

## AlphaScreens: the might of momentum

8 January 2024

### Taking earnings momentum into 2024

*Which companies are taking share price momentum into the new year and does this correspond to recent earnings upgrade momentum indicating positive sentiment by analysts towards the underlying businesses?*

- **Rolls-Royce (RR.)** was one of the stock market stories of 2023 and over the most recent three months the shares are up 41 per cent. The danger with any such strong story is that animal spirits could have taken over and the froth of optimism overruns fundamental justification for the higher share price. Earnings upgrades over the past year have been driven by a combination of recovery in the end markets for its civil aerospace arm's large engines since the Covid-19 pandemic, alongside enthusiasm for the CEO's cost rationalisation and efficiency drive. According to FactSet data eight of fifteen estimates surveyed were up on a brokers' previous assessment, with two now lower. Furthermore, the actual positions being informed by those ratings are overwhelmingly 'buys' or 'overweights' with only a few 'holds'. However, as a cautionary note, the buoyant mood should be tempered by considerations such as how the business manages its working capital requirements and liabilities under existing contracts [going forward](#).
- Our US screen is topped by travel technology group **Expedia (US:EXPE)**, which analysts expect to post double-digit earnings growth in the current and next financial years. It is also notable that streaming and entertainment platform **Netflix (US:NFLX)**, which has fallen away from being included in acronyms and phrases to describe America's titan tech stocks. It is, however, expected to accelerate earnings growth over the next two financial years, albeit the valuation of almost 30 times forward twelve months' earnings isn't cheap.
- In the UK mid-cap space, train and bus operator **FirstGroup (FGP)** has seen its slicker operational performance and commitment to returning cash backed by investors. However, the impressive earnings upgrades still forecast by analysts may yet be revised depending on expectations for transport policy should (as current polls suggest) the UK elect a Labour government later in the year.

## Alpha UK large-cap momentum selection (passing at least 6 out of 7 tests)

Name	Ticker	Share Price (last close)	Market 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 price mom (%)	Net cash (£mn)	Tests passed (out of 7)	Tests failed
Rolls-Royce	RR	296.60	24,964	23.00	0.00	154	402.30	31.50	41	-11159.0	7	na
Wise, Class A	WISE	834.60	8553	30.50	0.00	71	154.30	-2.30	24	-	6	>10% EPSgrth FY+2/

Source: FactSet, Investors' Chronicle

## Alpha UK mid-cap momentum selection (passing at least 6 out of 7 tests)

Name	Ticker	Share Price (last close)	Market 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 price mom (%)	Net cash (£mn)	Tests passed (out of 7)	Tests failed
Marks and Spencer	MKS	284.20	5607	11.80	0.40	62	27.4%	10.50	25	-1625.5	7	na
FirstGroup	FGP	175.60	1146	11.50	2.50	57	30.8%	17.50	21	-1207.9	7	na
Shaftesbury Capital	SHC	135.50	2647	35.00	2.40	30	49.1%	17.90	22	-	7	na
XPS Pensions	XPS	228.00	473	14.40	3.80	26	10.6%	17.60	17	-	6	/1mthMom/
easyJet	EZJ	499.00	3784	8.50	0.90	50	25.9%	14.20	14	-1219.0	6	/6mthMom/
M&G	MNG	225.00	5329	9.30	8.80	13	-	23.70	17	-	6	>10% EPSgrth FY+1/
Trainline	TRN	310.00	1470	24.80	0.00	17	39.1%	20.30	16	-155.4	6	/1yrMom/
AO World	AO	91.80	531	20.90	0.00	45	248.9%	19.00	13	-259.4	6	/1mthMom/

Source: FactSet, Investors' Chronicle

## Alpha UK small-cap momentum selection (passing at least 6 out of 7 tests)

Name	Ticker	Share Price (last close)	Market 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 price mom (%)	Net cash (£mn)	Tests passed (out of 7)	Tests failed
Hostelworld	HSW	139.50	172	12.70	0.00	52	-	40.60	19	4	6	/>10% EPSgrth FY+1/
Saga	SAGA	143.00	203	4.20	0.00	-10	68.5%	76.30	29	-197	6	/1yrMom/
Luceco	LUCE	127.40	205	11.00	3.60	21	-6.4%	12.40	7	-49	6	/>10% EPSgrth FY+1/

Source: FactSet, Investors' Chronicle

Aim screen results below

## Alpha UK Aim momentum selection (passing at least 6 out of 7 tests)

Name	Ticker	Share Price (last close)	Market 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 price mom (%)	Net cash (£mn)	Tests passed (out of 7)	Tests failed
Ashtead Technology	AT	610	488	16.50	0.20	40	57.00	25.80	44	-12.8	6	/1mthMom/
YouGov	YOU	1145	1341	23.20	0.80	14	11.40	28.00	60	16.1	6	/1yrMom/
hVIVO	HVO	26	179	22.20	0.00	61	35.30	-2.90	30	-1.3	6	/>10% EPSgrth FY+2/
Yu Group	YU	1270	213	9.20	0.50	185	362.50	-0.60	23	-54.9	6	/>10% EPSgrth FY+2/
Spectra Systems	SPSY	227	102	16.00	4.00	13	-1.20	21.00	30	8.7	6	/>10% EPSgrth FY+1/
Cerillion	CER	1575	465	32.20	0.70	9	2.40	12.90	30	12.9	6	/>10% EPSgrth FY+1/
Elixirr International	ELIX	620	293	16.00	1.70	13	14.50	10.90	24	-0.8	6	/1yrMom/
Tristel	TSTL	450	213	30.60	2.30	27	22.10	25.10	13	3.8	6	/1mthMom/
Burford Capital	BUR	1144	2505	9.40	0.90	52	1,484.50	-31.40	7	-	6	/>10% EPSgrth FY+2/

Source: FactSet, Investors' Chronicle

US momentum screen results below

## Alpha US S&P500 momentum selection (passing at least 7 out of 7 tests)

Name	Ticker (All US)	Share Price \$ (last close)	Market Cap \$mn	NTM PE	LTM DY (%)	NTM EPS Upgrade (%)	Fwd EPS Grwth current FY (%)	Fwd EPS Grwth next FY (%)	3-mth price mom (%)	Net cash (\$mn)	Tests passed (out of 7)
Expedia	EXPE	146.32	19,508	11.90	0.00	10.00	40.30	28.20	46.00	-4879	7
Netflix	NFLX	474.06	207,486	29.70	0.00	17.00	22.10	31.00	27.00	-1873	7
Broadcom	AVGO	1,049.28	491,211	21.70	1.80	13.00	11.10	17.90	27.00	6784	7
Arista Networks	ANET	230.92	71,839	31.80	0.00	21.00	43.10	10.70	23.00	1730	7
Westinghouse Air Brake Technologies	WAB	125.49	22,483	18.70	0.50	12.00	22.80	12.10	23.00	-2926	7
Trane Technologies	TT	240.56	54,741	23.90	1.20	14.00	22.20	11.60	20.00	-4466	7
Meta Platforms, Class A	META	351.95	781,191	19.90	0.00	76.00	67.20	23.10	15.00	14,006	7
Martin Marietta Materials	MLM	486.80	30,088	23.30	0.60	21.00	53.60	12.70	16.00	-382	7
Eaton	ETN	234.86	93,780	23.50	1.40	10.00	18.70	10.90	16.00	-5805	7
Booking Holdings	BKNG	3,408.14	118,910	19.60	0.00	24.00	47.20	18.30	13.00	3952	7
Marriott International, Class A	MAR	222.42	65,323	23.10	0.80	13.00	28.30	12.10	14.00		7

Source: FactSet, 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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