Frightened Children

Analysts clinging onto the Mother of Guidance

1st September 2016
Mike Newman

***"A mother understands what a child does not say"* – Jewish proverb**

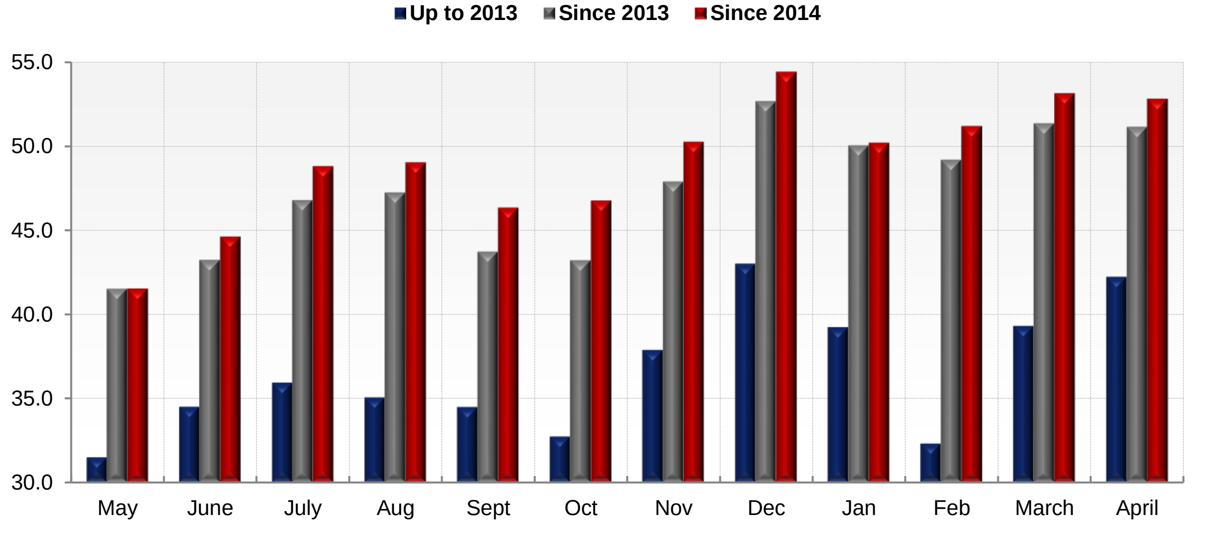
Consensus huggers

We looked at the growing consensus hugging nature of analysts in Japan who increasingly base their forecasts on a +/-5% range within company guidance.

Over 50% of analysts hug consensus

Fig.1 below shows how the trend has climbed in the past 3 years. Whether one blames compliance or a lack of capability, consensus hugging now pervades over 50% of analysts from around 35% prior to 2013.

Fig.1 : % of Companies with Consensus Estimates less than +/-5% from company Guidance

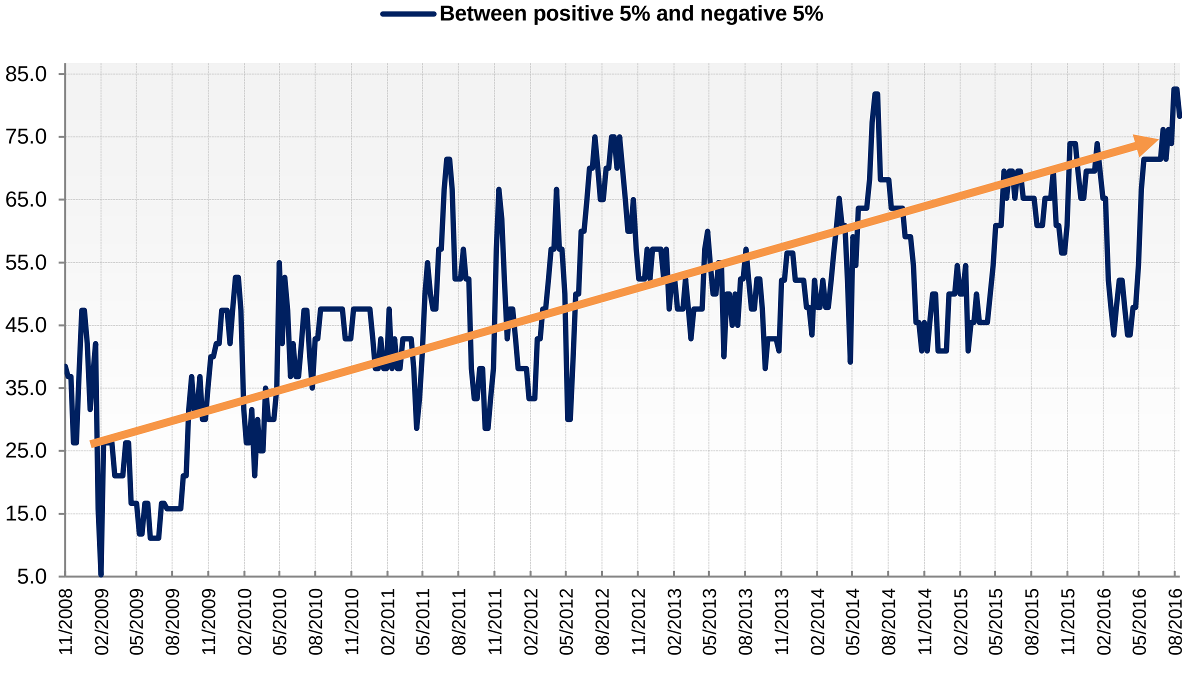


Source: Custom Products Research

Financials the worst offender

The study gets worse when we look at it by sector. Since Lehman Shock, 75% of **financial** analysts in aggregate are within 5% of company guidance from 35% in late 2008. Unsurprisingly after the immediate crash, most analysts were way out of line with company guidance.

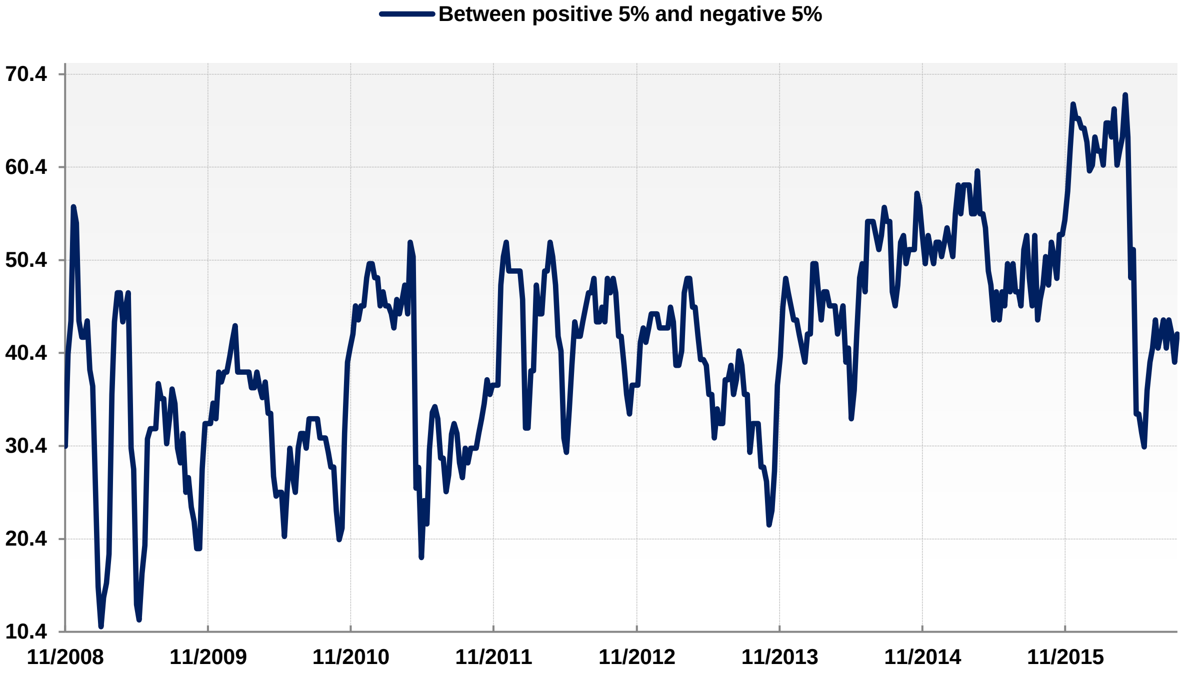
Fig. 2: % of Financials with Consensus Estimates less than +/-5% from company Guidance



Source: Custom Products Research

Industrials **Industrials** have also fared poorly. Around 30% of analysts hugged guidance in late 2008 jumping to around 60% before cooling off to around 40 within +/-5% of guidance, Fig. 3.

Fig. 3: % of Industrials with Consensus Estimates less than +/-5% from company Guidance

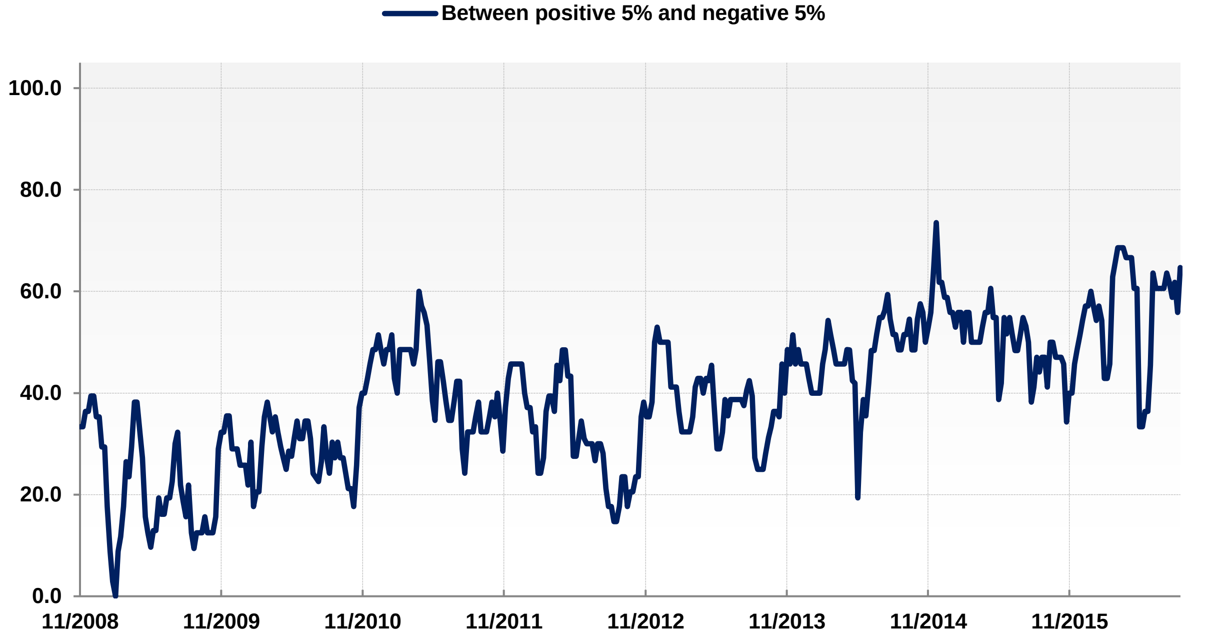


Source: Custom Products Research

Materials

Materials analysts suffered a similar fate moving from 35% to over 60% respectively.

Fig. 4: % of Materials with Consensus Estimates less than +/-5% from company Guidance

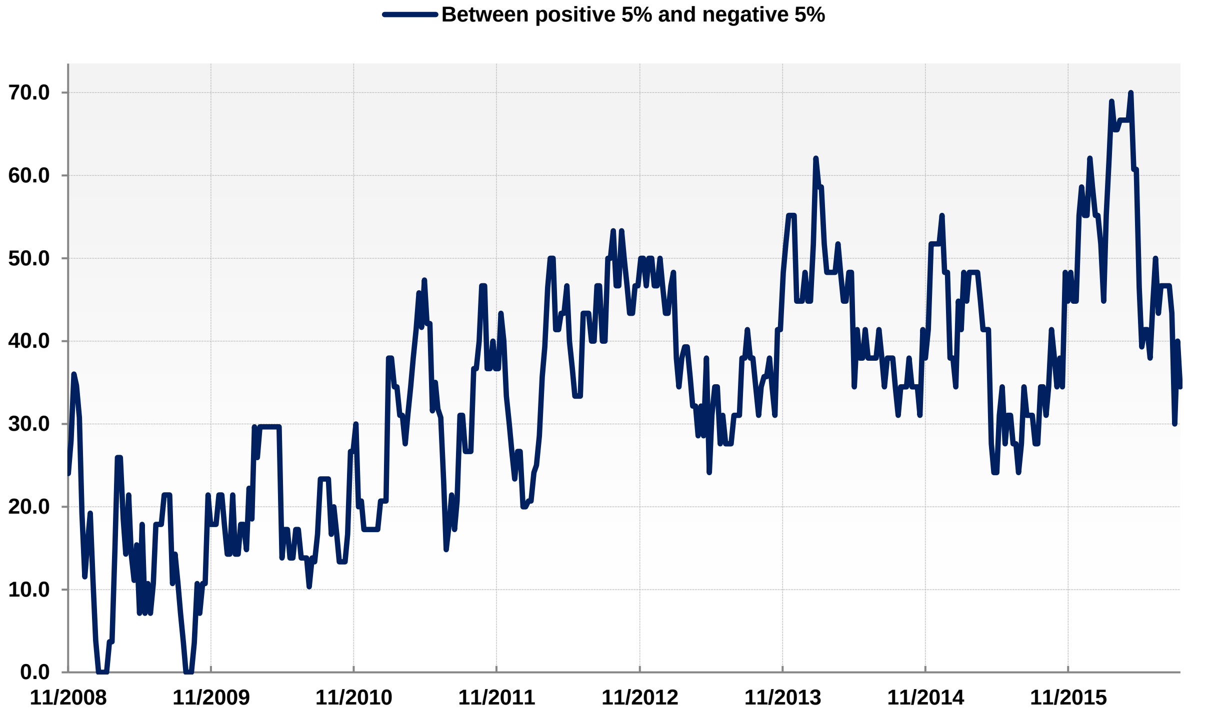


Source: Custom Products Research

Consumer Discretionary

On the **Consumer Discretionary** front the company guidance hugging trend is evident rising from 25% to 35% although hitting highs of 70%.

Fig. 5: % of Consumer Discretionary with Consensus Estimates less than +/-5% from Company Guidance

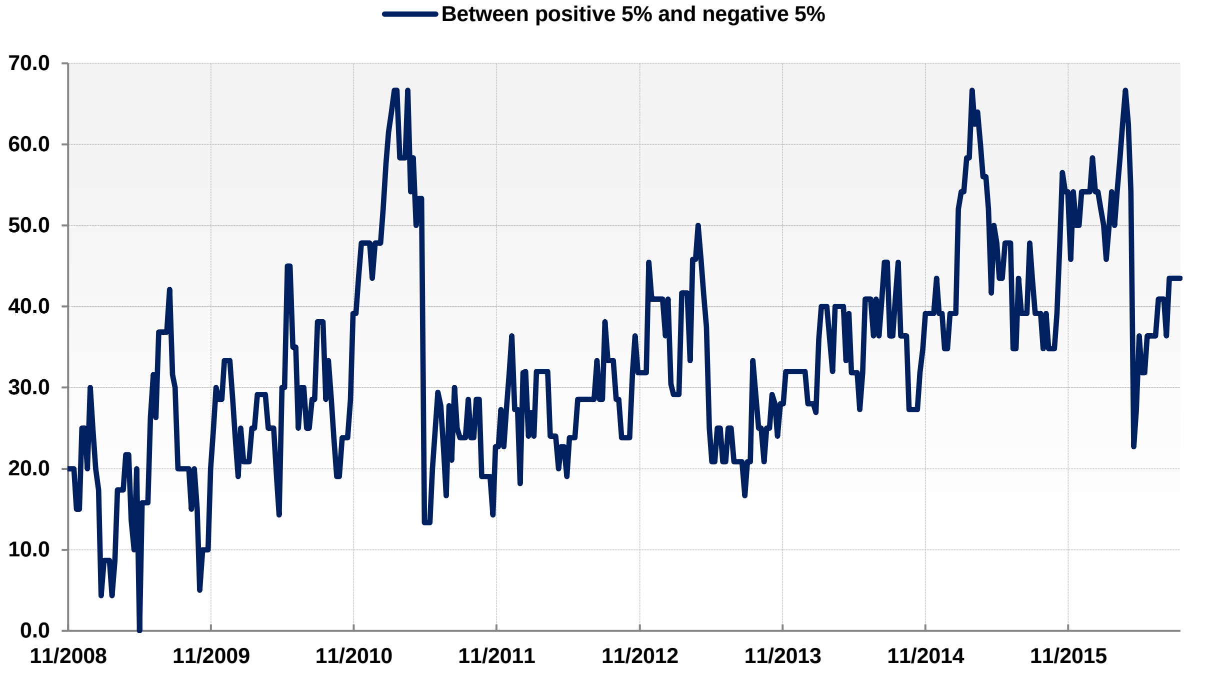


Source: Custom Products Research

IT consensus hugging

Information Technology analysts have also moved toward a more company estimates hugging stance, doubling from 20% in late 2008 to 45% today. Earnings volatility is a hallmark of IT stocks but the trend has been toward guidance hugging.

Fig. 6: % of Info Tech with Consensus Estimates less than +/-5% from company Guidance

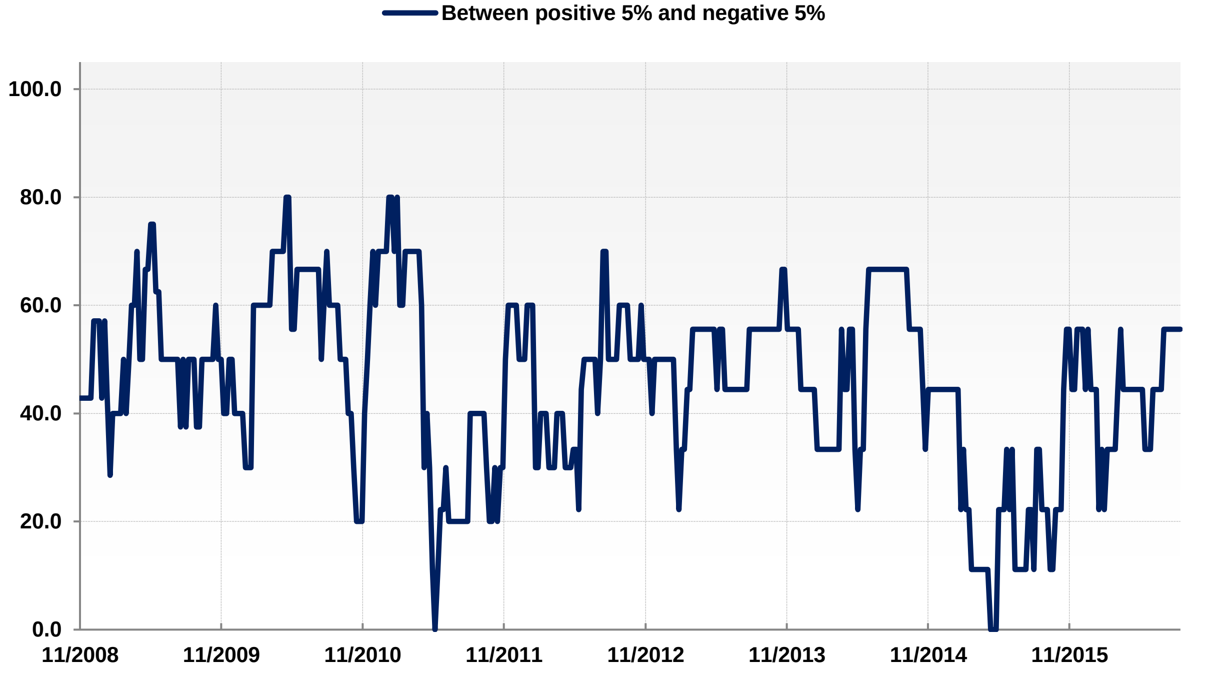


Source: Custom Products Research

Some positives

On the positive side, **Healthcare** (Fig. 7) and **Consumer Staples** (Fig. 8) have at least showed lateral movement among analyst guidance hugging.

Fig. 7: % of Healthcare with Consensus Estimates less than +/-5% from company Guidance

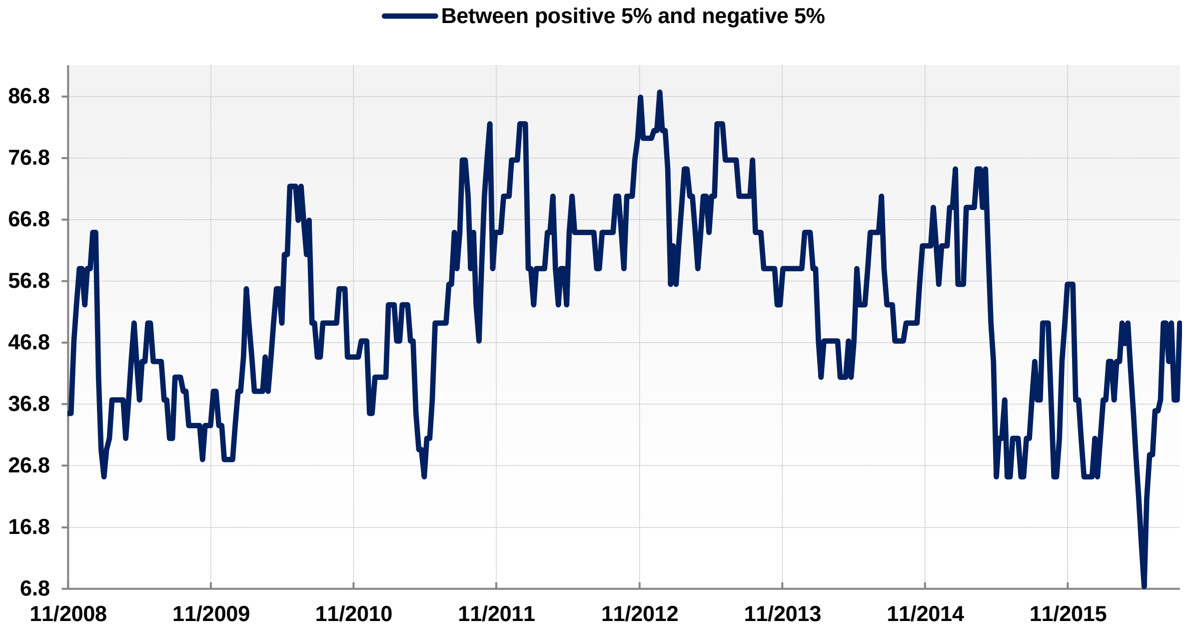


Source: Custom Products Research

Less volatility?

Although given the relatively stable nature of the defensive earnings one might expect less volatility than this.

Fig. 8: % of Cons Staples with Consensus Ests less than +/-5% from company Guidance

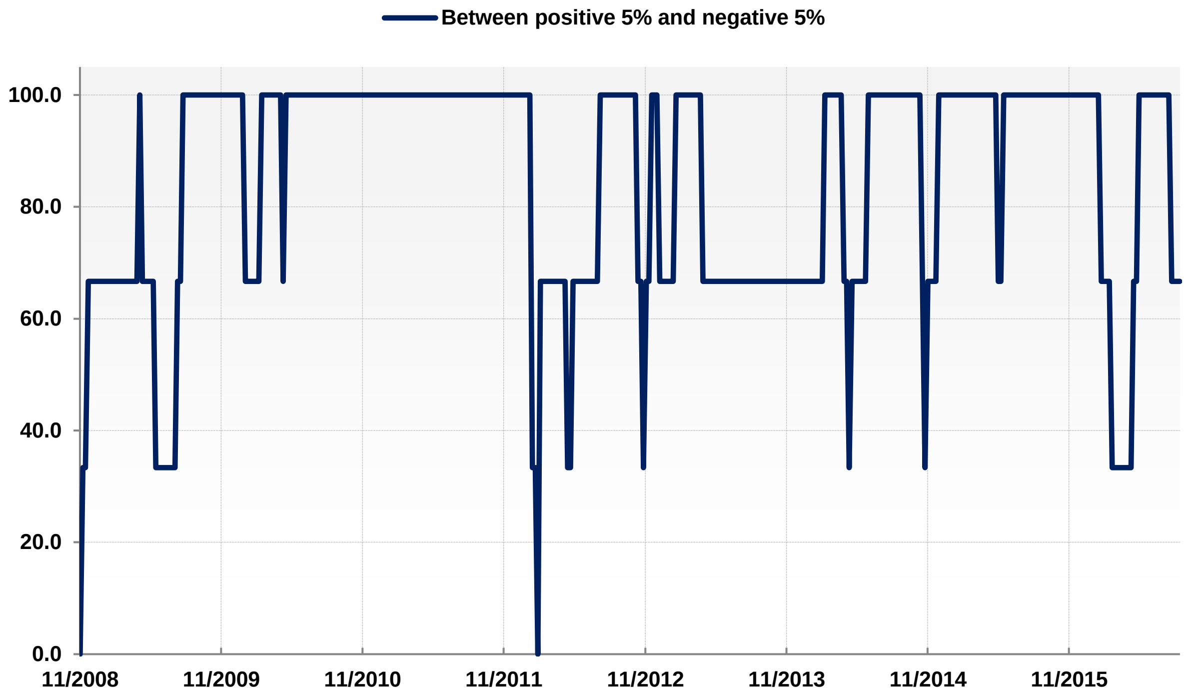


Source: Custom Products Research

Defensives

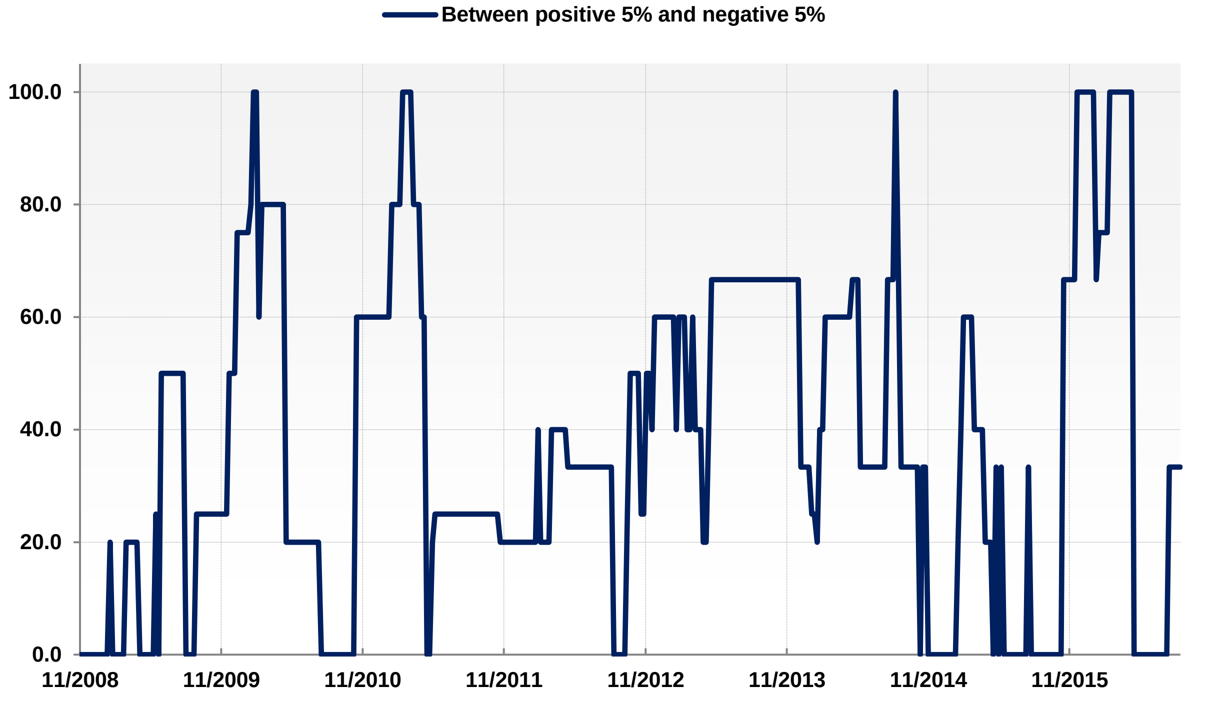
For **Telecoms** and **Utilities**, those analysts hugging company guidance and not within a +/-5% range tends to trend between 0% and 100%.The wide swings are also due to fewer companies in each sector.

Fig. 9: % of Telecoms with Consensus Ests less than +/-5% from company Guidance



Source: Custom Products Research

Fig. 10: % of Utilities with Consensus Ests less than +/-5% from company Guidance

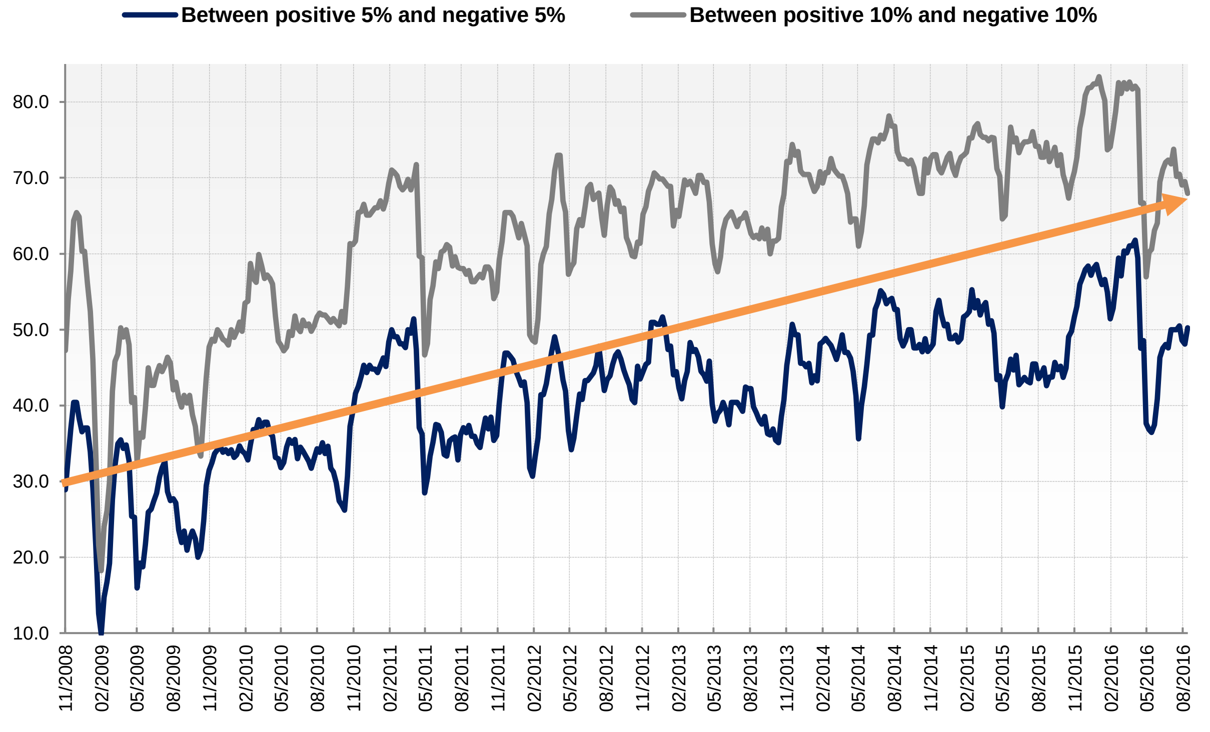


Source: Custom Products Research

At +/-10% nearly 70% of analysts hug

When we broadened the study to +/-10% of guidance, nearly 70% of analysts are holding within that range. Has the hollowing out on the sell-side of more experienced analysts caused the trend? Naturally, the compression of commissions has forced many firms to cut overhead and the trend toward less experienced analysts has grown.

Fig. 11 % of All stocks estimates +/10% of company guidance



Source: Custom Products Research

Summary

Looking at this study it is clear that analysts are becoming greater company guidance huggers. We wonder what value the buy-side can truly garner from paying for research that invariably tells a similar tale as the company. If financial houses continue to shed more (expensive) experienced staff, we would not be surprised to see this trend continue. As we wrote in *The future is always brighter…* and *ETF behaviour in bear markets* we note that the qualitative reasons for earnings and target price setting is becoming even less relevant too. So whatever MiFID II ends up instructing the sell-side and buy-side to do it would seem that the "client" has ample excuse not to bother with spending too much time on justifying payment to the regulator.

Important Disclosures:

This material was prepared for you and is for your information and use only. This material should only be distributed to other members of that organization on a need to know basis and should not be distributed or disseminated to any other person or entity.

This material is for information purposes only and it should not be regarded as an offer to sell or as a solicitation of an offer to buy the securities or other instruments mentioned in it. This material is based on current public information that Custom Products Group Limited ("Custom Products") considers reliable, but we make no representation that it is accurate or complete, and it should not be relied on as such. No investment opinion or advice is provided, intended, or solicited. Custom Products offers no warranty, either expressed or implied, regarding the veracity of data or interpretations of data included in this report. This material is provided with the understanding that Custom Products is not acting in a fiduciary capacity. Opinions expressed herein reflect the opinion of Custom Products and are subject to change without notice.

The products mentioned in this document may not be eligible for sale in some states or countries, and they may not be suitable for all types of investors. The value of and the income produced by products may fluctuate, so that an investor may get back less than they invested. Value and income may be adversely affected by exchange rates, interest rates, or other factors. Past performance is not necessarily indicative of future results. If a product is income producing, part of the capital invested may be used to pay that income.

Contacts

Hong Kong
Simon Rigney
+852-3958-2394 (HK)
+81-3-5786-3712 (Tokyo)
simon.rigney@custprd.com

Salt Lake City
Patrick Hansen
+852-8191-6925 (HK)
+1-801-230-4796 (SLC)
patrick.hansen@custprd.com

Tokyo
Robert Rowland
+81-3-5786-3711
robert.rowland@custprd.com

Michael Newman
+81-3-5786-3713
michael.newman@custprd.com

Office Locations

Hong Kong
15/F Langham Place
8 Argyle Street
Mong Kok, Kowloon
Hong Kong S.A.R.

Tokyo
17/F Roppongi Hills North Tower
6-2-31 Roppongi,
Minato-ku, Tokyo
Japan 106-0032

Salt Lake City
299 South Main Street
Suite 1300
Salt Lake City, UT
United States, 84111