Investors' Chronicle | Alpha

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AlphaScreens: the might of momentum

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Aim's momentum winners

The UK is a bit of an unloved market, but look beyond the negativity in the media and there are some companies catching investors' imagination. Our earnings upgrade momentum screen has flagged a number of interesting companies on London's junior market. It must be said, the same is true of large US companies on our S&P 500 screen, but investors should be positive that we live in an era where it is easy to buy shares listed on either side of the Atlantic.

- Leading the way on our Aim screen is specialist corporate sector utility supplier **Yu Group (YOU)**, a company analysts have increased their FY2024 earnings per share projections for by 150 per cent in the past 12 months. The positive upgrade momentum has translated into three-month share price momentum of 55 per cent. This was helped by a positive trading update at the end of July, where H1 2023 highlights included 56 per cent growth in the number of supplied meter points in the period and average monthly bookings of £51.3mn. Now valued at over 11 times the next twelve months' earnings per share projections, the company (which unlike larger, traditional utility companies isn't an income play) is still not hugely expensive and cites the roll-out of its smart meter services as a potential source of further growth.

- Other Aim companies for which analysts have significantly upgraded next year earnings forecasts include cosmetics business **Warpaint London (W7L)**, which now trades on 18.5 times mean NTM earnings expectations. There is also **Altitude Group (ALT)**, which has a technology niche operating the digital marketplace for promotional products (branded merchandise) used by small-to-medium sized enterprises (SMEs). Although these businesses have earned the confidence of analysts recently, when assessing if the momentum will continue, investors need to think about the forwarded valuations which are now quite expanded for both of these companies.

- Longer forward multiples depend on optimism, so do compress when the mood sours. If there is a recession, for example, then SMEs may scale back on promotional activity, which would be bad for Altitude. There is an argument that companies which provide efficient solutions will weather any storm better as they help businesses support their activity better and cost-effectively, but it's still worth considering. One thing to check, is the level of operational gearing the business has. If the proportion of fixed costs (and thus the level of operational gearing) is relatively low, then any fall in sales won't hurt profits as much.

- The difficulties of keeping up with the earnings projections at litigation funder **Burford Capital (BUR)** will have kept analysts tasked with covering the stock busy. The shares have been incredibly volatile thanks to constant uncertainty about the value of its legal assets. After some favourable rulings the EPS expectations for the current full year represents significant growth. However, having once been one of the most hyped stocks on the junior market, the flat momentum in the share price over the past three months seems to hint investors are weary of the drama.

- Our US screen is headed by the hype stock of 2023, **Nvidia (US:NVDA)**, but there are other interesting stocks with a fair wind. These include digital travel booking service **Booking Holdings (US:BKNG)** and a less glamorous 'shovel' business in the cloud computing boom and artificial intelligence (AI) hype: **Arista Networks (US:ANET)**. Follow the links for Phil Oakley's recent analysis pieces for Alpha on Arista and Booking.

- Other interesting US companies that have scored well on earnings upgrade momentum include construction and mining plant manufacturer **Caterpillar (US:CAT)**, which has enjoyed a fruitful 2023 as customers replenished following the pandemic years. Intuitively, one might think this is a business that is dependent on customers' equipment replacement cycles and the strength of the global economy. For essential industries like mining and oil & gas and construction of energy transition infrastructure, however, heavy-duty plant is essential. Although Caterpillar has had a good run, 11 of 26 analysts surveyed by FactSet still have it on a buy, albeit that's fewer than a year ago.

Full September share price and earnings upgrade momentum screen results are below:

UK large-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 current FY	Fwd EPS grwth next FY	3-mth share price mom.	Net cash (£mn)	Tests passed (out of 7)	Tests failed
Rolls-Royce	RR	219	18441	22.1	0.0%	105%	342.8%	21.8%	50%	-11159.0	7	na
Informa	INF	736	10253	16.1	1.7%	14%	54.2%	18.1%	6%	117.0	7	na
CRH	CRH	4550	32535	12.4	2.3%	16%	17.9%	9.9%	19%	-2454.9	6	/>10% EPSgrth FY+2/
Whitbread	WTB	3469	6740	17.8	2.1%	33%	15.9%	7.5%	5%	319.2	6	/>10% EPSgrth FY+2/

Source: FactSet, Investors' Chronicle

UK mid-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 current FY	Fwd EPS grwth next FY	3-mth share price mom.	Net cash (£mn)	Tests passed (out of 7)	Tests failed
Indivior	INDV	1819	2509	14	0.0%	6%	11.1%	31.9%	25%	-104.7	7	na
Darktrace	DARK	370	2594	34	0.0%	191%	3289.1%	70.9%	29%	55.0	6	/1yrMom/
Marks and Spencer	MKS	228.2	4501	12	0.0%	16%	4.7%	14.1%	26%	-1625.5	6	/>10% EPSgrth FY+1/
TBC Bank	TBCG	2825	1558	4	6.0%	17%	4.5%	13.6%	18%	-	6	/>10% EPSgrth FY+1/
4imprint	FOUR	5140	1448	18	6.1%	25%	11.4%	8.9%	9%	-0.5	6	/>10% EPSgrth FY+2/

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 year 12-mth EPS upgrade	Fwd EPS grwth current FY	Fwd EPS grwth next FY	3-mth share price mom.	Net cash (£mn)	Tests passed (out of 7)	Tests failed
AO World	AO	93	538	21.3	0.0%	284%	258.3%	26.1%	39%	-259.4	7	na
Bank of Cyprus	BOCH	259	1153	3.8	1.7%	158%	89.9%	-6.8%	17%	-	6	/>10% EPSgrth FY+2/
FirstGroup	FGP	148	1006	12.2	2.6%	29%	5.3%	28.3%	28%	-1207.9	6	/>10% EPSgrth FY+1/
XPS Pensions	XPS	185	383	13.5	4.6%	20%	3.0%	13.3%	12%	-	6	/>10% EPSgrth FY+1/
ME Group Intnl.	MEGP	162	613	12.1	3.7%	29%	25.4%	5.6%	8%	36.5	6	/>10% EPSgrth FY+2/

Source: FactSet, Investors' Chronicle

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 current FY	Fwd EPS grwth next FY	3-mth share price mom.	Net cash (£mn)	Tests passed (out of 7)	Tests failed
Yu Group	YU	920	154	11.1	0.3%	150%	118.7%	39.4%	55%	-54.9	7	na
Warpaint London	W7L	290	224	18.5	2.4%	66%	28.6%	13.2%	20%	-2.7	7	na
Vertu Motors	VTU	70	238	6.8	3.1%	32%	12.8%	10.2%	18%	-737.4	7	na
Burford Capital	BUR	1094	2395	6.7	1.0%	48%	1263.5%	10.3%	0%	-	7	na
Altitude Group	ALT	52	37	25.5	0.0%	68%	3.1%	50.6%	30%	-2.5	6	/>10% EPSgrth FY+1/
Blancco Technology	BLTG	226	171	23.4	0.0%	20%	16.1%	7.1%	40%	-2.9	6	/>10% EPSgrth FY+2/
Serica Energy	SQZ	252	971	3.2	8.7%	35%	12.0%	17.9%	16%	186.7	6	/1yrMom/
Ashtead Technology	AT	392	313	14.0	0.3%	51%	42.3%	10.0%	7%	-12.8	6	/>10% EPSgrth FY+2/
Volex	VLX	322	584	12.5	1.2%	5%	5.3%	18.7%	19%	-129.6	6	/>10% EPSgrth FY+1/
Eagle Eye Solutions	EYE	545	159	35.7	0.0%	35%	561.3%	18.3%	-3%	-8.6	6	/1yrMom/

Source: FactSet, Investors' Chronicle

US screen results on next page

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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
NVIDIA Corp.	NVDA	485.09	1198172	34.3	0.0%	168%	218.8%	56.4%	22%	6733.0	7	na	Info Tech
Schlumberger N.V.	SLB	60.12	85442	17.5	1.4%	11%	36.7%	22.7%	34%	-9124.0	7	na	Energy
Booking Hldgs	BKNG	3114.89	111177	19.5	0.0%	24%	43.6%	17.0%	22%	3952.0	7	na	Consumer Disc.
Textron Inc.	TXT	78.22	15493	13.8	0.1%	13%	32.7%	10.4%	26%	-1635.0	7	na	Industrials
Trane Technologies	TT	205.23	46874	21.8	1.4%	13%	20.1%	10.1%	24%	-4466.3	7	na	Industrials
Arista Networks,	ANET	197.36	61099	29.9	0.0%	35%	34.7%	10.5%	18%	1730.2	7	na	Info Tech
TransDigm Group	TDG	911.32	50290	29.4	0.0%	17%	47.7%	24.3%	17%	1575.0	7	na	Industrials
Fair Isaac Corp.	FICO	896.56	22286	37.9	0.0%	9%	16.2%	19.7%	13%	-198.3	7	na	Info Tech
Rockwell Automation	ROK	314.05	36072	23.8	1.5%	10%	26.0%	11.2%	12%	-3060.3	7	na	Industrials
Netflix	NFLX	439.88	194931	30.9	0.0%	13%	19.3%	29.7%	9%	-1872.5	7	na	Comm. Serv.
Caterpillar	CAT	286.25	146028	13.9	1.7%	39%	43.9%	4.8%	37%	-24527.0	6	/>10% EPS grth FY+2/	Industrials
United Rentals	URI	491.17	33538	11.8	0.6%	16%	23.1%	6.2%	45%	-2339.0	6	/>10% EPS grth FY+2/	Industrials
Parker-Hannifin	PH	422.46	54257	18.3	1.3%	13%	5.0%	11.7%	30%	-7251.8	6	/>10% EPS grth FY+1/	Industrials
Ceridian HCM Hldg	CDAY	73.11	11377	48.8	0.0%	63%	61.8%	30.2%	17%	-4100.8	6	/6mthMom/	Industrials
Constellation Energy	CEG	107.29	34504	19.0	0.8%	12%	-	23.7%	21%	-7311.0	6	/>10% EPS grth FY+1/	Utilities
Delta Air Lines	DAL	42.86	27577	5.9	0.2%	17%	107.5%	13.1%	18%	-19268.0	6	/1mthMom/	Industrials
Palo Alto Networks	PANW	242.72	74237	44.8	0.0%	44%	20.0%	19.7%	12%	-5340.6	6	/1mthMom/	Info Tech
Arch Capital Group	ACGL	77.01	28721	10.7	0.0%	29%	40.2%	7.9%	11%	-	6	/>10% EPS grth FY+2/	Financials
Meta Platforms Inc. Class A	META	296.38	658729	18.9	0.0%	26%	56.0%	25.5%	9%	14006.0	6	/1mthMom/	Comm. Serv.
W.W. Grainger	GWW	710.78	35540	18.9	1.0%	19%	21.3%	7.2%	8%	-1685.0	6	/>10% EPS grth FY+2/	Industrials
Everest Group	EG	364.8	15834	6.6	1.8%	21%	78.6%	20.6%	7%	-	6	/6mthMom/	Financials
Salesforce	CRM	221.53	215549	25.3	0.0%	40%	52.1%	17.1%	4%	-13383.0	6	/3mthMom/	Info Tech
Cadence Design Systems	CDNS	243.56	66197	43.6	0.0%	10%	19.0%	14.9%	5%	-465.4	6	/3mthMom/	Info Tech

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

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.

Methodology

- **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.

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