd.	PLUS	1935	1818	8.9	5.1%	68%	28.3%	-25.8%	16%	-	5	/>10% EPSgrth FY+2/1mthMom/
Inchcape	INCH	836.5	3133	11.6	2.8%	22%	25.8%	3.3%	12%	-1145.6	5	/>10% EPSgrth FY+2/1yrMom/
Energean	ENOG	1365	2430	3.3	1.9%	58%	-	351.6%	8%	258.9	5	/>10% EPSgrth FY+1/1mthMom/
Beazley	BEZ	649	4356	8.2	2.0%	2%	-52.2%	374.9%	11%	-	5	/>10% EPSgrth FY+1/1mthMom/
QinetiQ	QQ	347.4	2011	13.3	2.1%	10%	20.1%	10.2%	3%	-246.3	5	/6mthMom/1mthMom/
Drax	DRX	616.5	2472	5.8	3.2%	25%	268.0%	38.2%	-7%	-1915.5	5	/6mthMom/3mthMom/

Source: FactSet, Investors' Chronicle

UK small-cap momentum selection (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 yr 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
Bank of Cyprus	BOCH	156.0	696	4.0	0.0%	118%	41.2%	66.7%	46%	-	7	na
TBC Bank	TBCG	2200.0	1207	3.9	6.3%	62%	60.1%	4.9%	26%	-	6	/>10% EPSgrth FY+2/
Kin and Carta	KCT	235.0	418	18.8	0.0%	30%	26.5%	25.8%	25%	-39.4	6	/1yrMom/
ME Group Int'l	MEGP	104.5	395	8.6	5.3%	53%	106.2%	8.0%	18%	25.8	6	/>10% EPSgrth FY+2/
4imprint	FOUR	4280.0	1202	20.2	1.3%	115%	229.0%	5.5%	16%	-23.2	6	/>10% EPSgrth FY+2/
Coats	COA	67.2	1074	9.0	2.5%	26%	30.6%	13.5%	18%	-257.8	6	/1mthMom/
Capital Limited	CAPD	95.0	181	5.5	3.1%	38%	7.3%	13.8%	16%	11.2	6	/>10% EPSgrth FY+1/
Baltic Classifieds	BCG	148.6	742	23.2	0.8%	40%	1294.1%	17.8%	12%	9.3	6	/1yrMom/
Just Group	JUST	77.5	805	3.8	1.9%	6%	-3.4%	14.4%	15%	-	6	/>10% EPSgrth FY+1/

Source: FactSet, Investors' Chronicle

Continued below

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UK Aim momentum selection (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 yr 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
Yu Group	YU	380.0	63	9.5	0.0%	201%	132.7%	16.0%	114%	-42.7	7	na
Crestchic	LOAD	344.0	97	12.3	0.7%	128%	281.3%	11.7%	33%	-7.4	7	na
ZOO Digital	ZOO	174.5	156	24.2	0.0%	180%	131.0%	50.4%	44%	-18.0	6	/1mthMom/
Warpaint London	W7L	196.5	151	19.9	3.1%	26%	20.5%	5.3%	71%	-4.3	6	/>10% EPSgrth FY+2/
Shoe Zone	SHOE	197.0	96	14.7	1.3%	73%	25.4%	-23.9%	19%	-21.9	6	/>10% EPSgrth FY+2/
Next Fifteen Com.	NFC	1038.0	1022	11.8	1.2%	50%	33.8%	12.5%	22%	-122.0	6	/1yrMom/
Keywords Studios	KWS	2948.0	2295	30.3	0.1%	20%	19.7%	8.2%	24%	-31.7	6	/>10% EPSgrth FY+2/
Kitwave	KITW	176.8	124	7.7	4.0%	61%	170.2%	6.0%	12%	-62.1	6	/>10% EPSgrth FY+2/
Ergomed	ERGO	1380.0	692	29.7	0.0%	15%	3.9%	14.5%	23%	-4.1	6	/>10% EPSgrth FY+1/
Learning Tech.	LTG	133.1	1050	14.1	0.9%	13%	69.7%	11.8%	16%	-135.8	6	/1yrMom/
GlobalData	DATA	1225.0	1449	26.7	1.7%	9%	15.9%	18.1%	12%	-105.4	6	/1yrMom/

Source: FactSet, Investors' Chronicle

US S&P 500 momentum selection (passing 6 out of 7 tests)

Name	Ticker (all US)	Share price $ (last close)	Mkt cap ($mn)	Fwd 12-mth PE	Trailing 12-mth DY	Next yr 12-mth EPS upgrade	Fwd EPS grwth cur FY	Fwd EPS grwth next FY	3-mth share price mom	Net cash ($mn)	Tests passed (out of 7)	Test failed	GICS sector
Enphase Energy.	ENPH	336	45670	63.7	0.0%	41%	81.2%	22.5%	20%	576.9	7	na	Information Tech
Schlumberger NV	SLB	52.79	74856	18.1	1.1%	19%	67.7%	39.1%	39%	-7220.0	6	/1mthMom/	Energy
United Rentals	URI	356.57	24713	9.8	0.0%	25%	47.8%	12.0%	23%	-2459.0	6	/1yrMom/	Industrials
Ceridian HCM Hldg	CDAY	69.72	10709	76.8	0.0%	49%	158.4%	38.1%	20%	-3372.5	6	/1yrMom/	Information Tech
Hess Corporation	HES	144.02	44403	14.9	1.0%	70%	251.8%	27.7%	19%	-351.0	6	/1mthMom/	Energy
Nucor Corporation	NUE	154.2	39559	10.7	1.3%	75%	23.8%	-54.1%	18%	-2539.6	6	/>10% EPSgrth FY+2/	Materials
W. R. Berkley Corp	WRB	75.67	20089	15.7	0.5%	25%	26.8%	12.9%	17%	-	6	/1mthMom/	Financials
Raymond James Financial	RJF	119.16	25627	12.0	1.1%	25%	29.4%	12.5%	15%	-	6	/1mthMom/	Financials
Juniper Networks.	JNPR	32.86	10665	14.6	2.5%	5%	11.7%	16.8%	17%	-621.3	6	/1yrMom/	Information Tech
Chubb Limited	CB	219.16	90962	12.2	1.5%	10%	23.2%	17.0%	15%	-	6	/1mthMom/	Financials
Arthur J. Gallagher & Co.	AJG	201.26	42434	23.2	1.0%	33%	42.1%	12.3%	12%	-	6	/1mthMom/	Financials
Ulta Beauty	ULTA	471.33	23982	19.9	0.0%	32%	26.7%	4.9%	11%	-1126.5	6	/>10% EPSgrth FY+2/	Consumer Disc.
Lamb Weston Hldgs.	LW	87.73	12618	25.3	1.1%	14%	44.2%	30.5%	12%	-174.1	6	/1mthMom/	Consumer Staples
ON Semiconductor	ON	73.04	31584	16.0	0.0%	46%	78.4%	-14.2%	8%	-170.7	6	/>10% EPSgrth FY+2/	Information Tech
FactSet Research Sys.	FDS	471.15	17941	31.0	0.7%	12%	10.1%	10.9%	9%	98.2	6	/1yrMom/	Financials
SolarEdge Tech.	SEDG	308.77	17259	39.6	0.0%	-1%	44.5%	83.1%	16%	172.6	6	/1yrMom/	Information Tech

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