

AlphaScreens: the might of momentum

17 March 2022

Energy and security stocks for the new era

Federal Reserve Chair Jerome Powell has finally signalled the US central bank's intent to take an aggressive line against inflation, although may have to get realistic about the prospects the actions will slow growth and have implications for employment figures. The companies that investors are keen on according to our momentum screen shows what the market expects given a new Fed policy regime and a very different geo-political backdrop.

- Energy security is a central theme for governments and investors following Russia's invasion of Ukraine and the subsequent sanctions imposed on the aggressor. The top two companies on our US screen are both oil engineering firms, **Halliburton (US:HAL)** and **Baker Hughes (US:BKR)**.
- Our UK large-cap screen is topped by British Gas owner **Centrica (CNA)**, which has a strong position in the consolidating energy supply market. Also ranking highly is **SSE (SSE)**, which has a strong focus on renewable energy provision. In the case of SSE, the earnings growth expectations are a little further out, but investors enjoy a decent dividend.
- Mid-cap and smaller UK company screens continue the energy-related theme, with the mid-cap UK screen topped by **Drax (DRX)**, a specialist in biofuels and hydro-electric assets. Our small-cap (including Aim-listed) shares screen sees **Serica Energy (SQZ)**, which is principally concerned with exploiting the UK's strategically important North Sea oil & gas reserves.
- Cyber security is another theme that was already important, but has only become more pertinent given the breakdown in relations between the West and Russia and deep mistrust with China. **Kape Technologies (KAPE)** rates highly on the UK small companies screen and from the US screen, **Juniper Networks (US:JNPR)** is a major player in network security solutions.

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.

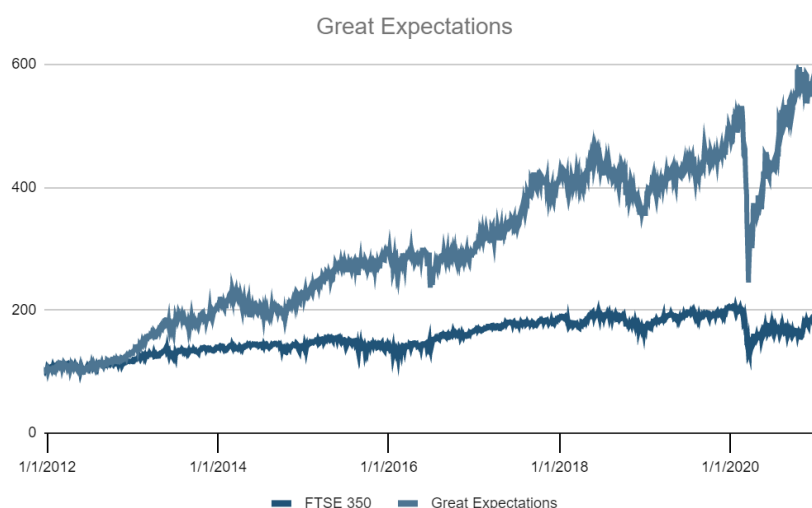
On a practical level, charges for churning between momentum stocks on a quarterly, or even half-yearly, basis would rack up costs. So, even when momentum works, charges seriously eat into the return premium.

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.

March 2022 results

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 growth cur FY	Fwd EPS growth next FY	3-mth share price mom.	Net cash (£mn)	Tests passed (out of 7)	Tests failed
Centrica	CNA	77.96	4585	8.8	0.0%	48%	105.3%	23.8%	15%	-12916.0	7	na
SEGRO	SGRO	1312	15776	38.7	1.9%	9%	13.0%	14.6%	-5%	-	7	na
Glencore	GLEN	473.15	62355	6.9	3.6%	119%	41.8%	-30.9%	29%	-33541.3	6 / >10% EPS growth FY+2/	
Airtel Africa	AAF	142.3	5348	9.2	2.3%	87%	116.4%	23.4%	10%	-1427.1	6 / 1mth Mom/	
InterContinental Hotels	IHG	5184	9539	25.1	1.3%	11%	81.1%	26.0%	17%	-127.0	6 / 1yr Mom/	
SSE	SSE	1651	17627	15.3	5.0%	4%	0.2%	24.2%	4%	-1906.3	6 / >10% EPS growth FY+1/	
Diageo	DGE	3592.5	83000	23.6	2.1%	13%	20.1%	11.8%	-9%	-4272.0	6 / 3mth Mom/	

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 growth cur FY	Fwd EPS growth next FY	3-mth share price mom.	Net cash (£mn)	Tests passed (out of 7)	Tests failed
Drax	DRX	684.5	2733	10.3	2.7%	54%	182.7%	47.2%	17%	-1915.5	7	na
Coats	COA	74	1075	12.7	2.2%	23%	10.7%	13.6%	11%	-257.8	7	na
Investec	INVP	454.3	3162	8.5	4.1%	22%	96.6%	9.3%	18%	-	6 / >10% EPS growth FY+2/	
Capital & Counties	CAPC	167.8	1428	94.0	0.9%	25%	216.2%	62.7%	6%	-	6 / 1yr Mom/	
Man Group	EMG	218.7	2978	10.1	4.8%	38%	-27.4%	13.6%	2%	-	6 / >10% EPS growth FY+1/	
Redde Northgate	REDD	429.5	1057	9.3	4.2%	31%	53.1%	-2.9%	2%	-263.6	6 / >10% EPS growth FY+2/	
Beazley	BEZ	415.3	2533	8.4	3.1%	21%	28.2%	23.6%	-2%	-	6 / 1mth Mom/	
Safestore	SAFE	1280	2699	27.2	2.0%	29%	12.4%	8.6%	-7%	-	6 / >10% EPS growth FY+2/	
Biffa	BIFF	329	1006	14.3	0.7%	28%	154.4%	18.5%	-7%	-317.0	6 / 1mth Mom/	
Sirius Real Estate Ltd	SRE	128.6	1507	17.7	2.7%	9%	43.3%	6.6%	-5%	-	6 / >10% EPS growth FY+2/	

Source: FactSet, Numis Mid Cap, Investors' Chronicle

Continued below...

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
Serica Energy	SQZ	340.0	917	2.6	1.0%	445%	2901.8%	53.3%	32%	-6.1	7	na
Coats	COA	74.0	1075	12.7	2.2%	23%	10.7%	13.6%	11%	-257.8	7	na
Next Fifteen Comm.	NFC	1280.0	1246	18.0	0.8%	39%	38.6%	23.7%	3%	-84.9	7	na
Galliford Try	GFRD	185.1	206	11.8	3.1%	8%	46.8%	18.2%	3%	-276.5	7	na
Kape Technologies	KAPE	385.5	1353	12.5	0.0%	19%	80.2%	57.3%	-4%	-21.7	7	na
Biffa	BIFF	329.0	1006	14.3	0.7%	28%	154.4%	18.5%	-7%	-317.0	7	na
Midwich	MIDW	590.0	524	18.2	1.9%	24%	23.2%	13.3%	-7%	-168.3	7	na
M.P. Evans	MPE	980.0	536	14.7	2.8%	126%	229.1%	-26.3%	20%	-32.3	6	/>10% EPSgrth FY+2/
PetroTal Corp.	PTAL	40.0	329	2.3	0.0%	16%	-	163.1%	90%	-36.2	6	/>10% EPSgrth FY+1/
Wilmington	WIL	259.0	227	14.3	2.4%	24%	26.8%	7.3%	26%	-54.0	6	/>10% EPSgrth FY+2/
M&C Saatchi	SAA	175.3	214	15.4	0.0%	208%	485.5%	24.7%	7%	-101.1	6	/1yrMom/
Lok'nStore	LOK	980.0	294	29.7	1.5%	106%	200.0%	-1.5%	6%	2.2	6	/>10% EPSgrth FY+2/
Kingswood Holdings	KWG	28.2	61	7.4	0.0%	15%	-	131.2%	13%	-	6	/>10% EPSgrth FY+1/
Chemring	CHG	324.0	917	17.2	1.5%	13%	12.6%	3.7%	12%	-96.7	6	/>10% EPSgrth FY+2/
Capital & Counties	CAPC	167.8	1428	94.0	0.9%	25%	216.2%	62.7%	6%	-	6	/1yrMom/
Reddle Northgate	REDD	429.5	1057	9.3	4.2%	31%	53.1%	-2.9%	2%	-263.6	6	/>10% EPSgrth FY+2/
Kenmare Resources	KMR	437.0	415	3.6	2.5%	77%	734.3%	41.7%	-1%	23.4	6	/1yrMom/
Belvoir	BLV	242.0	90	12.9	3.8%	26%	45.9%	-11.7%	1%	-	6	/>10% EPSgrth FY+2/
Pendragon	PDG	21.7	303	7.7	0.0%	106%	671.9%	-39.9%	-2%	-913.6	6	/>10% EPSgrth FY+2/
Record	REC	72.0	143	14.2	4.1%	6%	60.8%	16.4%	6%	-	6	/1yrMom/
Hurricane Energy	HUR	8.1	162	2.4	0.0%	-61%	-	405.3%	83%	68.3	6	/>10% EPSgrth FY+1/
Macfarlane	MACF	130.0	205	11.5	2.5%	20%	43.0%	0.0%	-2%	-67.4	6	/>10% EPSgrth FY+2/
Motorpoint	MOTR	308.0	278	13.9	0.0%	25%	123.7%	18.9%	-5%	-122.2	6	/1yrMom/
Gateley	GTLT	211.5	252	13.7	5.0%	25%	6.5%	11.4%	-8%	-13.4	6	/>10% EPSgrth FY+1/
Frenkel Topping	FEN	69.5	79	15.1	2.0%	9%	146.0%	41.9%	-7%	-	6	/1mthMom/
Medica	MGP	148.0	181	15.3	1.8%	10%	119.4%	23.9%	-8%	-0.2	6	/1yrMom/
Knights	KGH	365.5	309	14.4	0.0%	10%	20.8%	17.2%	-9%	-35.5	6	/1yrMom/
Ocean Outdoor	OOUT	710.1	383	19.5	0.0%	-126%	-	190.6%	-2%	-102.7	6	/>10% EPSgrth FY+1/
Tatton Asset Mgmt	TAM	462.5	272	22.0	2.5%	19%	24.6%	15.1%	-22%	-	6	/3mthMom/

Source: FactSet, NSCI plus Aim, Investors' Chronicle

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

Name	Ticker	Share price (\$)	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
Halliburton	HAL	34	30551	17.9	0.5%	43%	64.6%	32.1%	51%	-1262.0	7	na	Energy
Baker Hughes Class A	BKR	33.65	32080	24.3	2.1%	20%	104.8%	35.4%	39%	-4234.0	7	na	Energy
Charles Schwab	SCHW	88.94	161392	21.8	0.8%	38%	19.6%	24.9%	6%	-	7	na	Financials
Dollar Tree	DLTR	152.08	34211	18.8	0.0%	17%	37.3%	13.2%	10%	-3191.7	7	na	Consumer Discretionary
Arthur J. Gallagher & Co.	AJG	162.67	33924	23.4	1.2%	24%	23.8%	11.8%	-2%	-	7	na	Financials
Union Pacific	UNP	264.15	168237	22.3	1.6%	11%	16.4%	11.0%	6%	-4719.0	7	na	Industrials
Sealed Air	SEE	67.24	9962	15.9	1.1%	15%	16.1%	11.4%	2%	-1446.3	7	na	Materials
Juniper Networks	JNPR	34.17	11029	16.8	2.3%	12%	13.6%	14.1%	2%	-621.3	7	na	Information Technology
Textron	TXT	73.58	15918	17.9	0.1%	16%	19.9%	18.4%	-1%	-1019.0	7	na	Industrials
VWV Grainger	GWW	491.18	25103	19.5	1.3%	19%	24.1%	12.3%	-3%	-1287.0	7	na	Industrials
Hartford Financial Serv.	HIG	69.74	23129	9.9	2.1%	11%	10.6%	16.4%	1%	-	7	na	Financials

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

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