AnalystSolutions

Overcoming the Challenges Research Analysts Face

James Valentine, CFA

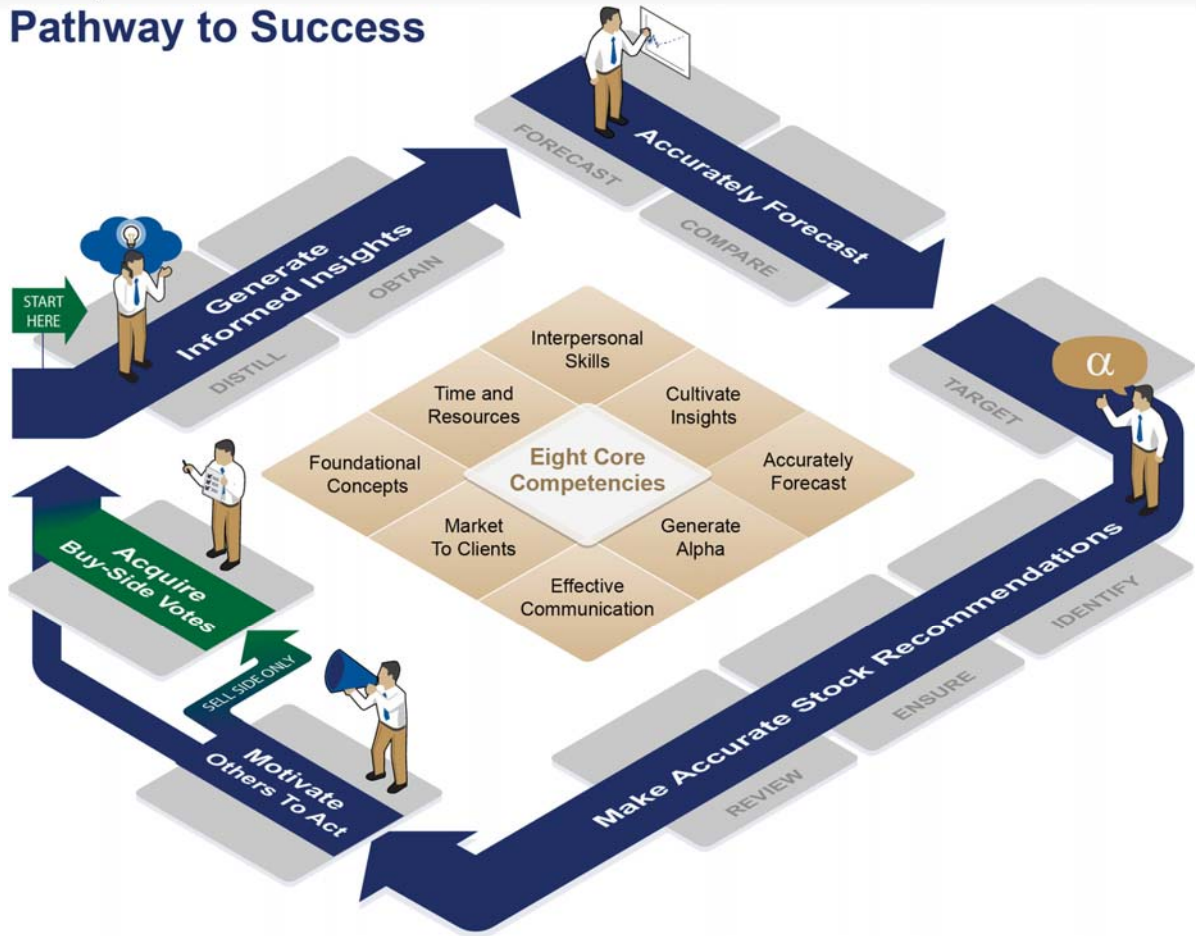| Service	Value-destruction (in Billions)
Long-only funds not generating alpha	$ 300
Wealth management not achieving benchmark returns	$ 250
Hedge funds falling short of target return	$ 51
Sell-side and credit rating agencies' inaccuracies	$ 459
Total	$1,060

Source: "Financial Markets 2020" study conducted by IBM as reported by the *Financial Times*, April 3, 2011

Pathway to Success

Eight Core Competencies
- Interpersonal Skills
- Time and Resources
- Cultivate Insights
- Foundational Concepts
- Accurately Forecast
- Market To Clients
- Generate Alpha
- Effective Communication

Generate Informed Insights — START HERE — DISTILL — OBTAIN

Accurately Forecast — FORECAST — COMPARE

Make Accurate Stock Recommendations — TARGET — IDENTIFY — ENSURE — REVIEW

Acquire Buy-Side Votes

Motivate Others To Act — SELL SIDE ONLY

Ten Greatest Challenges

Effectively managing time and information flow

Identifying the critical factors likely to drive a universe of stocks

Developing unique sources of content

Ensuring stock calls are differentiated from the consensus view

Deriving a price target more accurate than consensus

Timing stock calls to maximize alpha

Avoiding the most common psychological mistakes made by investors

Communicating unique stock calls successfully so others take action

Deriving useful insights and detecting deception from information sources

Forecasting more accurately than consensus

Greatest Challenge #1: Effectively managing time and information flow

#1. Effectively managing time and information flow

Some analysts play defense…

#1. Effectively managing time and information flow

While *great* analysts play offense…

#1. Effectively managing time and information flow

DEFENSE

#1. Effectively managing time and information flow
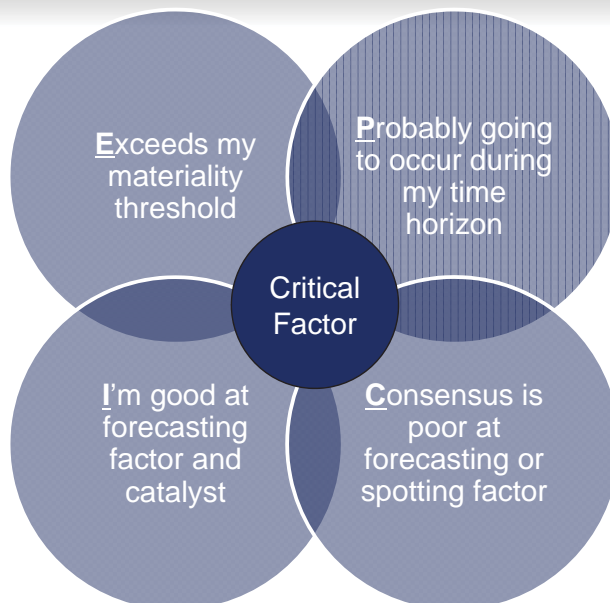
OFFENSE

See QRC: "Best Practices for Time Management"

Analyst Solutions Time Management Matrix

		Generates Differentiated Insights Useful for Stock Picking	
		LOW	**HIGH**
		"Enabler" for Alpha	Generate Alpha
Initiating vs. Responding	**You INITIATE (Offense)**	Read portions of regulatory filing that pertain to critical factors and their catalysts	Make 10 outgoing calls in one day to discuss assumptions for critical factors with proprietary sources of information
	You RESPOND (Defense)	IR contact from company you don't cover calls to tell you about an issue that has no importance to your assigned coverage	Accept a last-minute one-on-one with management at investor conference
		Waste of Time?	Surprise Find

Greatest Challenge #2: Identifying the critical factors likely to drive a universe of stocks

CRITICAL FACTORS ?

Greatest Challenge #2: Identifying the critical factors likely to drive a universe of stocks

Exceeds my materiality threshold

Probably going to occur during my time horizon

Critical Factor

I'm good at forecasting factor and catalyst

Consensus is poor at forecasting or spotting factor

EPIC™ stock calls include critical factors that meet all four criteria

Greatest Challenge #2: Identifying the critical factors likely to drive a universe of stocks

1. Identify *when* historical anomalies occurred	→	2. Identify *why* historical anomalies occurred	→	3. Identify *current* investment controversies
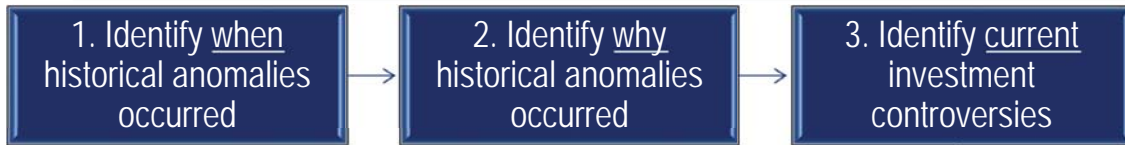
4. Using the information above, communicate with industry and market participants to answer these questions (the EPIC™ framework):

- Would changes in consensus expectations Exceed my materiality threshold if this factor were to occur during my investment time horizon?
- Is there a high Probability this factor will become much more certain to occur (or deviate materially from the expected trend) during my investment time horizon?
- Am I good at forecasting this factor and its catalyst?
- Will Consensus be poor at accurately forecasting (or spotting) this factor?

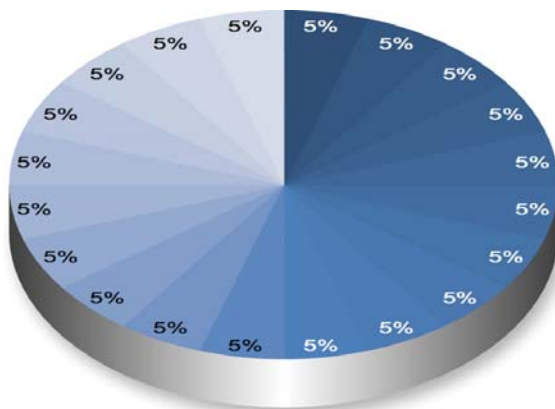   When the answer is "yes" to all, it is likely a critical factor that can add alpha

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Greatest Challenge #2: Identifying the critical factors likely to drive a universe of stocks

Critical Factors Not Defined

Critical Factors Defined
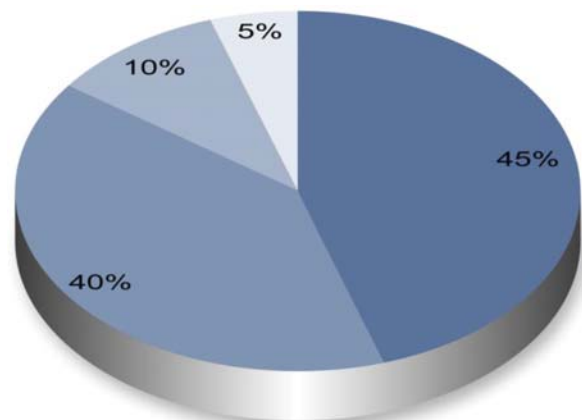
Greatest Challenge #3: Developing unique sources of content

Management of or bloggers
Trade journalists private companies
Colleagues covering related sectors
Management of competitors
publicly-traded competitors
Trade association
employees/members
Consultants/retirees from the sector
GOVERNMENT OFFICIALS
OR STAFFERS

Communicate
Stock Calls

Make Accurate Stock Recommendations

FORECASTING

VALUATION

Generate Informed Insights

Greatest Challenge #3: Developing unique sources of content

Public Information

- News stories
- Company press releases
- Conference call transcripts
- Regulatory filings
- Industry trade journals and blogs
- Sell-side research (for buy-side)

BAD GOOD

Proprietary/Unique Information

Communicating with...
- Colleagues covering related sectors
- Management of private companies
- Management of publicly-traded competitors
- Consultants/retirees from the sector
- Trade journalists or bloggers
- Trade association employees/members
- Government officials or staffers
- Sell-side analysts (for the buy-side)

BAD GOOD

See QRC: "Helpful Live Information Sources"

AnalystSolutions

| Provides no help in forecasting | Helps in forecasting but not the critical factors | Helps in forecasting critical factors but consensus is not wrong | Helps in forecasting critical factors and consensus is wrong |

Greatest Challenge #4: Ensuring stock calls are differentiated from the consensus view

Consensus View

Great Stock Calls

Ensure a Differentiated Stock Call with the FaVeS™ Framework

Forecast	• Financial forecast superior to the market (used at least 85%)
Valuation	• Valuation methodology or valuation multiple superior to the market
Sentiment	• Forecast of short-term investor sentiment superior to the market • Most difficult among the three • Assumes no immediate justifiable change to financial forecast or valuation method/multiple

AnalystSolutions
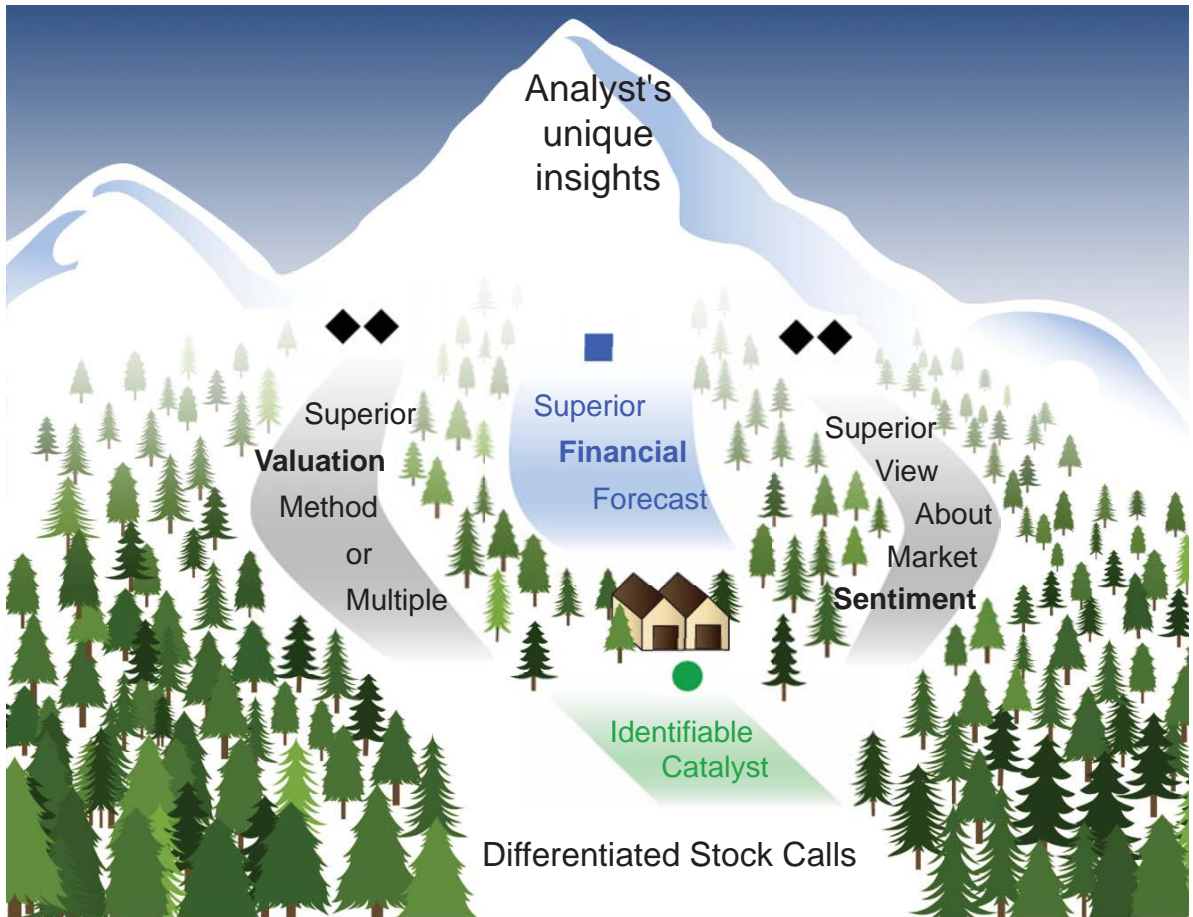
Greatest Challenge #5: Deriving a price target more accurate than consensus

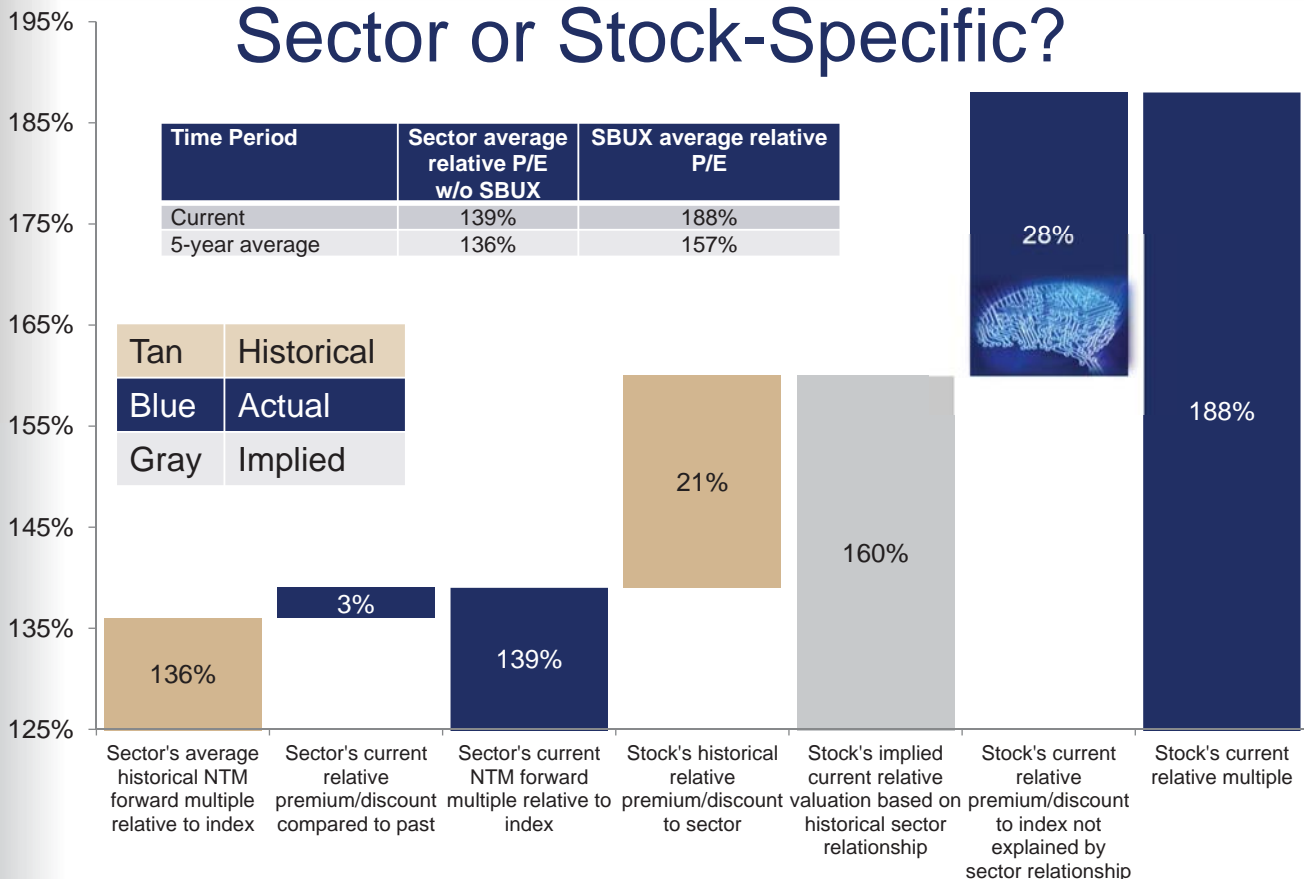# SHARE™ to Create a Price Target More Accurate than Consensus

S	• **S**elect method(s)
H	• **H**istorical & current data review
A	• **A**djust for future time period
R	• **R**ange of multiples and price targets
E	• **E**valuate as circumstances change

Sector or Stock-Specific?

Time Period	Sector average relative P/E w/o SBUX	SBUX average relative P/E
Current	139%	188%
5-year average	136%	157%

Tan	Historical
Blue	Actual
Gray	Implied

Chart values:
- Sector's average historical NTM forward multiple relative to index: **136%**
- Sector's current relative premium/discount compared to past: **3%**
- Sector's current NTM forward multiple relative to index: **139%**
- Stock's historical relative premium/discount to sector: **21%**
- Stock's implied current relative valuation based on historical sector relationship: **160%**
- Stock's current relative premium/discount to index not explained by sector relationship: **28%**
- Stock's current relative multiple: **188%**

Legend: Upside — Downside — Base-case

Chart values:
- Two years ago: $8
- Year ago: $9
- Now: $10
- One Year in Future: Upside $14, Base-case $11, Downside $8

Y-axis: $7 to $16
X-axis: Two years ago, Year ago, Now, One Year in Future

Greatest Challenge #6: Timing stock calls to maximize alpha

Validate Your View

Assess and Influence the Market's View

Greatest Challenge #6: Timing stock calls to maximize alpha

Validate Your View

- Resist predetermining the rating
- Validate heuristics
- Ensure call is differentiated (FaVeS™)
- Weigh risk as well a return
- Ensure no imminent danger
- Document thesis
- Sleep on it

Assess and Influence the Market's View

- Monitor trading data
- Know consensus
- Survey market sentiment
- Monitor technical indicators
- Influence the market

Greatest Challenge #7: Avoiding the most common psychological mistakes made by investors

- Fear of failure
- Costly psychological shortcuts
- Following the herd
- Pollyannaish or hopeful thinking

Signs You Are Ignoring a Bias

Being close-minded about new information

Seeing only one side of the trade

Disinterested in assessing the downside or risk

Failing to completely analyze/research important factor

Allowing emotions to govern decisions despite the facts

Refusing to accept responsibility while blaming others

Taking shortcuts that are not built on solid research

Going with what is easiest or most comfortable, rather than what is best

Reacting to short-term fluctuation without a long-term view

Eliminating Psychological Biases from Your Stock Calls

Document your thought process and review it periodically

Document changes to your financial forecasts, then look for inconsistencies

Ask trusted colleagues (or investment committee) to alert you to blind spots in your investment thesis

Create automatic stop-loss triggers and mechanical sell disciplines

Accept mistakes as valuable opportunities to learn

Complete thorough research before making a stock recommendation

Greatest Challenge #8: Communicating unique stock calls successfully so others take action

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How Do Analysts Differ from Sector (or "Beat") Journalists?

	Equity Research Analysts	Experienced Sector Journalists
Understand industry fundamentals	Y	Y
Listen to company conference calls	Y	Y
Read company press releases	Y	Y
Review company regulatory filings	Y	Y
Cultivate a list of insightful industry contacts	Y	Y
Interview industry experts to identify changes in the industry	Y	Y
Speak with company management	Y	Y
Write about developments within a company and across the industry	Y	Y

3 Steps For Communicating Stock Recommendations

STEP 1: ENSURE CONTENT HAS VALUE (ENTER™ framework)

- Expectational
- Novel
- Thorough
- Examinable
- Revealing

STEP 2: UTILIZE THE OPTIMAL CHANNEL

- In-person conversation
- Telephone conversation
- Leaving voicemail
- Presenting, five minutes or less
- Presenting, in-depth
- Sending an email or text message
- Writing a report

STEP 3: ENSURE MESSAGE HAS VALUE (ADViCE™ framework)

- Aware
- Differentiated
- Validated
- Conclusion-oriented
- Easy-to-consume

See QRCs for utilizing ENTER™ and ADViCE™

Both content and message matter
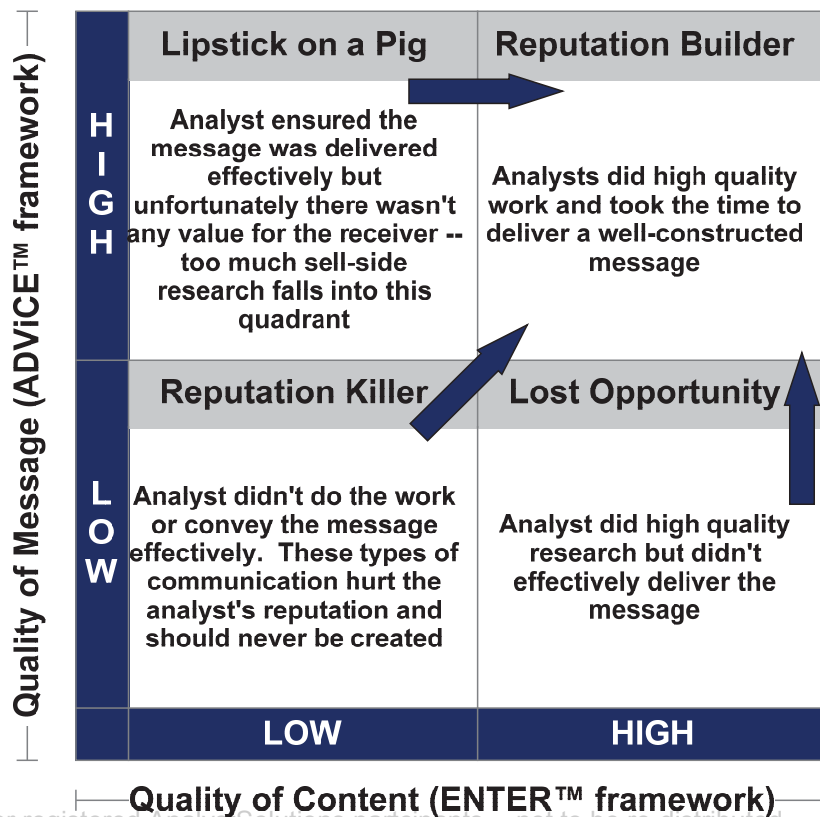
Quality of Message (ADViCE™ framework)

	LOW	**HIGH**
HIGH	**Lipstick on a Pig** Analyst ensured the message was delivered effectively but unfortunately there wasn't any value for the receiver -- too much sell-side research falls into this quadrant	**Reputation Builder** Analysts did high quality work and took the time to deliver a well-constructed message
LOW	**Reputation Killer** Analyst didn't do the work or convey the message effectively. These types of communication hurt the analyst's reputation and should never be created	**Lost Opportunity** Analyst did high quality research but didn't effectively deliver the message

Quality of Content (ENTER™ framework)

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Workshops that Address Universal Needs

- Maximize Your Time for Alpha Generation
- Identify & Monitor a Stock's Critical Factors
- Master the Stock Call Techniques of Highly Experienced Analysts
- Communicate Unique Stock Calls Successfully So Others Take Action
- Identify Benefits & Limitations of Commonly Used Valuation Methods
- Eliminate Psychological Biases From Your Stock Calls
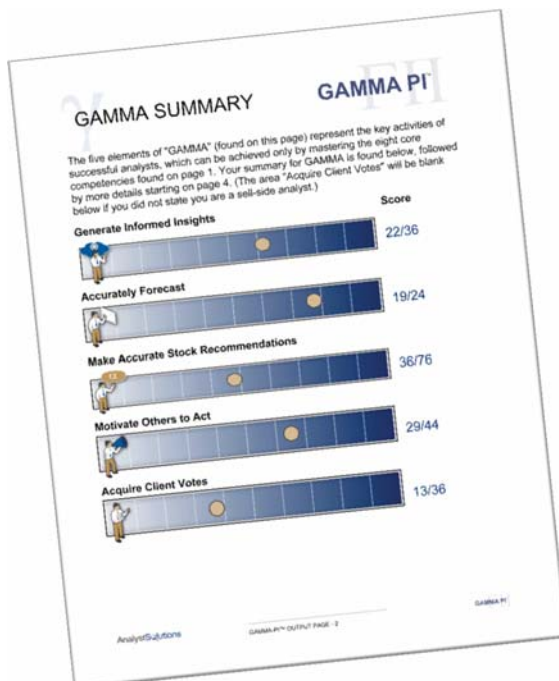- Influence Others to Accumulate Insights and Be Heard

Coaching Accelerates Learning

- Improving existing behaviors, such as:
  - More thorough and focused research
  - Communicating more effectively
- Developing new skills such as identifying factors most likely to move a stock
- Increasing self-awareness for professional development such as the cause of failed stock calls

Assess Needs Before Developing the Solutions

GAMMA SUMMARY — GAMMA PI

The five elements of "GAMMA" (found on this page) represent the key activities of successful analysts, which can be achieved only by mastering the eight core competencies found on page 1. Your summary for GAMMA is found below, followed by more details starting on page 4. (The area "Acquire Client Votes" will be blank below if you did not state you are a sell-side analyst.)

	Score
Generate Informed Insights	22/36
Accurately Forecast	19/24
Make Accurate Stock Recommendations	36/76
Motivate Others to Act	29/44
Acquire Client Votes	13/36

134 questions assessing the following areas:
- **G**enerate informed insights
- **A**ccurately forecast
- **M**ake accurate stock recommendations
- **M**otivate others to act (communications)
- **A**cquire buy-side votes (sell-side only)
- **P**roductivity
- **I**ndividual characteristics

Q&A

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AnalystS🔍lutions