TRENDRATING

INVESTMENT DISCIPLINE THAT OUTPERFORMS

Trendrating Momentum Analytic versus Analyst Recommendations

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Summary

We demonstrate the significant value that the Trendrating Momentum Analytic can add to an investment process that incorporates analyst recommendations in its security selection process. We analyse two baskets of stocks recommended by consensus analysts as strong buys and strong sells for the period spanning 01/01/2016 to 31/12/2016 sourced from two articles, *UK analyst recommendations lag behind wider market*[1]] and from *Do brokers pick the winners?*[2]. The Trendrating Momentum analytic generates a return of 10.39% versus the analyst return of 3.92% for the list of strong buys and a return of 33.15% versus the analyst return of 0%[1] for the list of strong sells, thus generating additional performance of 6.47% and 33.15% for the list of strong buys and strong sells respectively.

References

[1] Sarah Gordon. *Financial Times*. February 8, 2017.
     https://www.ft.com/content/ac89e6ac-edfb-11e6-930f-061b01e23655

[2] AJ Bell. *You Invest*. January 12, 2017.
     https://www.youinvest.co.uk/articles/investmentarticles/105550/do-brokers-pick-winners

1   Introduction

Trendrating's **Smart Momentum** Analytic captures price trends early, in a robust and highly accurate manner, to offer investors the opportunity to maximise their participation of up-trends and limit draw-downs through minimal participation in down-trends. The objective of this paper is not to question the efficacy of analyst forecasts but to emphasise that accurate identification of the prevailing price trend has major implications for portfolio returns.

In this study we investigate the performance of two baskets of stocks rated by consensus analysts as strong buys and strong sells respectively. We overlay the Trendrating Momentum Analytic to compare the performance that investors would have generated by following the Trendrating recommendation versus the consensus recommendation.

The Trendrating rating scale ranges from A through D, where ratings of A & B signal an up-trend whilst ratings of C & D signal a down-trend. A rating of B signals the start of an up-trend while a rating of A confirms the up-trend; Trendrating's recommendation is to establish a long position in a security only when its rating changes to an A. Down-trends tend to be sharper and thus a rating of C is sufficient to exit a position as a high proportion of C's turn into D's that signal strong down-trends. Trendrating's Momentum Analytic carries an accuracy rate between 70-80% at the security level, and thus offers investors a robust mechanism to capture the **momentum** risk premia.

2   Framework

We employ a simple analysis framework to illustrate the efficacy of the Trendrating Momentum Analytic. We identify a basket of stocks rated strong buys by consensus analysts and a basket of stocks rated strong sells by consensus analysts, and form two equally weighted portfolios from each basket. For each security in each portfolio, we calculate the performance over the entire analysis period that also represents the performance that the investor would have experienced via the analyst recommendation. We also

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[1]The analyst delivered return for strong sells is zero due to non-participation

calculate the Trendrating performance for each security, which is the rating driven performance using the Trendrating recommendation rule that a long position is established at a rating of A whilst an exit from a position is triggered by a rating of either C or D.

The analyst return for each portfolio is the equally weighted return using the full period return whilst the Trendrating return is the equally weighted return using the Trendrating performance. It is important to note that the consensus analyst recommendations remained constant throughout the analysis period whilst the Trendrating recommendation changed for most securities but more importantly, the Trendrating recommendation differed from that of the consensus rating.

2.1 Strong Buys

Table 1 displays the strong buy portfolio positions along with the associated rating and return contribution statistics. Figure 1 shows the additional performance that an investor would have gained using the Trendrating recommendation over the analyst recommendation.

It is evident from Table 1 that Trendrating signalled different recommendations from the analyst recommendation for several stocks in the strong buy portfolio, in fact only 7 stocks ended the period with a rating out of a total of 13 stocks.

The rating changes coupled with differences in recommendation enabled Trendrating to capture a high proportion of the up-trends whilst limiting participation in the down-trends.

| TICKER	Name	Latest Rating Date	Current Rating	Beginning Rating	Return (%)	Trendrating Return (%)
NMC	Nmc Health	01/01/2016	A	A	83.70	83.70
III	3i	03/06/2016	A	C	46.18	29.17
AHT	Ashtead	15/07/2016	A	B	41.20	39.82
EXPN	Experian	04/04/2016	A	A	31.06	15.93
GKN	Gkn	09/08/2016	A	B	7.56	9.18
PRU	Prudential	22/08/2016	A	B	6.30	17.85
AV.	Aviva	28/10/2016	A	B	-5.74	8.86
LAND	Land Securities	23/12/2016	B	A	-9.43	-5.01
VEC	Vectura	07/06/2016	D	A	-22.10	-11.48
IAG	International Consolidated Airlines	22/02/2016	D	A	-27.78	-17.04
DC.	Dixons Carphone	18/04/2016	D	A	-29.08	-17.34
IRV	Interserve	16/11/2016	D	D	-34.34	0.00
LOOK	Lookers	11/04/2016	D	A	-36.62	-18.59
	Total				3.92	10.39

Table 1: Strong Buy Portfolio
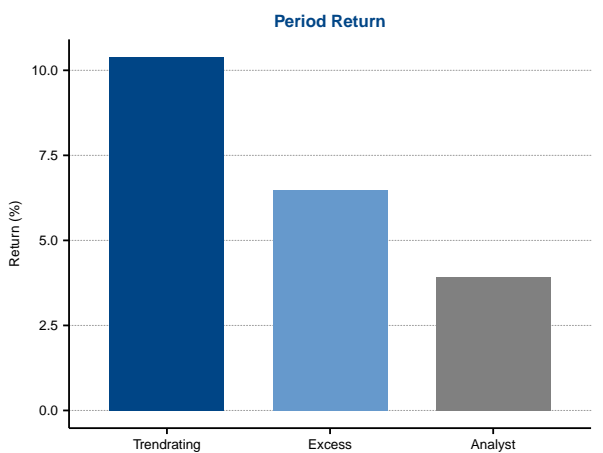
Figure 1: Strong Buy Portfolio

Figure 2 shows Prudential's (Ticker: PRU) stock price evolution along with a history of Trendrating's rating[2] changes over the analysis period.
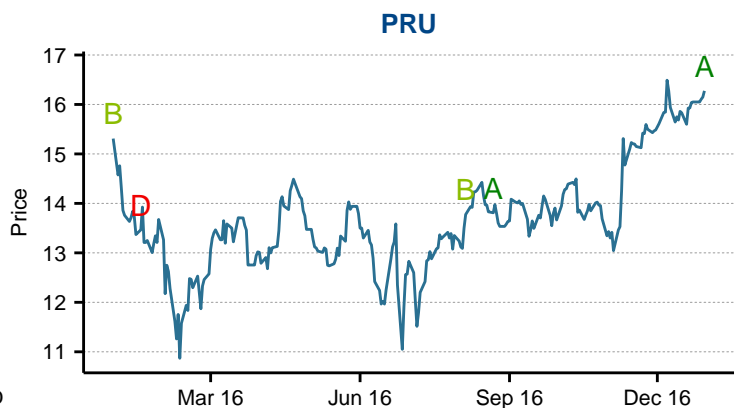
Figure 2: PRU Rating History

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[2]In addition to the changes to the ratings in the analysis period, the charts also show the prevailing rating at the start and at the end of the analysis period

As a constituent of the strong buy portfolio, the analyst recommendation would have been to hold PRU for the entire period whereas Trendrating did not signal a buy recommendation until well into the analysis period.

The stock price remained flat for several weeks and then experienced a sharp surge upwards resulting in a return of 17.85% versus the analyst recommended return of 6.3%. This example is quite typical of the power of the Trendrating model that it will capture trends quickly and accurately allowing investors sufficient time to implement changes to their portfolios.

Appendix A contains the rating and price evolution charts for the rest of the constituents of the strong buy portfolio.

The upside capture[3] from the Trendrating recommendation for the strong buy portfolio was 91%. This means that an investor following the Trendrating recommendation would have realised a return of 33% out of a maximum possible of 36%.

Trendrating makes a crucial difference in the downside capture[4] of 37% where an investor following its rating recommendation would have realised only -9% of the negative return out of the maximum draw-down of -24%.
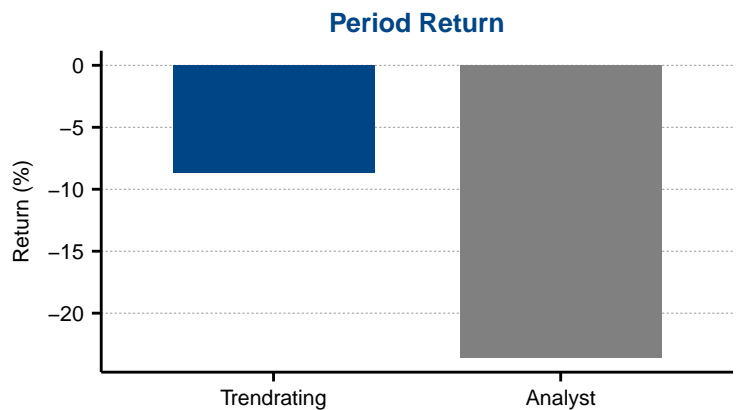
Period Return

Figure 3: Strong Buy Upside Capture

Period Return

Figure 4: Strong Buy Downside Capture

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[3]The percentage participation in upside return
[4]The percentage participation in downside return

2.2 Strong Sells

Table 2 displays the strong sell portfolio positions along with associated rating and return contribution statistics. Figure 5 shows the additional performance that an investor would have gained using the Trendrating recommendation over the analyst recommendation.

Table 2 shows that Trendrating signalled buy recommendations for 7 stocks from the total number of 12 stocks in the strong sell portfolio. It is clear from the performance of the strong sell portfolio that this set of stocks displayed considerably strong positive performance in comparison to the strong buy portfolio, so investors following analyst recommendations would have suffered a huge opportunity cost. The Trendrating model captured the strong up-trend in this set of stocks.

TICKER	Name	Latest Rating Date	Current Rating	Beginning Rating	Return (%)	Trendrating Return (%)
VED	Vedanta Resources	13/06/2016	A	D	219.59	128.38
EVR	Evraz	23/03/2016	A	D	202.80	148.93
ECM	Electrocomponents	01/01/2016	A	A	100.04	100.04
ROR	Rotork	26/05/2016	A	D	32.02	20.84
CCH	Coca-cola Hbc	08/06/2016	A	A	22.24	17.28
HSP	Hargreaves Services	05/10/2016	A	D	5.43	36.68
AGK	Aggreko	30/11/2016	D	D	0.44	-23.95
SL.	Standard Life	23/09/2016	A	C	-4.54	5.32
INTU	Intu Properties	28/09/2016	D	B	-11.35	-5.52
PSN	Persimmon	14/09/2016	D	C	-12.38	-6.19
HL.	Hargreaves Lansdown	13/10/2016	D	A	-19.46	-24.06
JWD	Jwd Infologistics	21/10/2016	D	Not Rated	-42.10	0.00
	Total				41.06	33.15

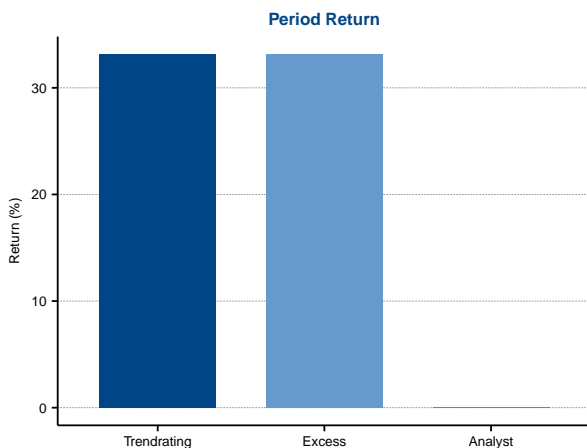**Table 2:** Strong Sell Portfolio

Figure 6 shows the stock price evolution along with a history of Trendrating's rating changes over the analysis period for Evraz (Ticker: EVR).
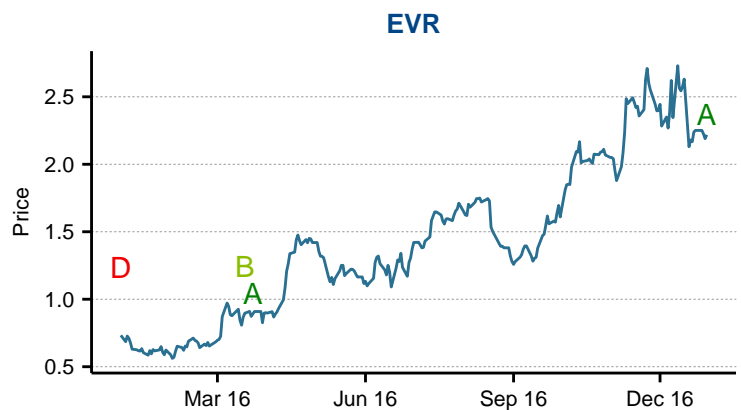

Figure 5: Strong Sell Portfolio

Figure 6: EVR Rating History

The analyst recommendation for Evraz was to sell or not hold the stock that would have meant an opportunity cost of 202.8%.

The stock price had a noisy path in its strong up-trend but the ability of the Trendrating model to filter out noise and capture the true long-term trend would have kept investors in the stocks from quite an early stage of the up-trend thus allowing investors to capture a return of 148.93%.

Appendix B contains the rating and price evolution charts for the rest of the constituents of the strong sell portfolio.

The upside capture[5] from the Trendrating recommendation for the strong sell portfolio was 74%. This means that an investor following the Trendrating recommendation would have realised a return of 61% out of a maximum possible of 83%.

The Trendrating model does have a non-zero downside capture of 34% versus the analyst recommendations that have a zero downside capture but it was a price worth paying because the Trendrating recommendation would have resulted in a negative return contribution of only -6% of the negative return out of the maximum draw-down of -18%.
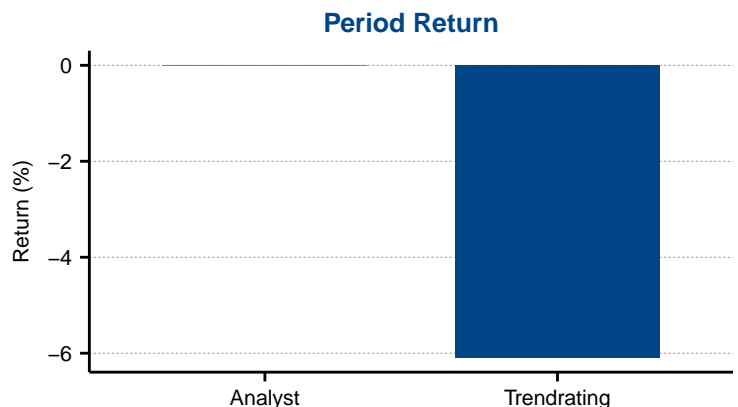
Figure 7: Strong Sell Upside Capture

Figure 8: Strong Sell Downside Capture

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[5]The percentage participation in upside return

3   Conclusion

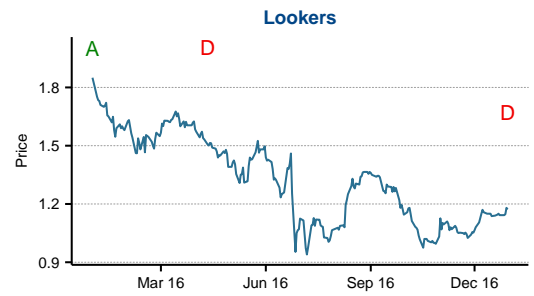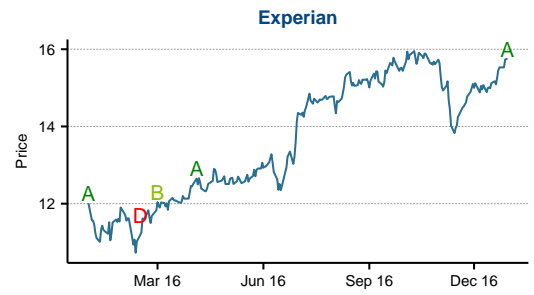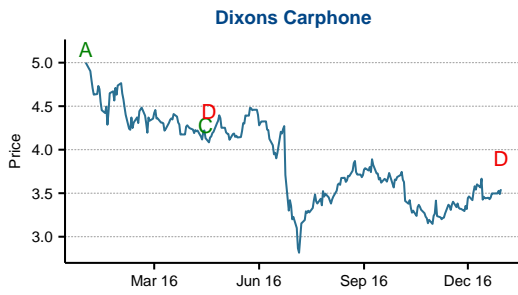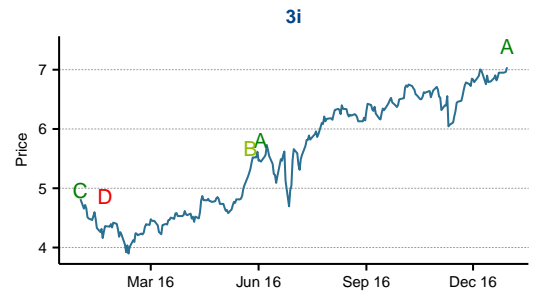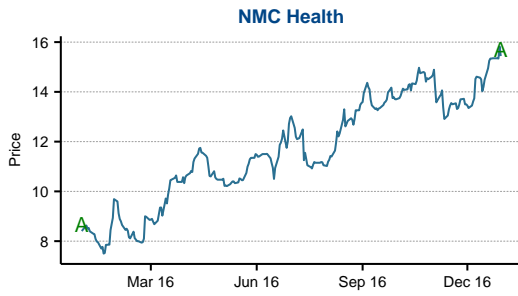Drivers of security prices are producing strong up-trends and down-trends, causing significant disconnects with underlying fundamentals for extended periods. These periods are sufficiently long and are producing sharp returns in both directions. Thus it is crucial that investors are able to capture the direction and strength of travel of the price trend in order to maximise returns and minimise losses in their portfolios.

Our analysis is not making assertions on the efficacy of the analyst recommendations but is rather highlighting our thesis that the prevailing price trends in the UK market were counter to the analysis of a large group of qualified investment professionals. Whilst it is possible that the prices of the securities illustrated in this analysis might ultimately reflect the analyst recommendations, following the analyst recommendations in 2016 would have had disastrous consequences for investor portfolios.

The Trendrating Momentum Analytic with its best of breed model is adept at capturing the prevailing trend in security prices in a highly robust and accurate manner. The model has granular accuracy to differentiate between price trends at the security level that makes it ideal for implementation in a wide spectrum of investment processes. The model can be used as a stand-alone driver of an investment process or used in conjunction with other quantitative and qualitative investment workflows.

Appendix

A   Strong Buy Portfolio: Rating & Price Evolution Charts

NMC Health

3i

Dixons Carphone

Experian

Ashtead

Lookers

International Consolidated Airlines

Vectura

Land Securities

Interserve

Aviva

Gkn
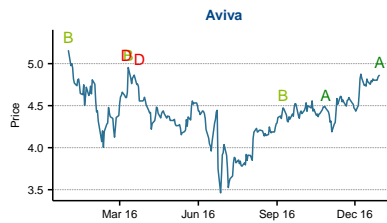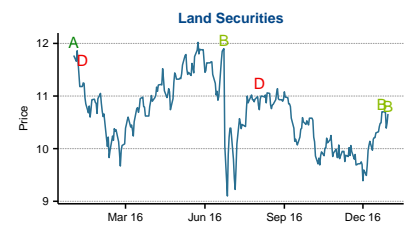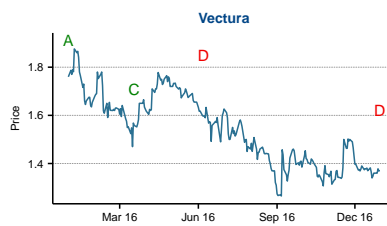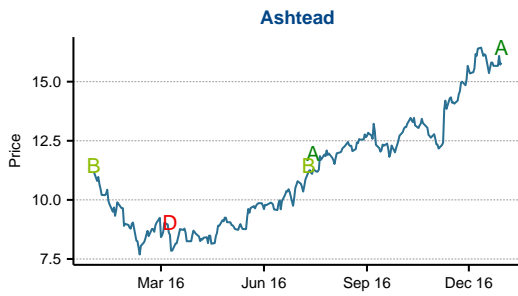
B   Strong Sell Portfolio: Rating & Price Evolution Charts

Hargreaves Services

Hargreaves Lansdown

Persimmon

Standard Life

Aggreko

Intu Properties

Jwd Infologistics

Coca–cola Hbc

Rotork

Electrocomponents

Vedanta Resources