

# AnalystSolutions

AnalystSolutions

## Master the Stock Call Techniques of Highly Experienced Analysts

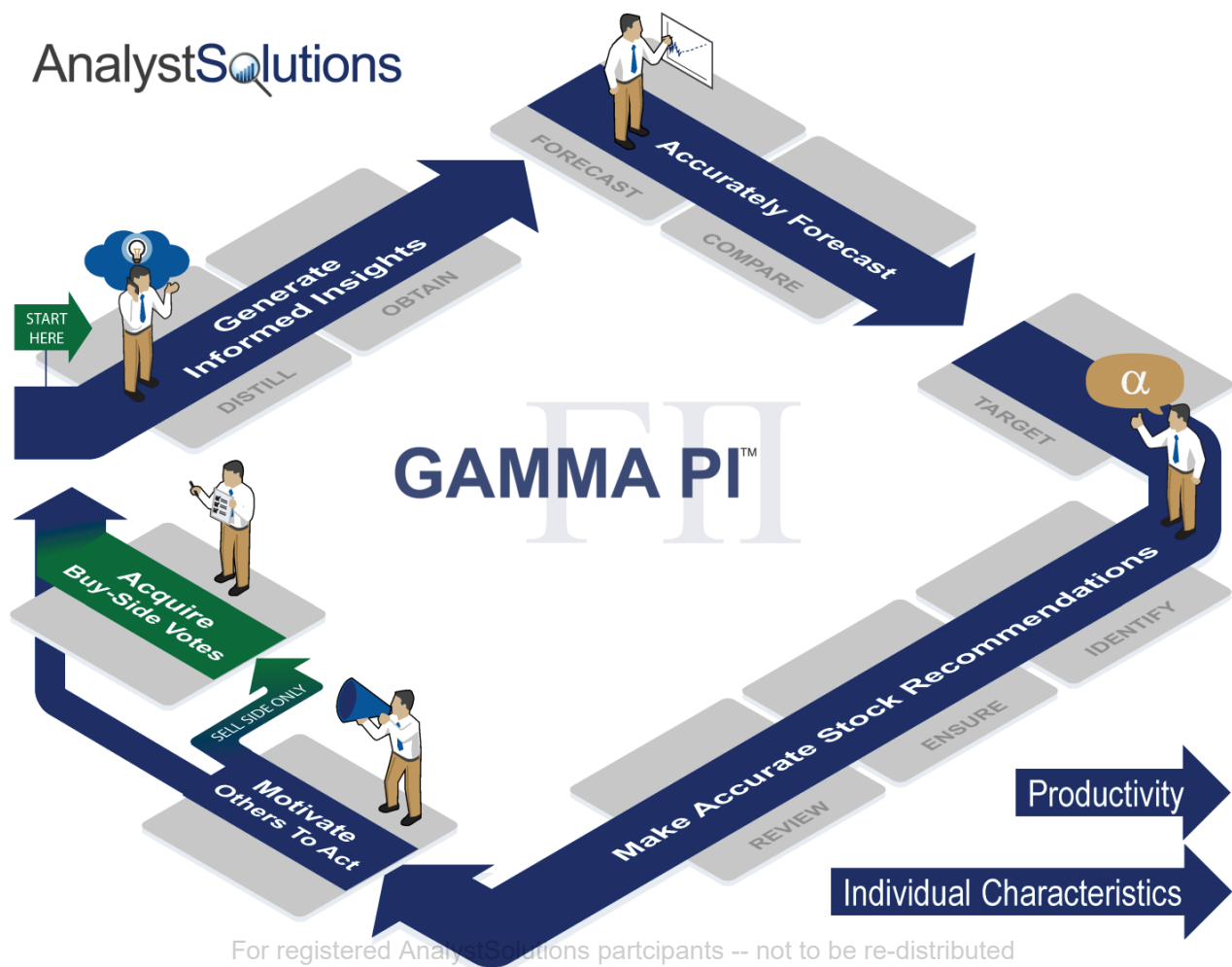
CE Qualified  
Activity  CFA Institute

For registered AnalystSolutions participants -- not to be re-distributed

# Pre-Work Exercises

- Exercises:
  - “How Does Your Future Look?”
  - “Circle the Symbols”
- Collect information
  - 3 example research reports to use for some of the exercises. Please try to bring reports that contain price target justifications, specifically the math required to build to the price target (e.g. \$3.00 EPS forecast x a 10x P/E multiple results in a \$30 price target). We will not collect this information and therefore, feel free to bring a draft report.
  - Earnings model (paper or digital copy) for a company of interest (can be the same as the one for the reports above)
  - If you have easy access to FactSet, generate a report of “Comprehensive Ownership Detail Report” for a stock of interest
  - Your comp table (paper or digital copy)

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# Opening Case

First section of your Learner Workbook



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## Key Elements of Great Stock Pickers

- Dispassionate -- Namely, they don't allow non-relevant factors to cloud their judgment
- Stick to their discipline and strategy over the long-term
- Self-aware of where they have expertise and where they don't



# Greatest Challenges to Stock Picking

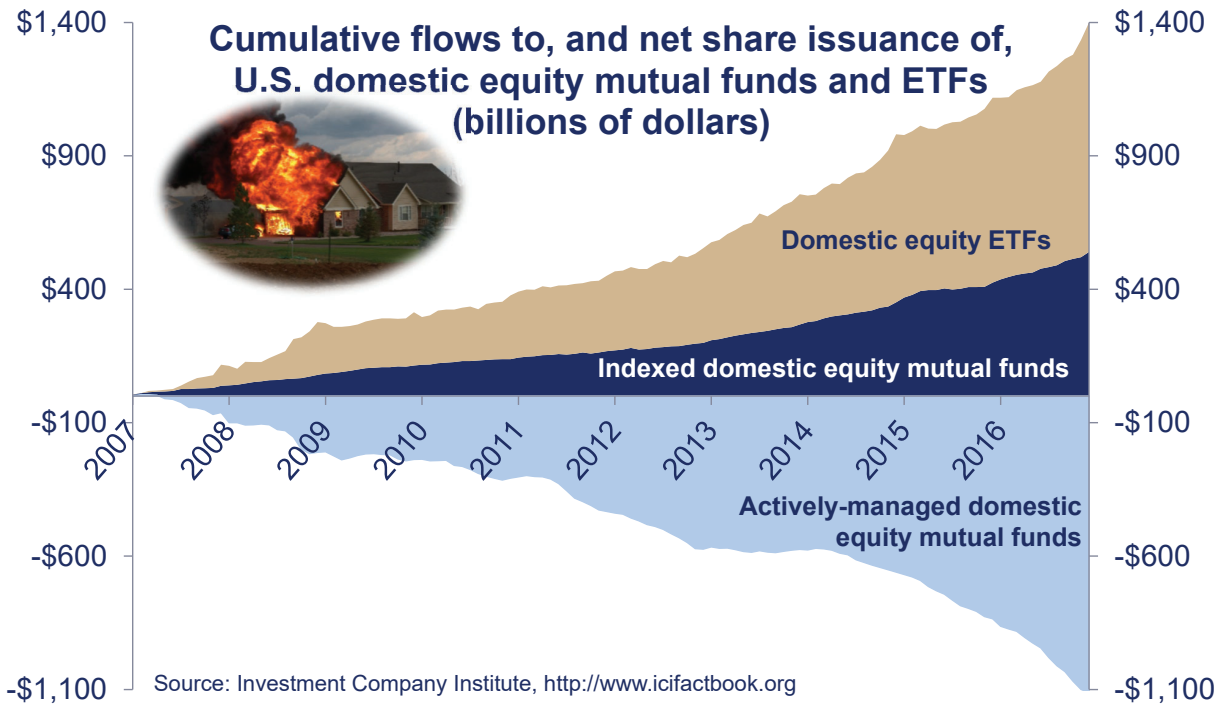
1. All of the information needed to make a perfect stock call is rarely available
2. Analysts need to balance relative urgency with the need for thorough research that produces unique insights
3. There isn't always a great stock-picking opportunity in an analyst's space
4. Some factors that move stocks can't be forecast
5. Many analysts are so overworked that they don't have time to find unique insight
6. Emotions cloud clear thinking, often causing an analyst to make the wrong decision



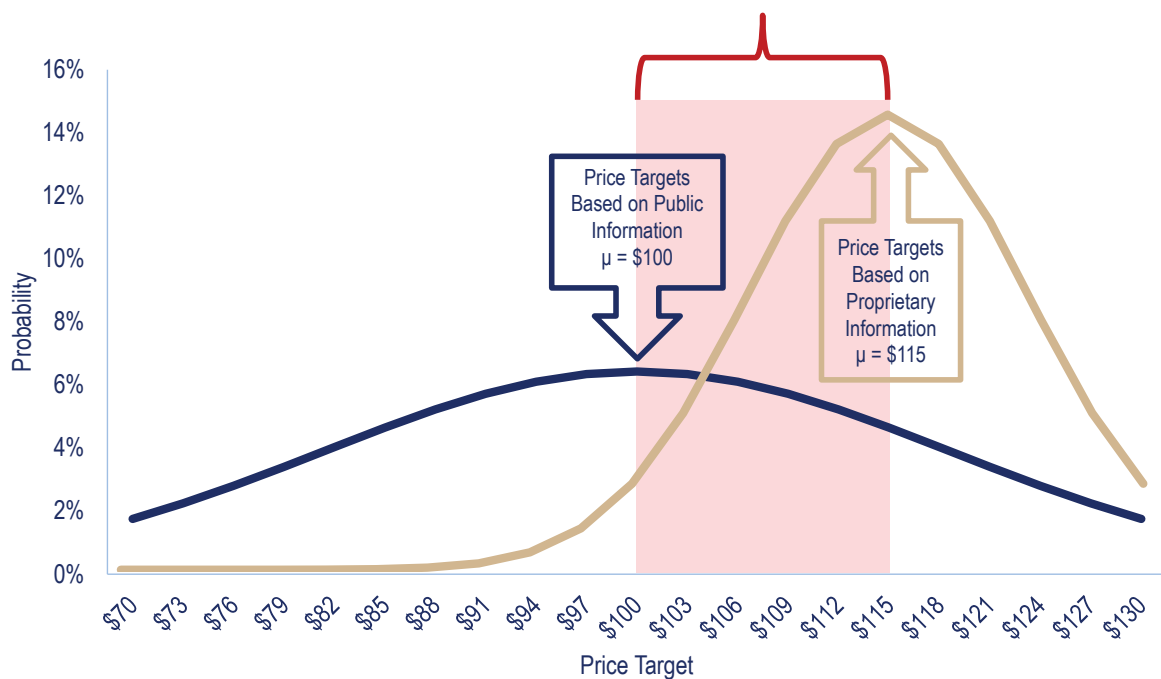
## Survey Responses: Make Accurate Stock Recommendations



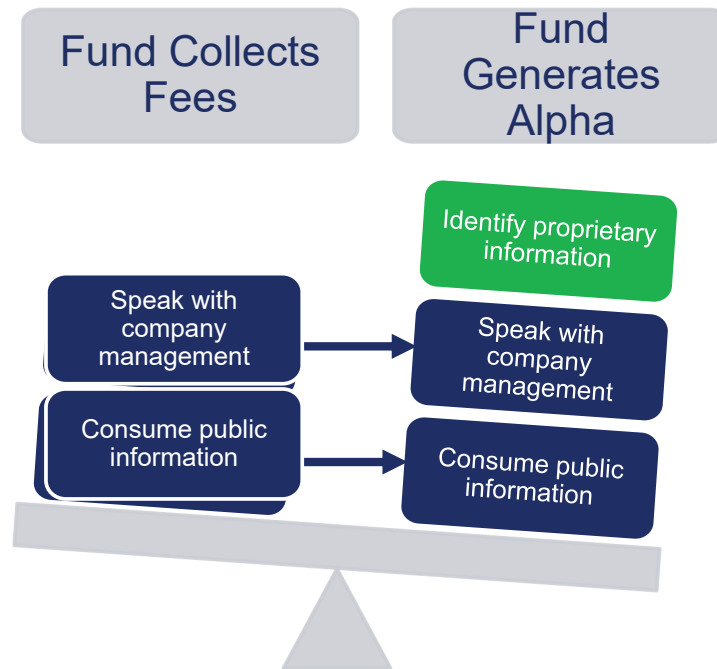
# Worthy of Analysis



# Information Asymmetry



# Information Asymmetry = Alpha

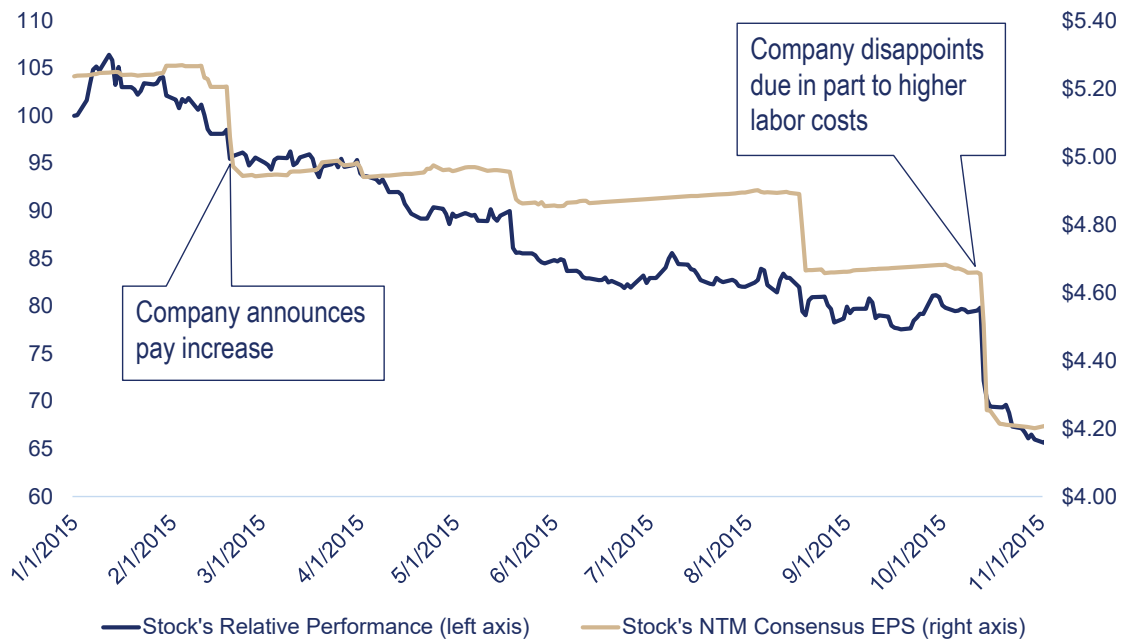


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## WMT

- October 14, 2015
  - (Bloomberg) Wal-Mart CEO Defends Plan After **Outlook Sends Stock Tumbling**
    - Earnings will fall as much as 12 percent in next fiscal year
    - Retail chain **investing in its workforce**, e-commerce programs
    - The CEO said in an interview that he's focused on the long-term health of the company, even as his efforts to **increase worker pay** and improve e-commerce capabilities cause "a pressure point."
- February 19, 2015
  - (Bloomberg) Wal-Mart to Raise U.S. Hourly Workers' Pay After Criticism
    - Wal-Mart Stores Inc. **will begin paying all of its U.S. hourly workers at least \$9 an hour by April and \$10 an hour by next February**

# WMT Performance

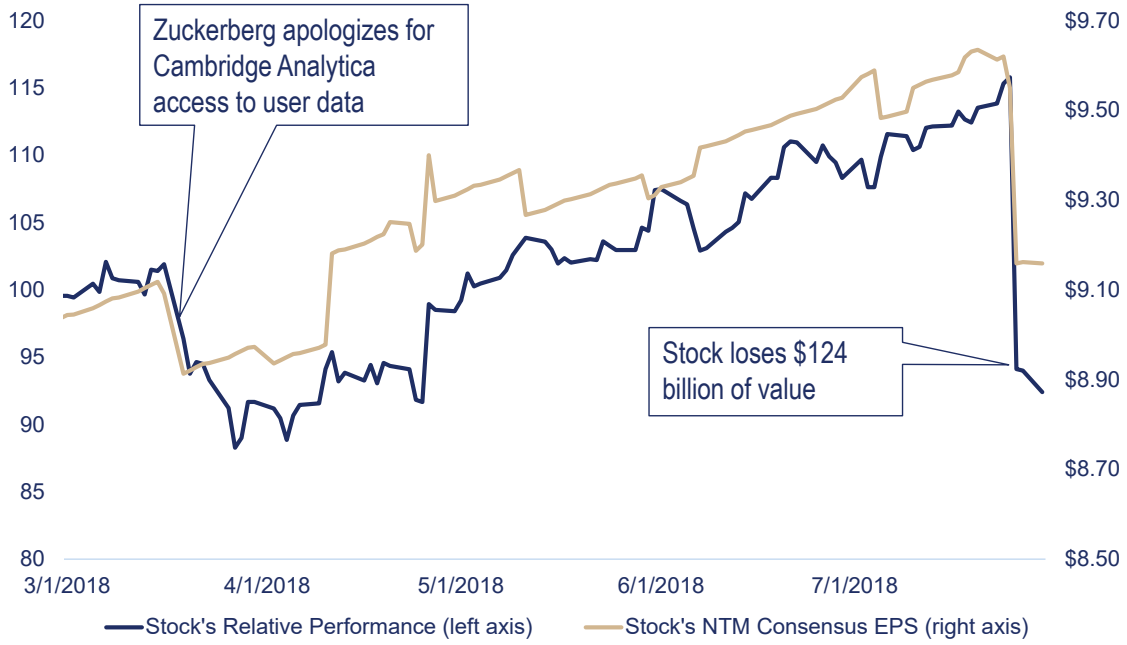


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# FB

- July 25, 2018
  - (Bloomberg) Facebook Revenue, **User Growth Miss Estimates as Scandals Hit**
    - Sales increase 42% while contending with new privacy rules
    - Workforce jumps 47% to manage manipulation, content issues
    - Facebook Inc. **saw the first signs of user disenchantment** in the midst of public scandals over privacy and content, with second-quarter revenue and average daily visitors missing analysts' projections.
- March 19, 2018 (**Most read Bloomberg for FB for first half of 2018**):
  - (Bloomberg) Facebook Falls as Pressure Mounts on Zuckerberg Over Data
    - **Demands follow report that Cambridge Analytica violated rules**
    - Lawmakers seek more than 'false reassurance' on data safety
    - Facebook Inc. shares posted their steepest drop since 2015 as **U.S. and European officials demanded answers** to reports that a political advertising firm retained information on millions of the social network's users without their consent.

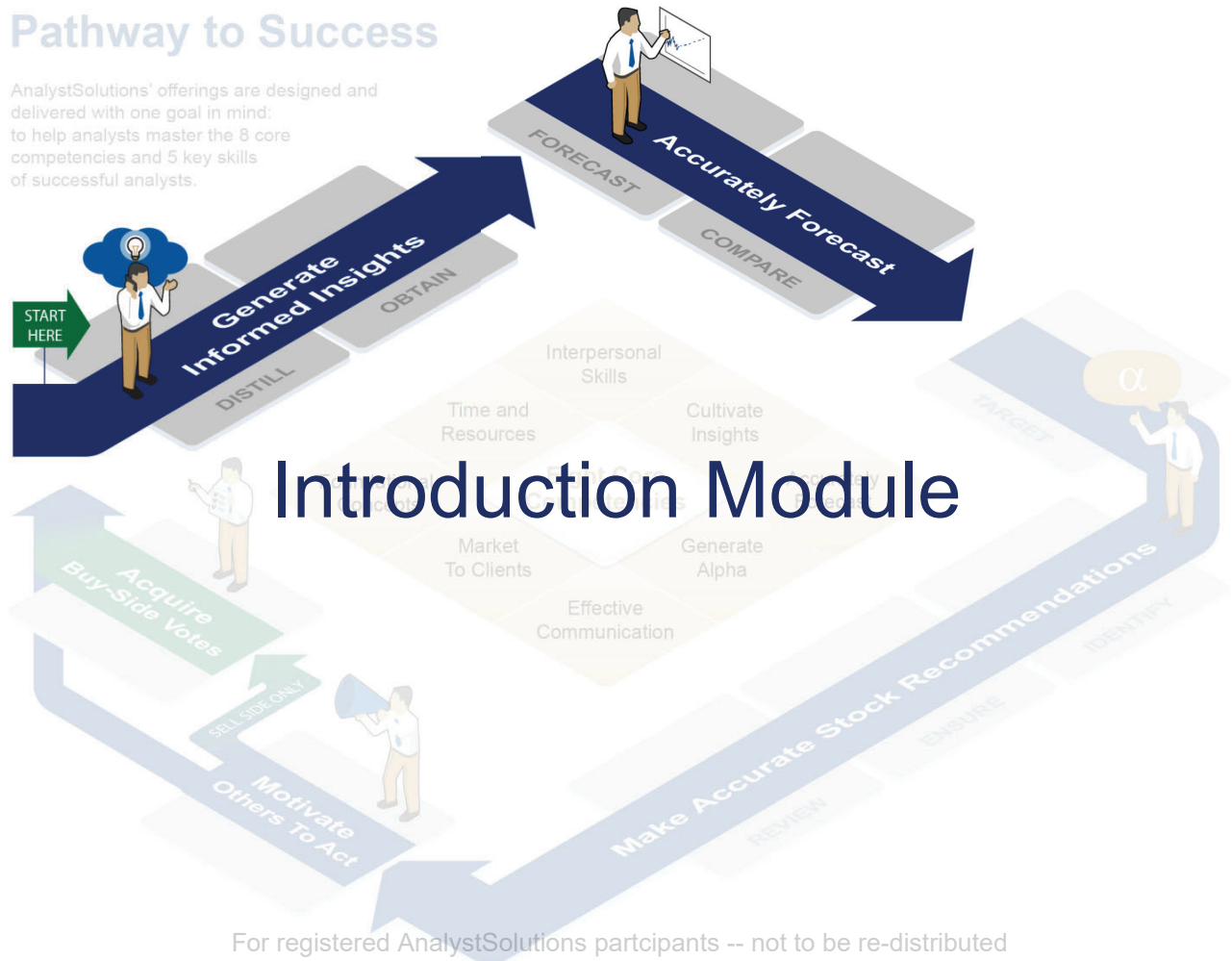
# FB Performance



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## Pathway to Success

AnalystSolutions' offerings are designed and delivered with one goal in mind: to help analysts master the 8 core competencies and 5 key skills of successful analysts.



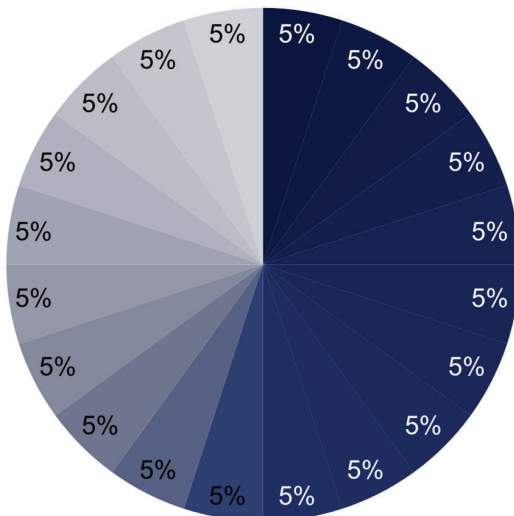
# EPIC™ Stock Calls Require Critical Factors Meet All Four Criteria



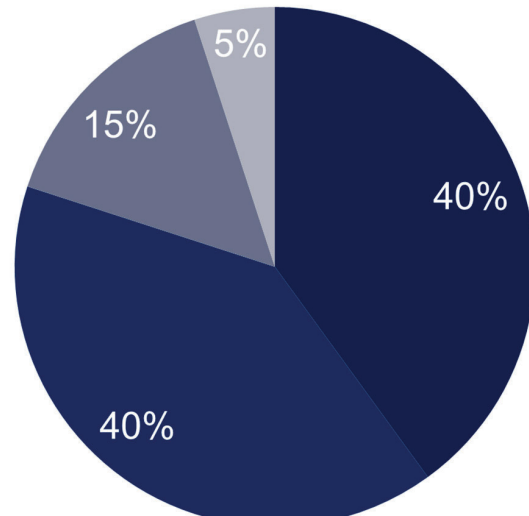
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# What Will Your Day Look Like?

**Critical Factors Not Defined**



**Critical Factors Defined**



# HELP™ Framework for Identifying Critical Factors


Research Historical data & documents


Explore Emerging data & documents


Validate/refute assumptions with Live sources

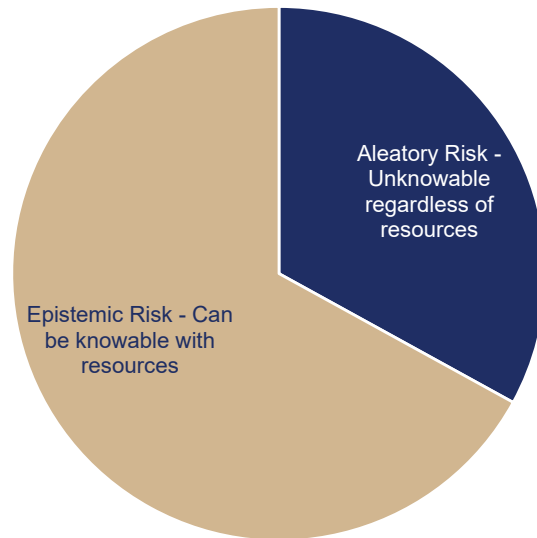

Prioritize factors using **EPIC™** framework

## Example Critical Factors

Factors for: FedEx in the 2005-2006 time period, ranked by "Total" column

Factor	Exceeds my materiality threshold of 10%	Probably going to occur during my time horizon	I'm good at forecasting the factor and catalyst	Consensus is poor at forecasting or spotting factor	Total
Improved network efficiency	4	4	4	5	17
Change in ability to collect fuel surcharge	4	4	4	4	16
Change in ground package growth	3	4	4	4	15
Acquisitions	5	3	2	5	15
Growth in Asia-Pacific	2	2	4	3	11
Purchase of new aircraft	1	4	4	2	11
Change in purchased transportation cost trends	1	2	2	4	9
Change in depreciation rate	1	2	2	4	9
Major weather disruptions	2	3	2	2	9

# Improving Return vs. Risk



[Integrity Research](#)

[Gerson Lehrman Doubles Down On Quantitative Insights Group](#)

Posted: 31 Jul 2018 05:55 AM PDT

Leading expert network GLG (Gerson Lehrman Group) is aggressively expanding its Quantitative Insights group. After examining LinkedIn registrations and new hires advertised on the company website, we estimate that the group is more than doubling in size during 2018, projected to grow to approximately 60 staff by year end. GLG has offered custom surveys which ...

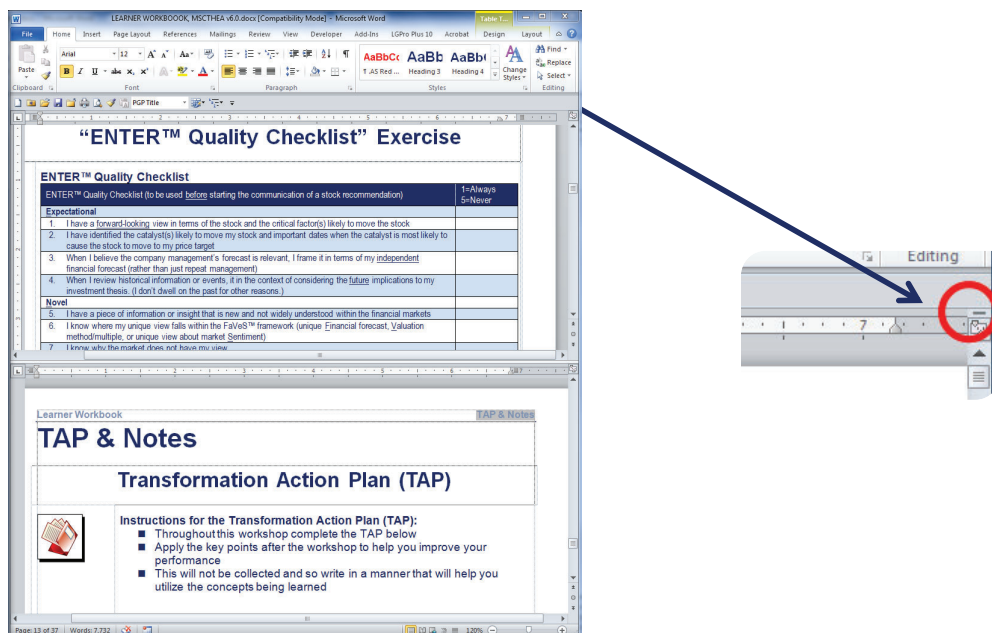
## Key elements to ensure you are prepared to ENTER™ the investment debate...



- E** • Expectational
- N** • Novel
- T** • Thorough
- E** • Examinable
- R** • Revealing

# EXERCISE: “ENTER™ QUALITY CHECKLIST”

## Split Your Screen if Using Electronic Version



# Complete Your TAP

## Section 1

### Transformation Action Plan (TAP)



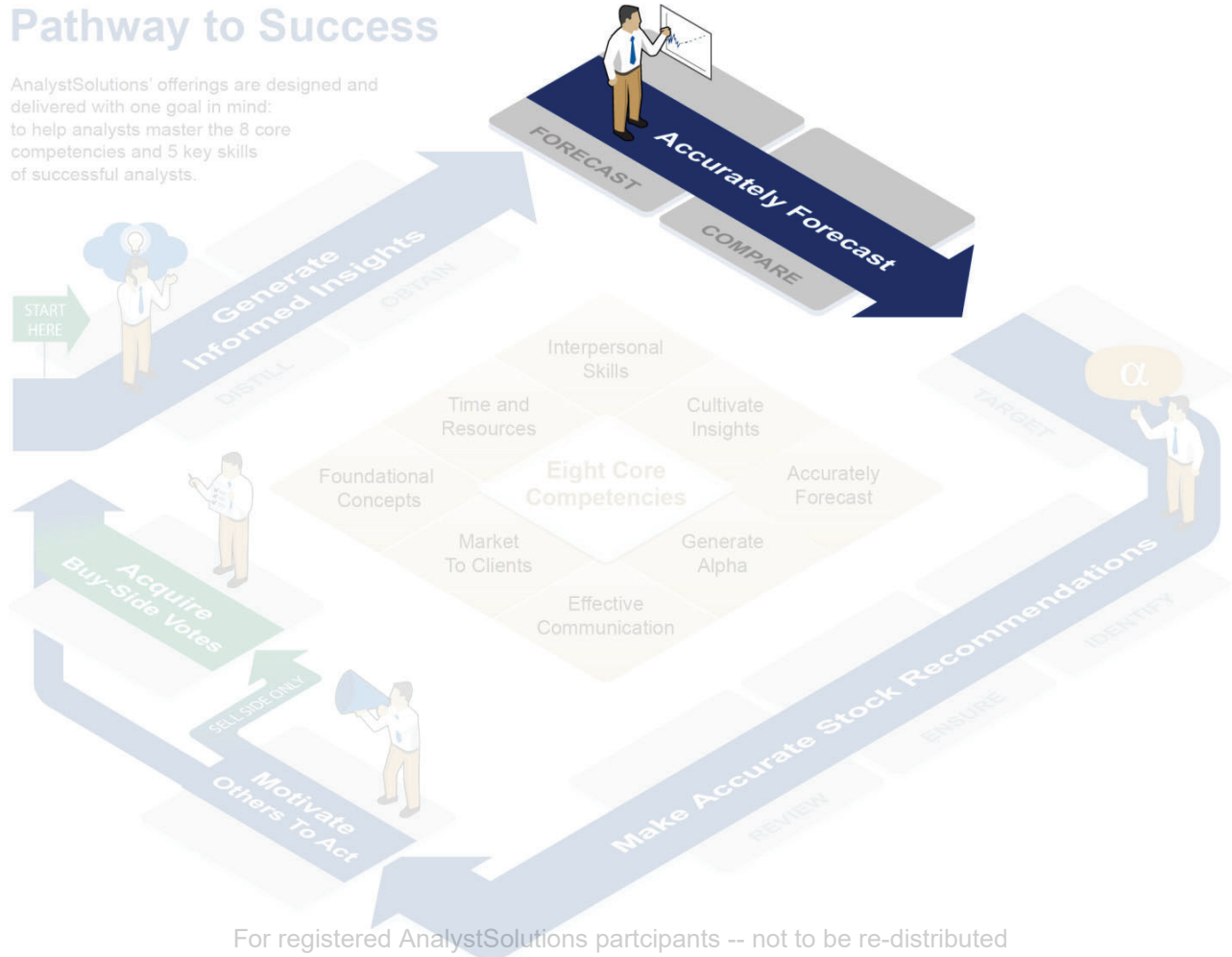
**Instructions for the Transformation Action Plan (TAP):**

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- Apply the key points after the workshop to help you improve your performance
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### Pathway to Success

AnalystSolutions' offerings are designed and delivered with one goal in mind: to help analysts master the 8 core competencies and 5 key skills of successful analysts.



## Price Target in Its Simplest Terms



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## Stress Test Your Forecast

- Develop base-case, upside and downside scenarios for the 1-4 critical factors most likely to move your stocks
- Assign quantitative metrics for each
- Assign probabilities



# EXERCISE: STRESS TEST YOUR FORECAST

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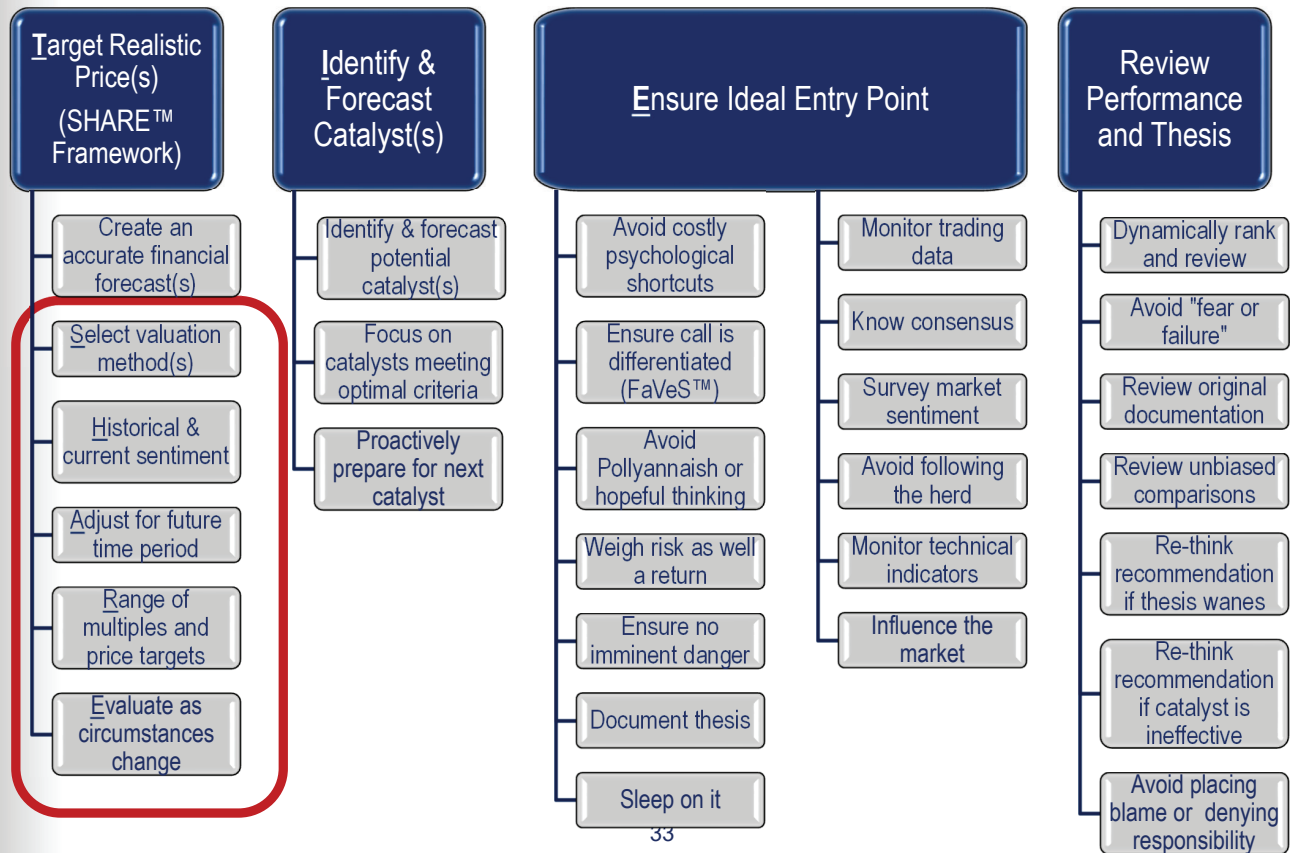
## Pathway to Success

AnalystSolutions' offerings are designed and delivered with one goal in mind: to help analysts master the key competencies and 5 key skills of successful analysts.

## Module 1:

# TIER™ Framework For Making Accurate Stock Recommendations





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## What Is Equity Valuation?

- What is the value of a \$100 payment per year into perpetuity if you have a 5% required rate of return?

$$\frac{\$100}{5\%} = \$2,000$$

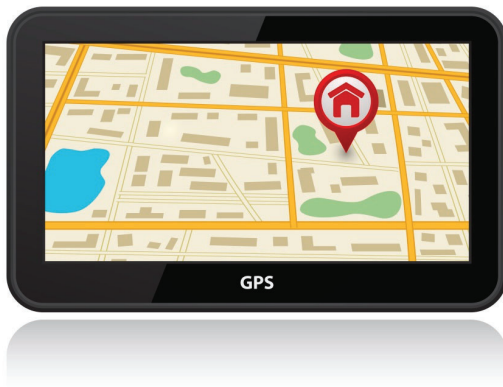
- Is there any debate about the \$2,000?
- Is there much debate about pricing government short-term bonds?
- Why is there a debate about stock valuations?
- We wouldn't need valuation if earnings forecasts were accurate into perpetuity. Put another way, valuation is a way of assessing if the market has the correct forecast and providing a mechanism to adjust when it's incorrect.

# Get In the “Mind of the Market”

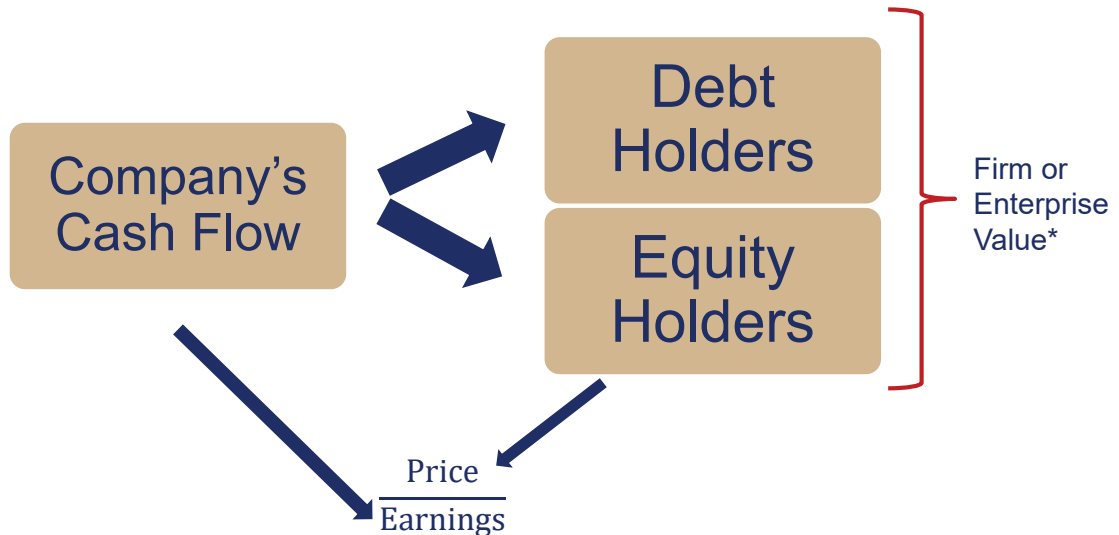


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# Valuation Accuracy



# What Are We Valuing?



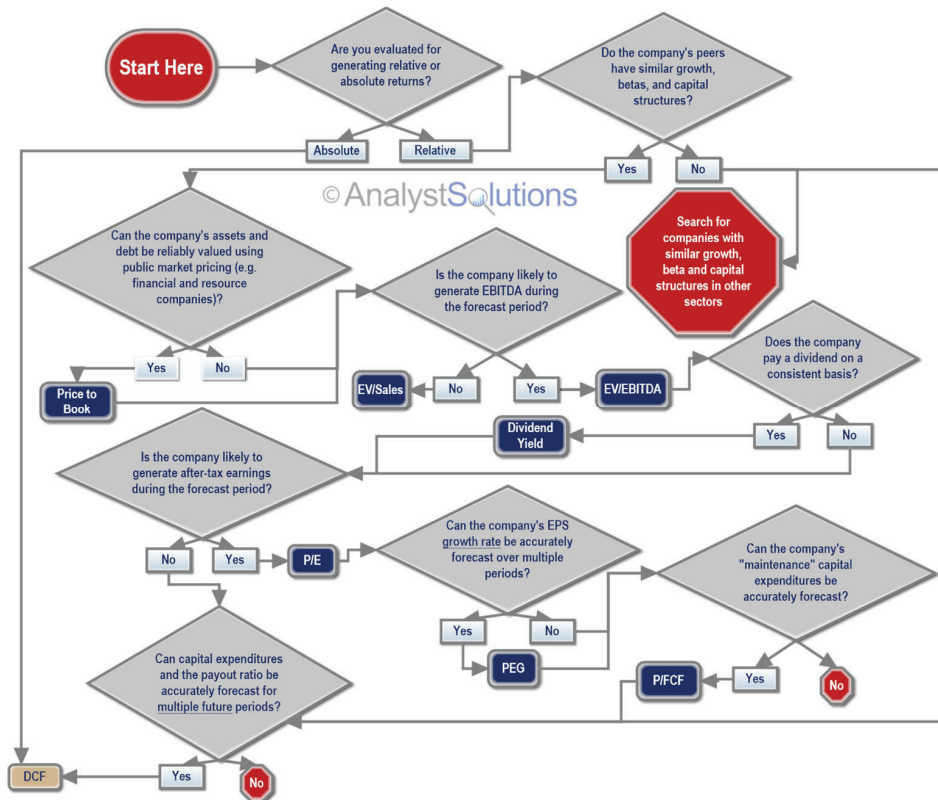
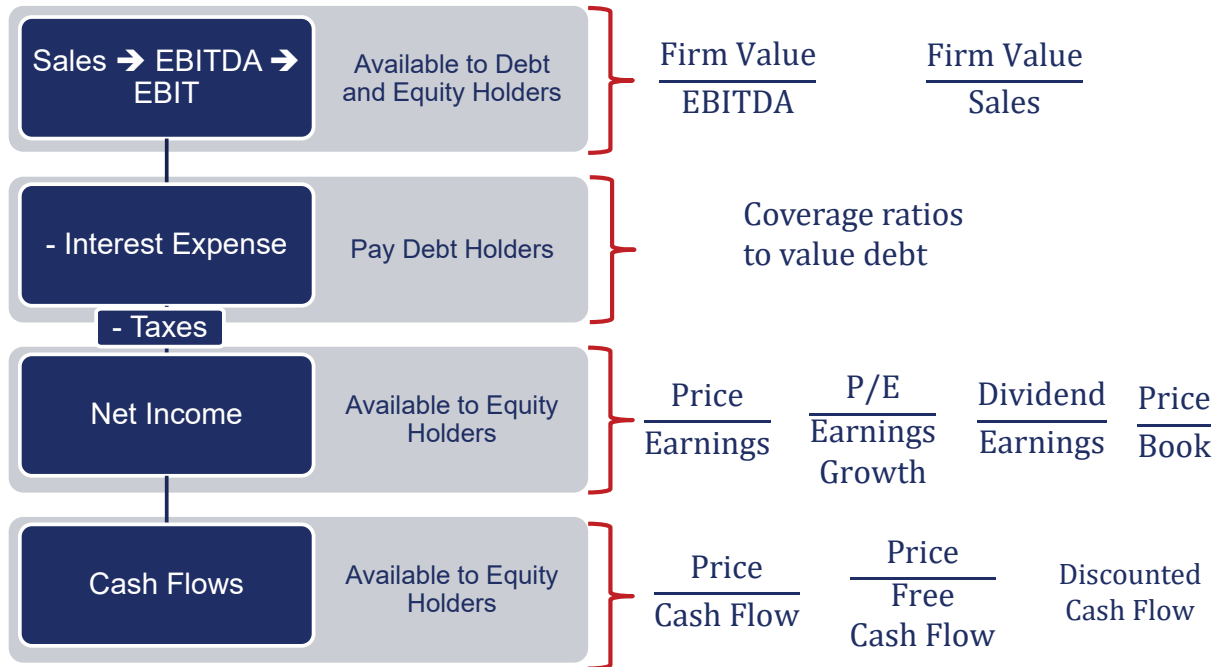
\*Firm Value = Enterprise Value = (Value of equity + Value of debt + Minority interest - Cash and investments)

# Two Valuation Approaches

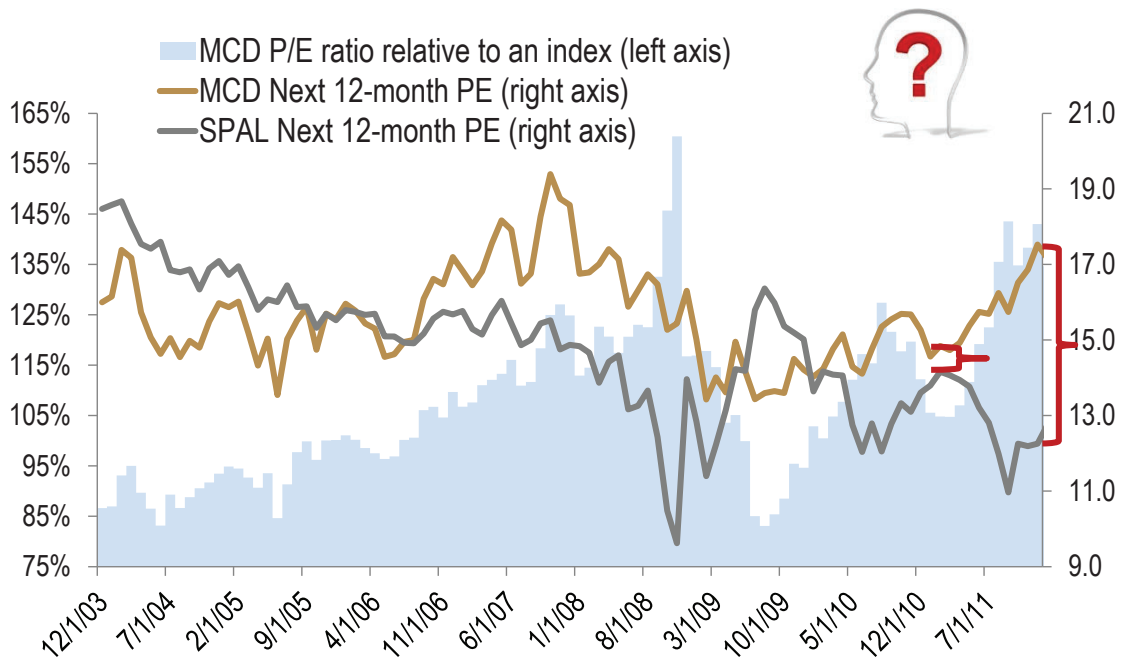
“Ratio-based” = “Single-period multiple” → Examples: P/E, P/CF, P/S

“Intrinsic value” = “Multi-period cash flow” → Examples: DCF, Residual Income

# What Are We Valuing?



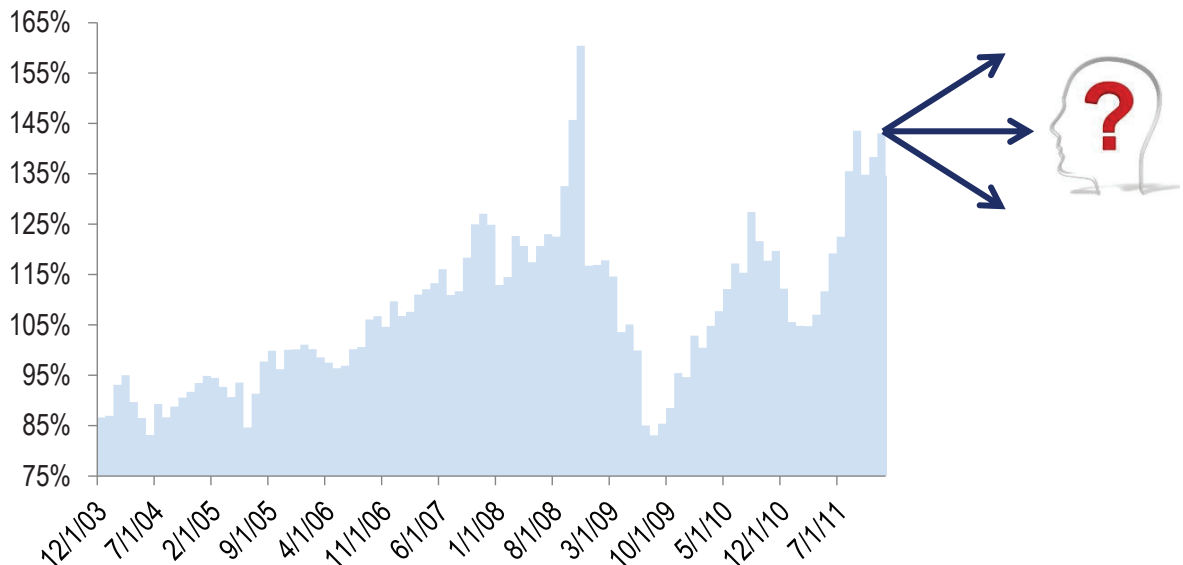
# MCD's Absolute and Relative P/E Ratio



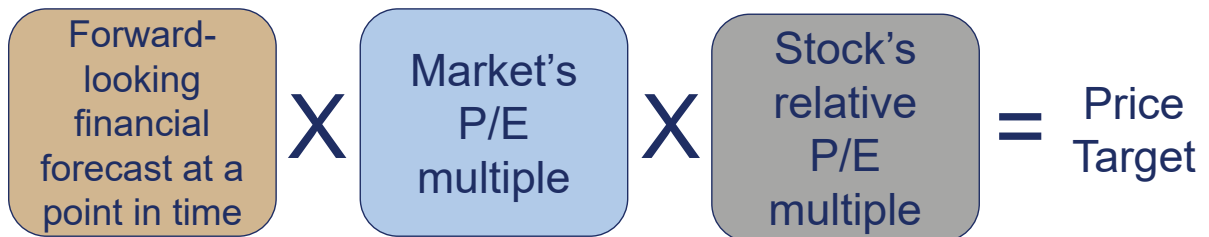
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# What Should We Use For a Future Price Target Valuation Multiple?

MCD P/E ratio relative to an index (left axis)



## Price Target Components for Relative P/E Ratio Valuation



\$1.00	14	Market multiple	\$14.00
\$1.00	14	10%	\$15.40
\$1.00	14	-10%	\$12.60

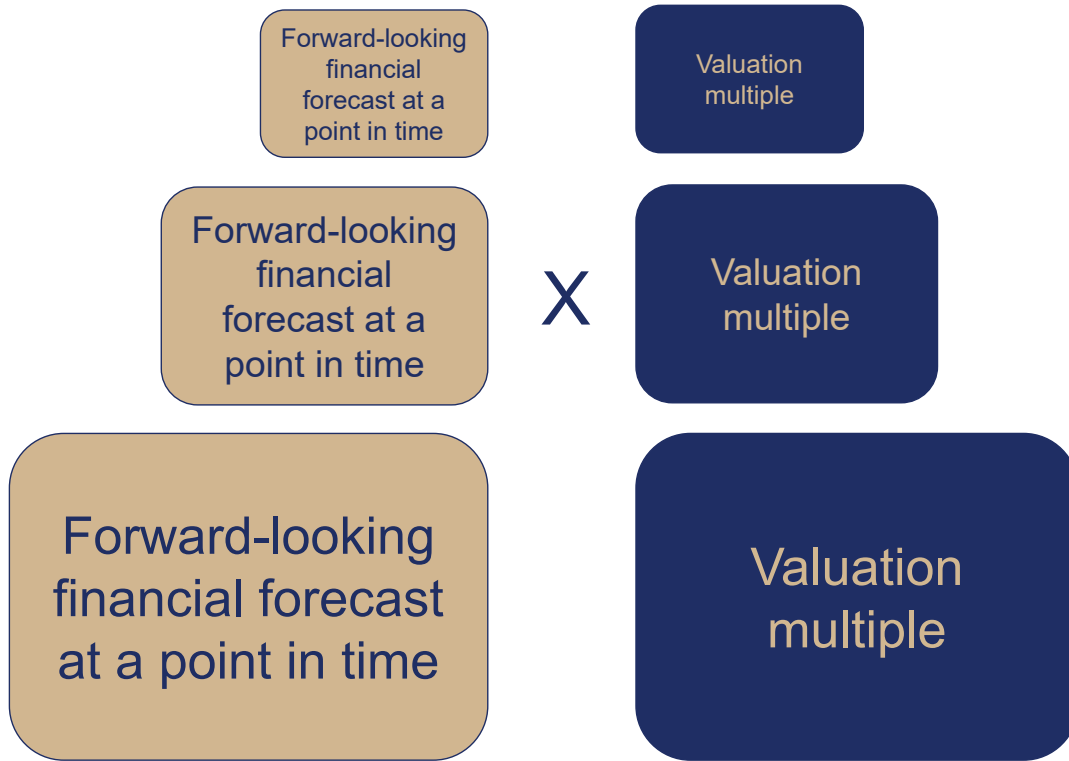
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## Be Aware of the Market Multiple You Select

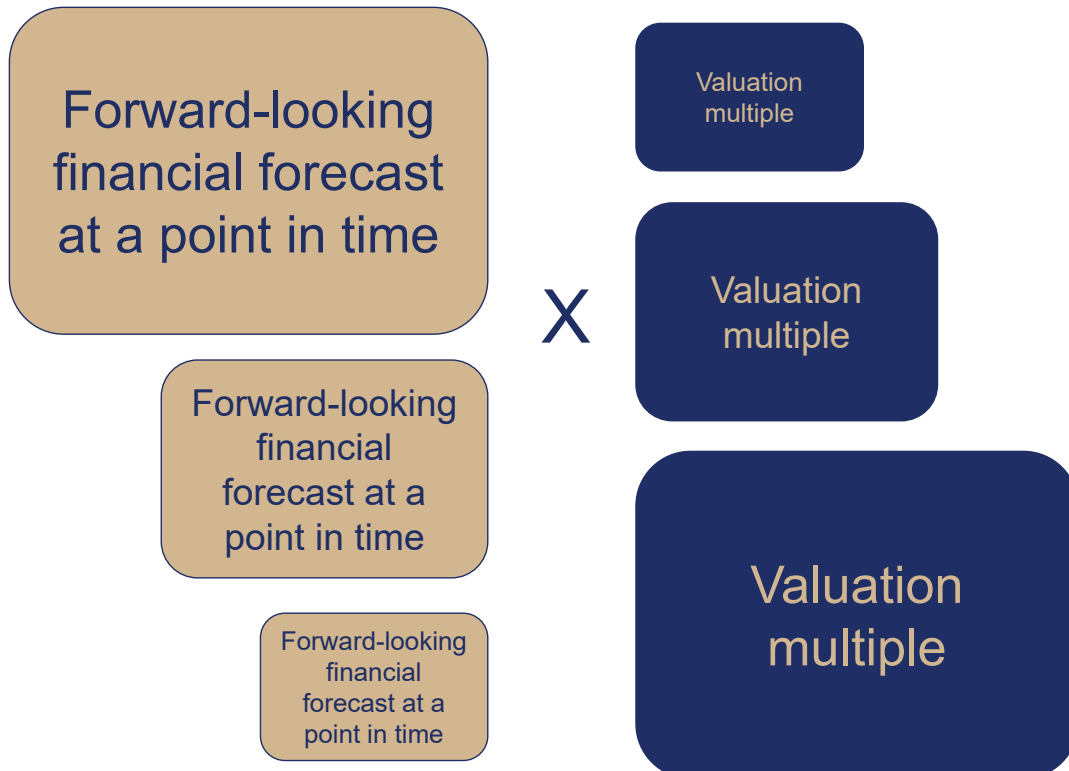


				Difference from base-case
\$1.00	18	Market multiple	\$18.00	
\$1.00	14.5	Market multiple	\$14.50	-19%
\$1.00	11	Market multiple	\$11.00	-39%

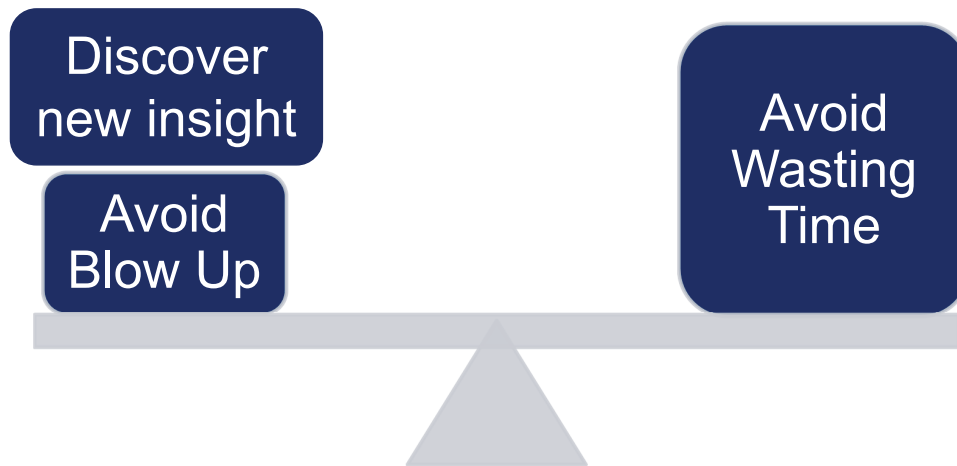
# Price Target in Its Simplest Terms



# Peak on Peak or Peak on Trough?



## Consider a Second Valuation Method If It Adds Value



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## Opening Case Examples We Covered in this Module

- **Best Practices by Robert and Lucas:**
  - Robert breaks down the potential upside into the two key components: the *forecast* or *valuation*
  - Robert wants to explore what could go wrong
- **Bad Practices by Lucas:**
  - Doesn't have a price target or range of targets
  - Doesn't know why some analysts value the stock with a PEG ratio while others use P/E ratio
  - Doesn't know if the stock has seen an expanding P/E in the past
  - Hasn't considered what could go wrong with his call

# Target Realistic Price(s) DRCs

## Detailed Reference Card (DRC)

**Best Practices for Making Accurate Stock Recommendations**

*Procedures for Target Realistic Price(s) (Step 1 of TIER™ which includes the SHARE™ framework):*

Create an accurate financial forecast(s)

Conduct research to develop informed insights about the few critical factors most likely to move a stock, following the ENTER™ quality framework (discussed in Chapters 8 and 23 of *Best Practices for Equity Research Analysts*), to derive a base-case financial forecast more accurate than consensus. Create plausible upside and downside forecasts to stress test the base-case scenario.

Select valuation method(s)

## Detailed Reference Card (DRC)

**Best Practices for Making Accurate Stock Recommendations**

*Perspectives for Target Realistic Price(s) (Step 1 of TIER™)*

**Momentum stocks can defy rational valuations:**  
Rapidly growing stocks (e.g. technology) are often owned by momentum players, and can defy rational valuation levels until approaching more

# Complete Your TAP

## Section 2

### Transformation Action Plan (TAP)



**Instructions for the Transformation Action Plan (TAP):**

- Throughout this workshop complete the TAP below
- Apply the key points after the workshop to help you improve your performance
- This will not be collected and so write in a manner that will help you utilize the concepts being learned

# Test Your TIER™ Knowledge



T \_\_\_\_\_ realistic price(s)



Identify & forecast catalyst(s)

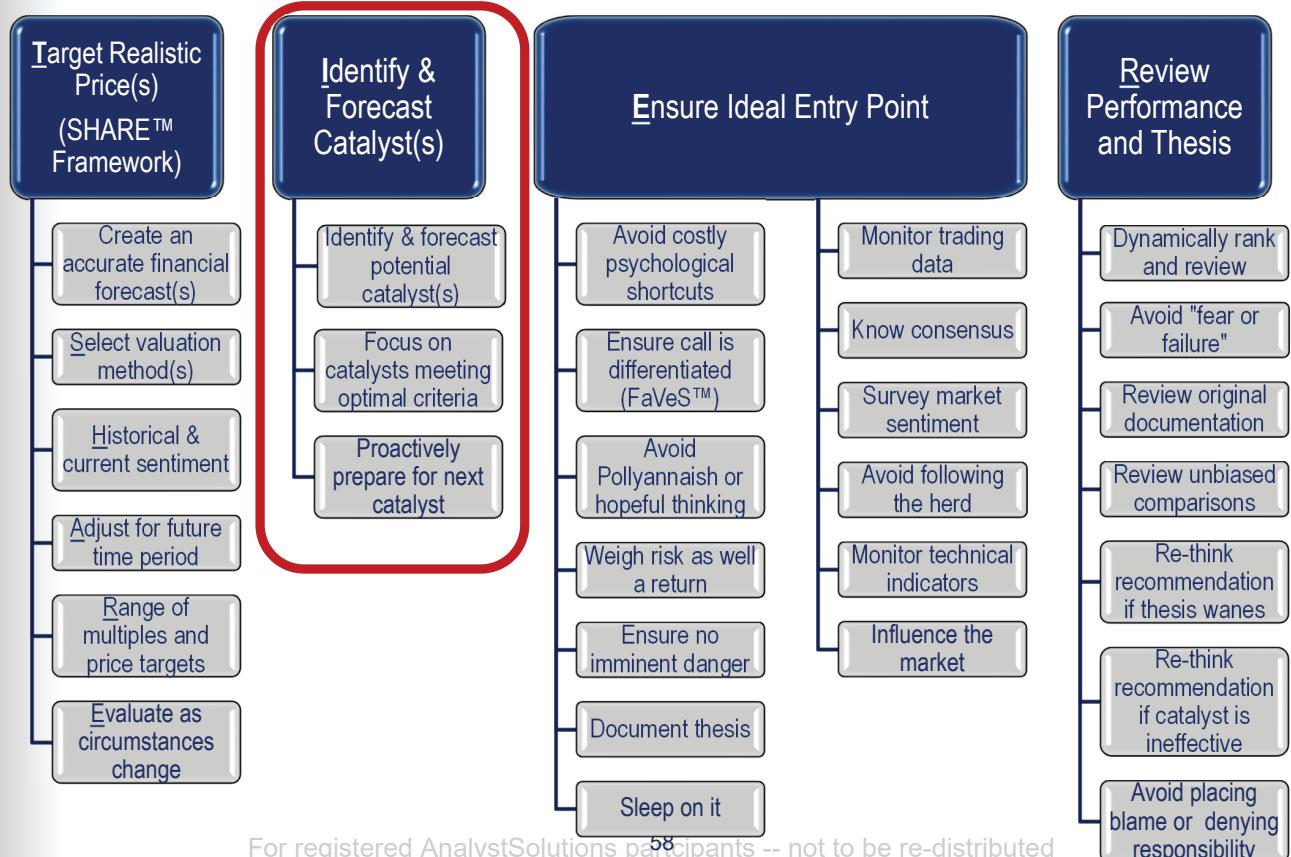


Ensure ideal entry point



Review performance and thesis

## Module 2



# Identify & Forecast Catalysts

Markets can remain irrational a lot longer than you and I can remain solvent

– John Maynard Keynes

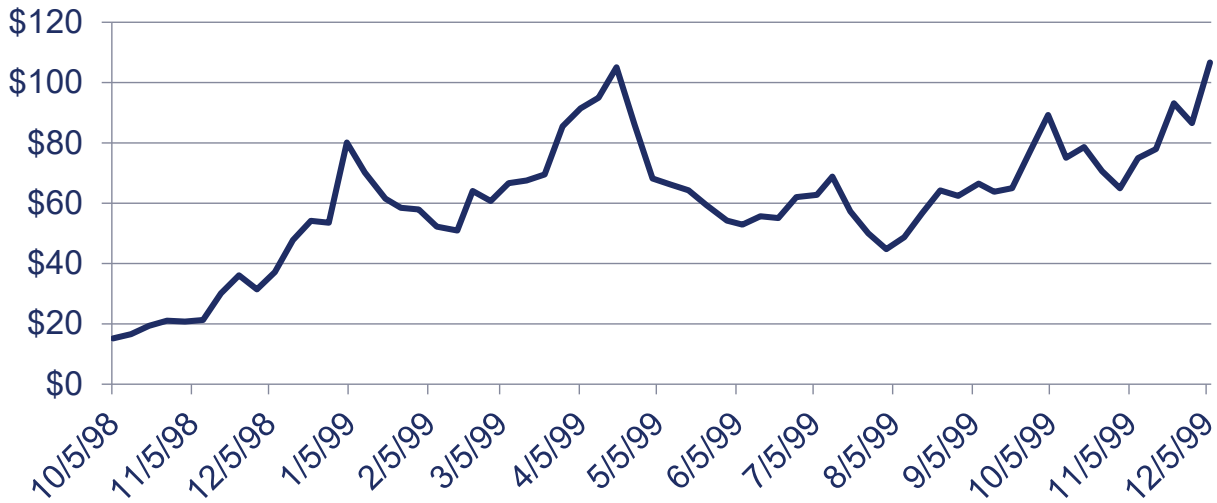
Among the most noted 20<sup>th</sup> century economists

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## Disagreement over AMZN

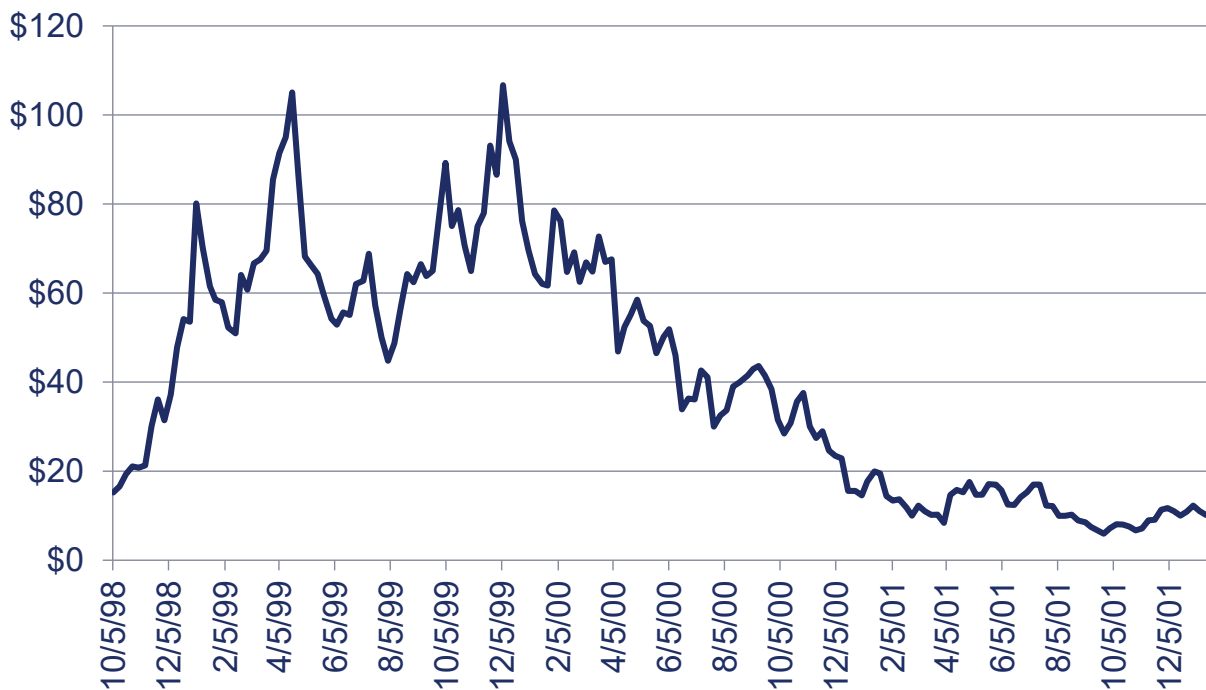
- In late 1998, Jonathan Cohen, then Merrill Lynch's head Internet analyst, publicly disagreed with Henry Blodget, then CIBC Oppenheimer analyst, about Amazon's valuation:
  - Cohen's price target: \$8 (\$50 pre-splits)
  - Blodget's price target: \$66 (\$400 pre-splits)
- Who was right?

### AMZN Stock Price



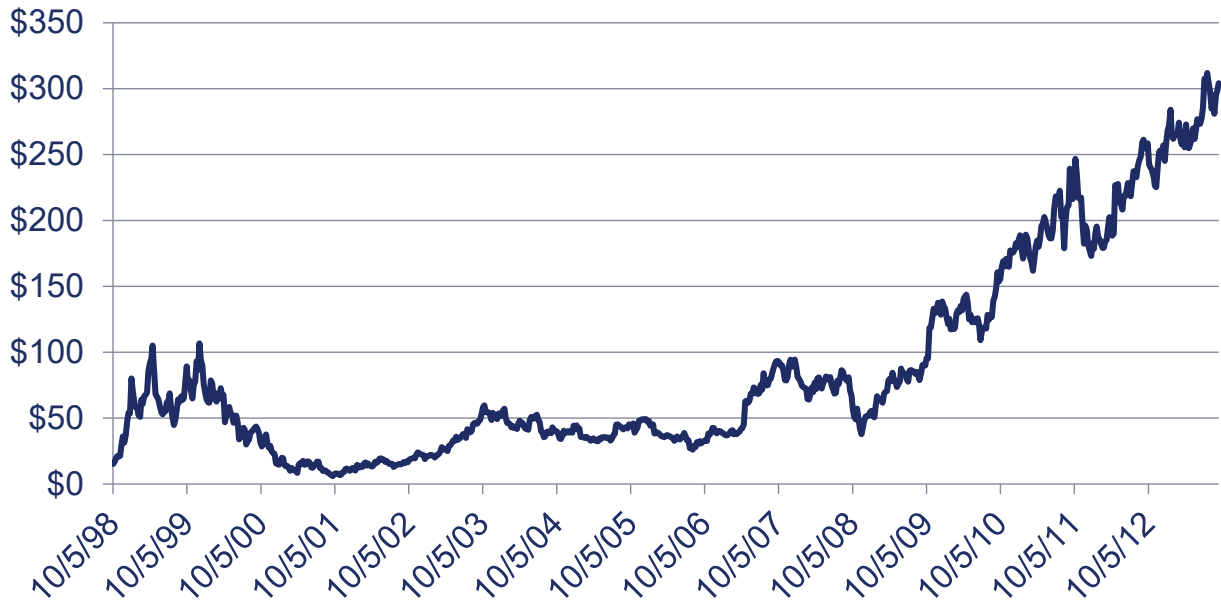
Cohen's price target: \$8 (\$50 pre-splits)  
 Blodget's price target: \$66 (\$400 pre-splits)

### AMZN Stock Price



Cohen's price target: \$8 (\$50 pre-splits)  
 Blodget's price target: \$66 (\$400 pre-splits)

## AMZN Stock Price



Cohen's price target: \$8 (\$50 pre-splits)  
Blodget's price target: \$66 (\$400 pre-splits)

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## Elements of a Catalyst

- Be more specific than simply the company is going to "beat" or "fall short" of the market's expectations
- Specify how future consensus earnings or cash flow will be impacted, specifically changes to these areas:
  - Pricing
  - Volume
  - Costs
  - Margins
  - Free cash flow
  - Returns
  - EPS growth rate







# Examples of Catalysts

The company's...

- Volume/pricing/new orders for a specific product or region will be better/worse than expected
- Market share will accelerate or decelerate more than expected
- Costs for a specific line item are going to be higher/lower than expected



## Identifying & Forecasting Catalyst(s)

		Catalyst	
		Doesn't Occur (or occurs late)	Occurs on time
Stock Movement	Stock call generates alpha	 Right for the wrong reasons (aka Lucky)	 Great call! You're following best practices
	Stock call doesn't generate alpha	 Poor analysis or thesis failed to play out	 Poor assessment of catalyst's impact

## What Makes a Catalyst High Quality?



- Pertains to a critical factor that is material enough to move the stock
- Likely to occur during the investment time horizon
- Not currently appreciated by the market
- Can be forecast with some level of certainty

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## Proactively Prepare (for yourself and those who rely on you)

- When an event is target-rich for catalysts and has a level of predictability, analysts should put the date in their calendars
- Predict a view about the event especially if it's likely to include a catalyst that impacts a stock recommendation
- Be mindful that a company can be impacted by announcements that come from events held by its competitors



# Target-Rich Catalyst Events

## Some of the more common places to expect catalysts include:

- Company-sponsored analyst meetings and calls
- Earnings releases
- The company's annual pricing, volume, or earnings guidance or projection
- Deadlines for new legislation, regulations, or court case outcomes
- Prescheduled announcements by the company's customers, competitors, or suppliers
- New product releases or significant product extensions
- Interim sales data, for the company or the sector
- Non-deal investor roadshows



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## EXERCISE: “IDENTIFY THE CATALYST” PART 1

# Identify the Catalyst, Scenario 1

	Stock Call	Catalyst	Quality of Catalyst: High, Medium, or Low	Timing of when the catalyst will be noticeable enough for the stock to begin to react
1.	We are recommending purchasing McDonald's Corp (MCD) and have a one-year price target of \$116 (up 21% from its current \$96). We believe accelerated growth from remodeled stores and expansion in China will allow the company to beat this year's consensus of \$5.80 by \$0.20 (most noticeable in 3Q and 4Q) which will be even more apparent next year, causing next year's consensus of \$6.20 to rise to our \$7.00.	Store remodeling and growth in China	Moderate quality because these are factors the analyst may not be able to forecast with a high degree of accuracy	Earnings during the second half of this year and all of next year

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# Identify the Catalyst, Scenario 2

	Stock Call	Catalyst	Quality of Catalyst: High, Medium, or Low	Timing of when the catalyst will be noticeable enough for the stock to begin to react
2.	We are no longer recommending purchasing SBUX because we believe the consensus expectation for the next fiscal year is 11% too high. Using our EPS forecast for next year of \$2.85 (while consensus is at \$3.20), we arrive at a base-case scenario price target of \$68, which would be a 9%-10% drop from the stock's close of \$75. Our proprietary work (survey and interview with industry sources) suggests by 3Q of this year the company will be unable to pass through the upward labor cost pressure driven by increases in minimum wages. By early next year, the company will see higher cost inflation or, if it raises prices, slower unit sales, either of which will slow EPS growth.	Inability to pass through wage inflation to customers	Medium to high quality because it's plausible, with effort, the analyst can determine if wage inflation is being passed through to customers	Third-quarter results should see some of the impact and will become more pronounced going into the following year

# Identify the Catalyst, Scenario 3

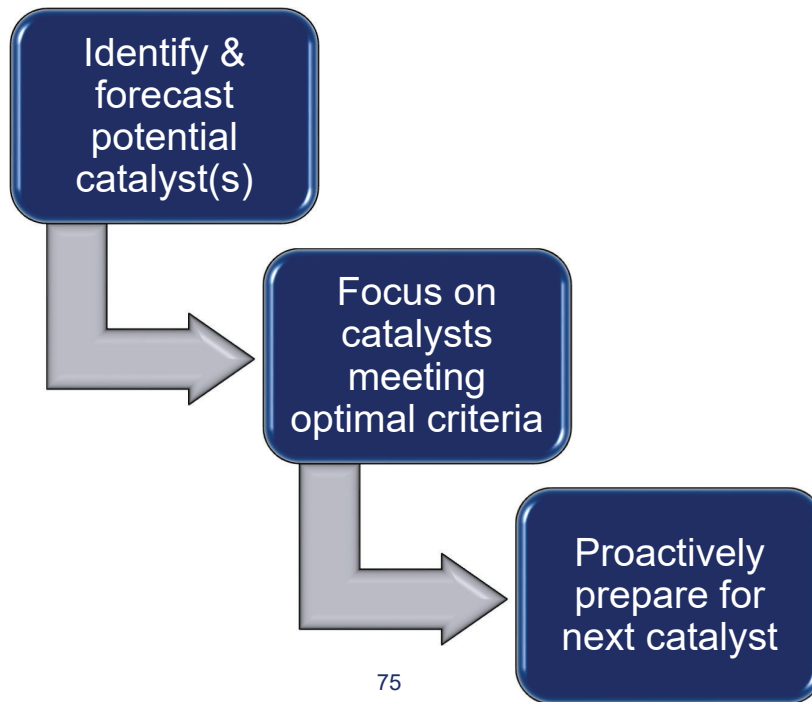
	Stock Call	Catalyst	Quality of Catalyst: High, Medium, or Low	Timing of when the catalyst will be noticeable enough for the stock to begin to react
3.	We are upgrading Alaska Air Group (ALK) because we believe it will be taken out at a premium as part of the North American airline industry consolidation trend. The stock is currently trading approximately 15% above its historical relative P/E ratio on forward earnings, which we believe could expand further as part of a takeout.	Industry consolidation	Low because it is almost impossible to forecast the timing. Also, the market may already be anticipating as shown in the stock's current premium.	Unknown

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## EXERCISE: “IDENTIFY THE CATALYST” PART 2

See exercise in Learner Workbook

# Step 2: Identify & Forecast Catalysts Summary



# Identify & Forecast Catalyst(s) DRCs

## Detailed Reference Card (DRC)

**Best Practices for Making Accurate Stock Recommendations**

*Procedures for Identify & Forecast Catalyst(s) (Step 2 of TIER™):*



Identify and forecast potential catalysts that would need to occur in order for the market to accept your out-of-consensus thesis. Be specific by estimating the future earnings or cash flow impact in areas such as:

- Pricing
- Volume
- Costs
- Margins
- Free cash flow
- Return

## Detailed Reference Card (DRC)

**Best Practices for Making Accurate Stock Recommendations**

*Perspectives for Identify & Forecast Catalyst(s) (Step 2 of TIER™):*

**Ensure your catalyst has a defined timetable:** Predict the catalyst before recommending a stock, or suffer the risk noted by John Maynard Keynes when he said, "Markets can remain

# Opening Case Examples We Covered in this Module

- Best Practices by Robert and Lucas:
  - Robert is trying to ascertain the catalyst that will move the stock (i.e. the date of the new products being released)
  - Robert wants to explore what could go wrong (negative catalyst)
- Bad Practices by Lucas:
  - Doesn't know when the new products will be released, which is the catalyst for his stock call
  - Doesn't seem to be concerned by the company's potential for falling short of the current quarterly consensus estimates (negative catalyst)

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## Complete Your TAP

### Section 3

#### Transformation Action Plan (TAP)

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-

# Test Your TIER™ Knowledge

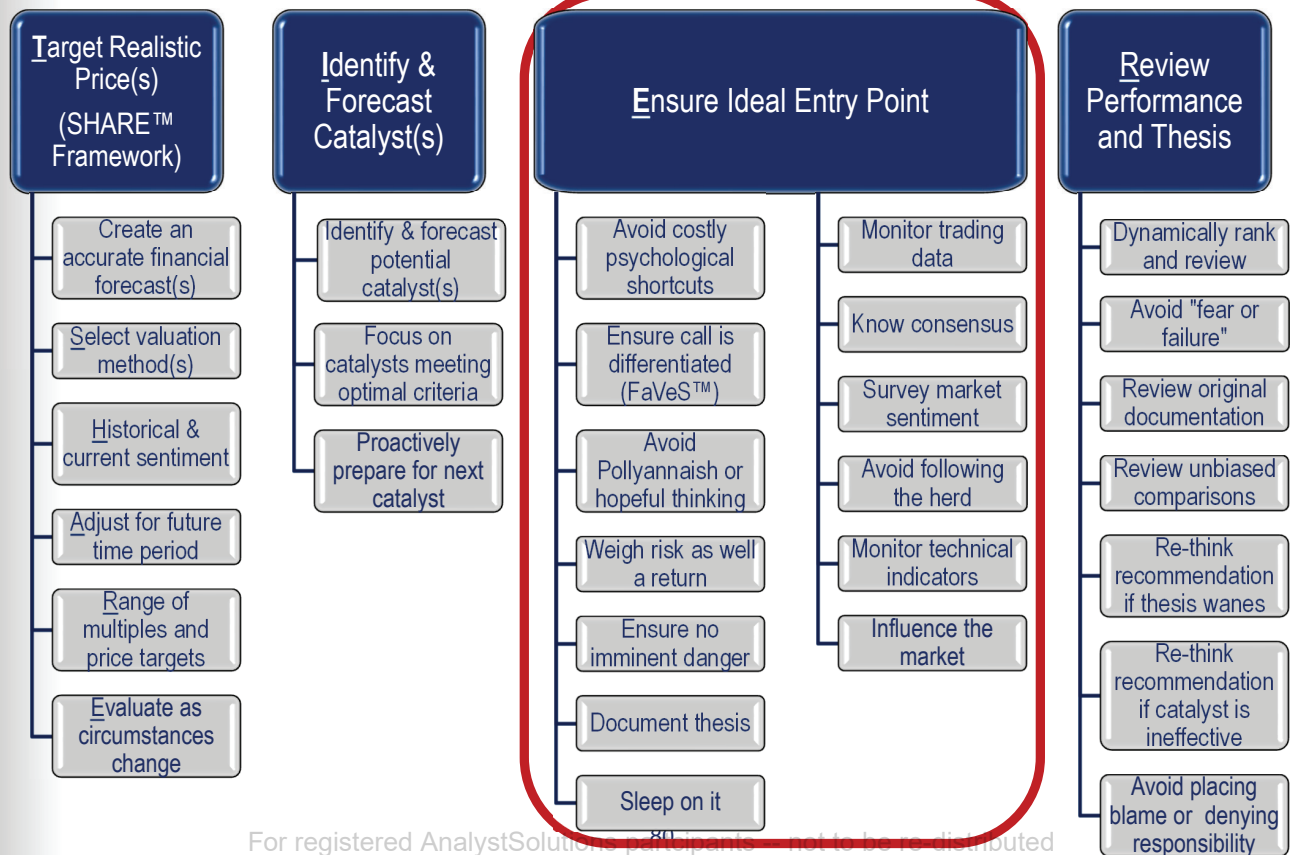
 \_\_\_\_\_ r \_\_\_\_\_ price(s)

 \_\_\_\_\_ & forecast c \_\_\_\_\_(s)

 Ensure ideal entry point

 Review performance and thesis

## Module 3



# Step 3A of TIER™: Ensure Ideal Entry Point

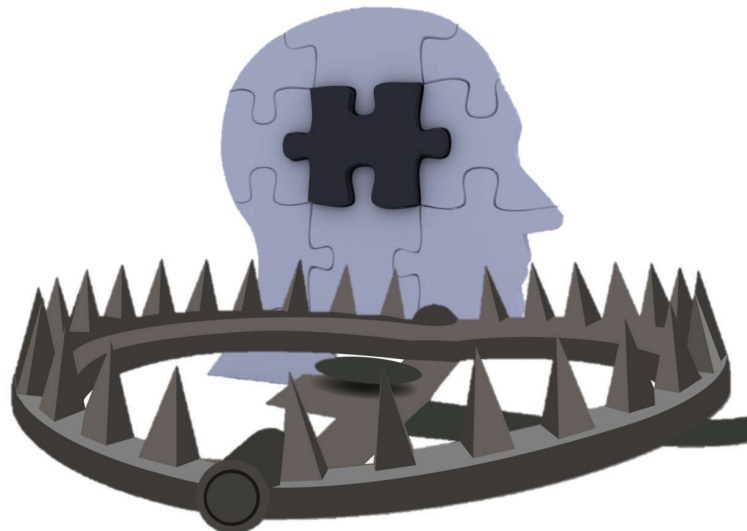
**Part A: Validate Your View**

**Part B: Assess and Influence  
the Market's View**



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# Avoid Mind Traps



# Poll Everywhere

- You do not need to sign up for an account
- Connect to Poll Everywhere
  - Polleverywhere.com/POSP
  - Poll Everyone app
    - POSP

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# Find the F's exercise

- Instructions for the “Find the F’s” exercise:
  - Step 1: Write down the number of “f’s” you see in the sentence when it appears below (do not say it aloud)
  - Step 2: Wait for additional instruction from the facilitator

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## Heuristics Mind Trap

- Problem: Blindly relying on or over-using mental shortcuts (“rules of thumb”) to make investment decisions without checking to ensure they are reliably accurate
- Manifestation:
  - You rarely use rigorous valuation techniques
  - You blindly rely on heuristics without checking the underlying reasoning



# Avoid Heuristics Mind Trap

- Make sure that any heuristics you use come from proven facts or historic trends
- If someone tells you to follow a “simple rule” in forecasting or valuation, test it with historical analysis before applying it



## LIST OF NAMES EXERCISE

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## Familiarity Bias Mind Trap

- Problem: preferring stocks you're familiar with over those you're less familiar with
- Manifestation:
  - You spend more time researching companies that are easy to follow than those more difficult to follow
  - When asked for a stock recommendation, you offer the one you know the best rather than the one with the best risk/return potential



## Avoid Familiarity Bias Mind Trap

- Don't make a suboptimal recommendation just because you know the stock better than the proposed alternatives
- Ensure there are no "forgotten" stocks in your assigned universe by setting aside time to ensure you are well-versed on all them (even the more complicated ones)

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## Avoid Recency Bias

- Avoid making recommendations where the stimulus is primarily based on a recent meeting or call with company management, especially if it's initiated by the company
- Don't ignore (or fail to research) a stock's critical factors of the past as they often come back and become the critical factors that move the stock in the future



# HOW DO YOU DIFFER?

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## Ensure a Differentiated Stock Call with a Superior FaVeS™ Insight

### 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

## Ensure a Differentiated Stock Call with a Superior FaVeS™ Insight

### 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

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## Use “Change in Valuation” Sparingly

Stock recommendations tend to fail when they are based solely on the analyst's expectations that:

- The stock's valuation multiple will be re-rated (void of an impending financial forecast change); or
- The market will change its preferred valuation methodology



## Ensure a Differentiated Stock Call with a Superior FaVeS™ Insight

### Forecast

- Financial forecast superior to the market (used at least 85%)

### Valuation

- Valuation methodology or valuation multiple superior to the market

### Sentiment

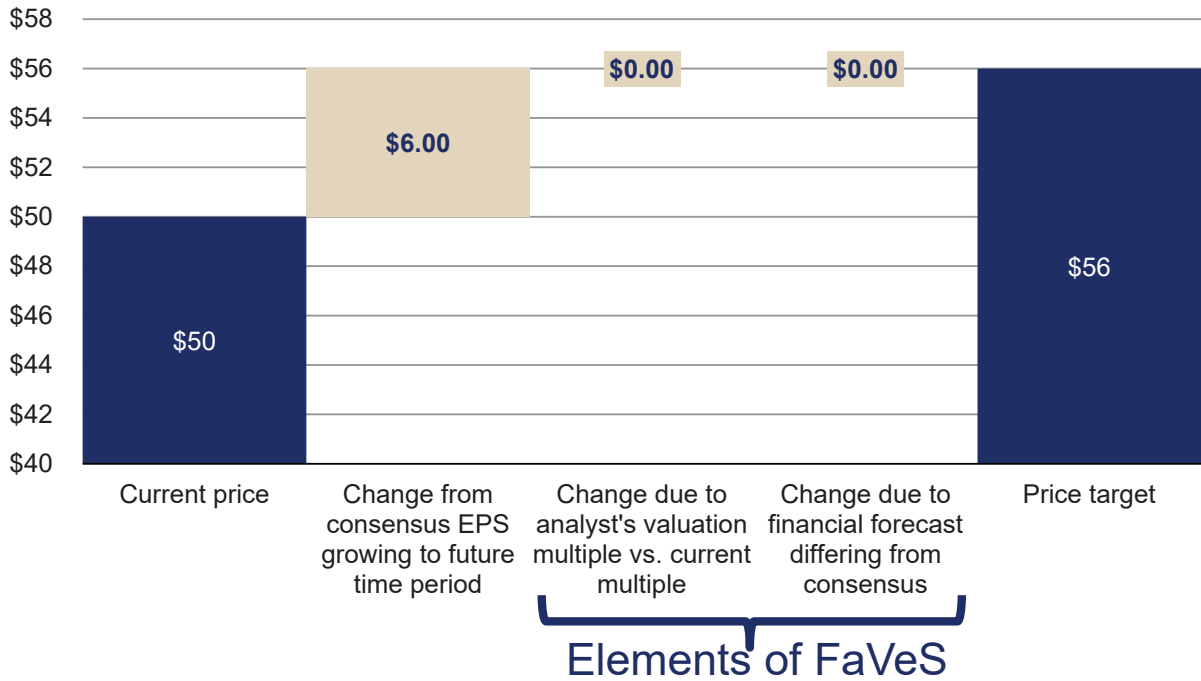
- Forecast of short-term investor sentiment superior to the market

99

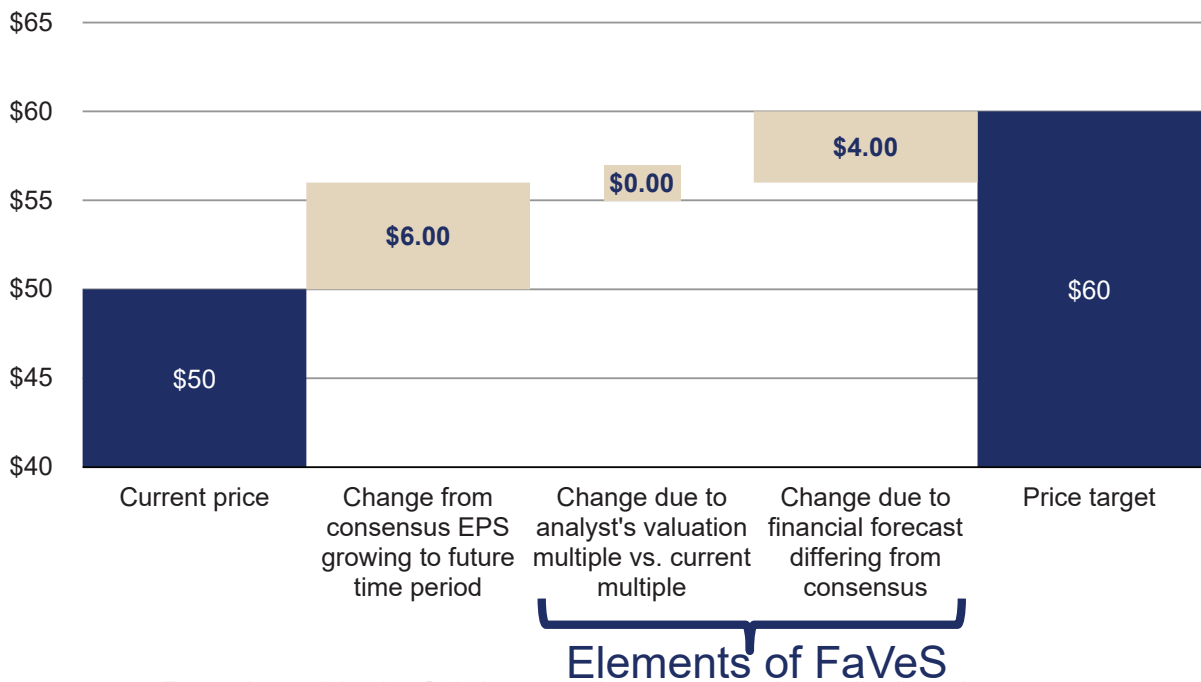
## Quantify “How Do You Differ?”

	Scenario			
	A	B	C	D
1. Current data				
Current stock price	\$50.00	\$50.00	\$50.00	\$50.00
Next 12-month (“NTM”) consensus EPS forecast at present (we call this “Year 1”)	\$5.00	\$5.00	\$5.00	\$5.00
Stock’s current valuation multiple based on Year 1 EPS	10.0	10.0	10.0	10.0
Current market multiple	15.0	15.0	15.0	15.0
Stock’s current premium or discount to the market multiple	-33%	-33%	-33%	-33%
2. Change from consensus EPS between Year 1 and Year 2				
NTM consensus in Year 2 (i.e. forecast at beginning of Year 2 for Year 2)	\$5.60	\$5.60	\$5.60	\$5.60
Difference between Year 2 and Year 1 consensus forecasts	12%	12%	12%	12%
Item #2 above is due to passage of time while #3 and #4 below are influenced by the analyst				
3. Change due to analyst’s financial forecast differing from consensus				
Analyst’s NTM EPS forecast in one year (i.e. forecast for Year 2)	\$5.60	\$6.00	\$6.00	\$6.60
Premium or discount of analyst’s EPS estimate in Year 2 compared to consensus’	0%	7%	7%	18%
4. Change due to analyst’s future valuation multiple differing from current multiple				
Analyst’s estimate of market multiple at beginning of Year 2 (typically keep same as present)	15.0	15.0	15.0	15.0
Analyst’s estimate of stock’s premium or discount to market multiple at beginning of Year 2	-33%	-33%	-27%	-20%
Valuation multiple used for price target at beginning of Year 2	10.0	10.0	11.0	12.0
Difference between analyst’s future multiple and stock’s current multiple				
5. Price target	\$56.00	\$60.00	\$65.70	\$79.20
Change from current price	12%	20%	31%	58%

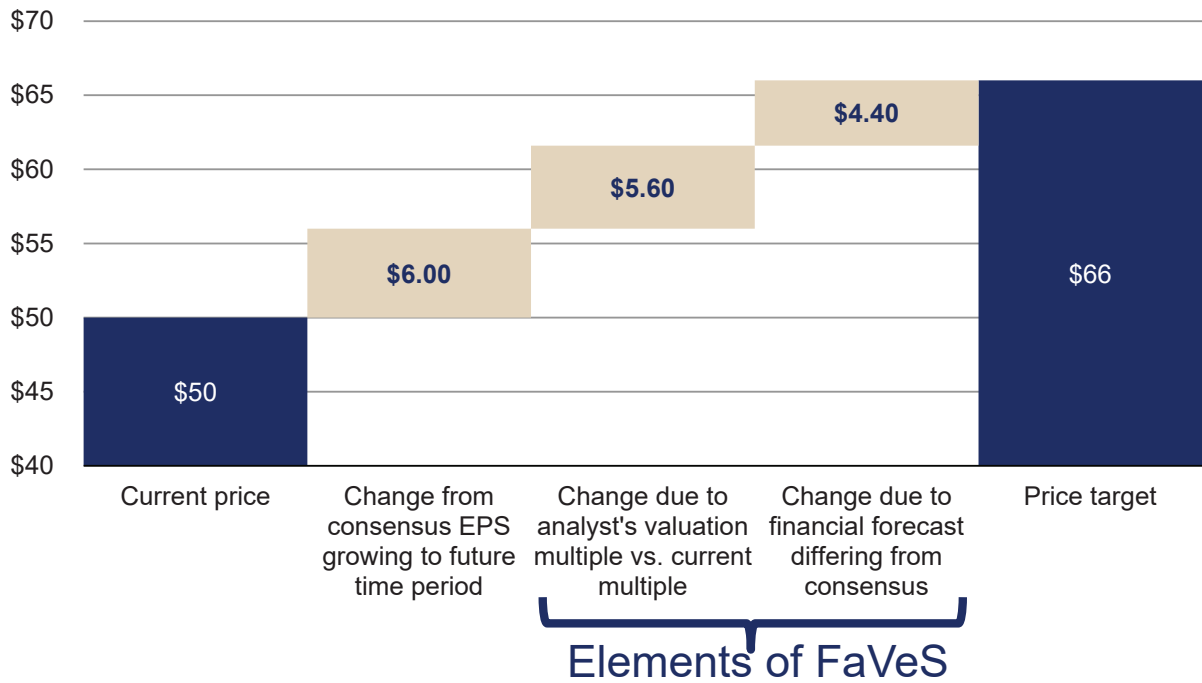
# Dissect How You Differ (A)



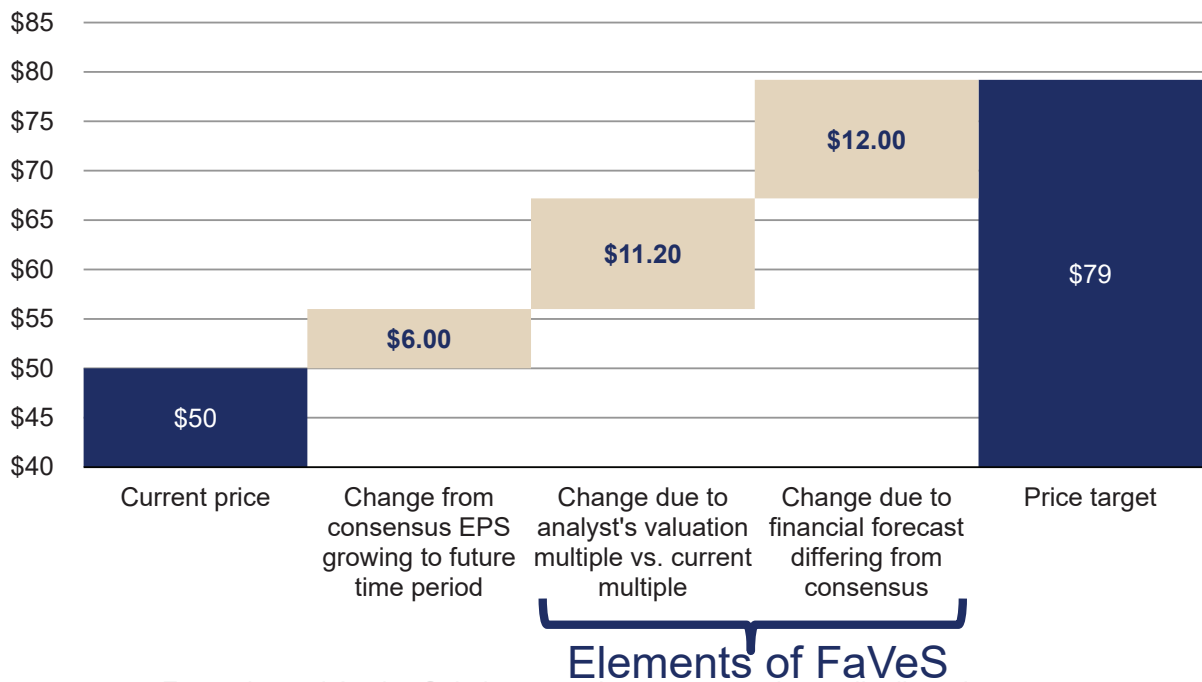
# Dissect How You Differ (B)



# Dissect How You Differ (C)



# Dissect How You Differ (D)



# “HOW DO YOU DIFFER?” EXERCISE

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## Forecasting Financial Results that Differ from Consensus

- Start by assuming you're wrong
- Ensure that the “differentiated” element of a forecast is concentrated in an area of expertise or has been thoroughly researched
- Forecast an upside, downside and base-case scenario before making a big stock call to stress test your thesis



# “RANK YOUR ABILITY” EXERCISE

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# Overconfidence Mind Trap

- Problem: assuming you're smarter than everyone else, which prevents you from exploring the real risks or reasons that a stock is not currently at your price target
- Manifestation:
  - You often put too much confidence in yourself
  - After string of success, you think you can't lose
  - You tend not to properly assess the downside or risk of an investment



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# Avoid Overconfidence Mind Trap

- Remind yourself that no professional investor is right 100% of the time
- Require yourself to fully understand the other side of the trade before making a recommendation
- Ask a trusted colleague or investment committee to scrutinize your thesis
- Any time you think “I can't lose”, think through the downside or risks of the investment

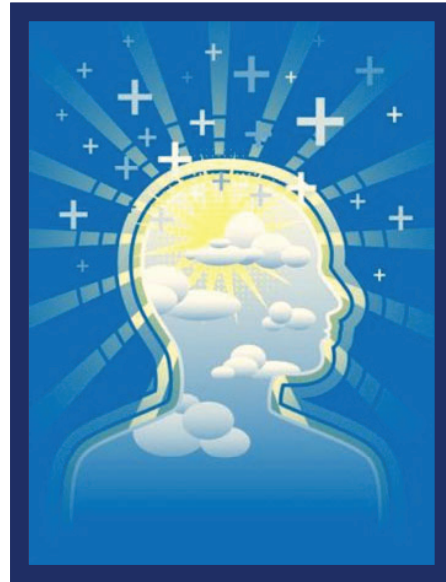
# **“HOW DOES YOUR FUTURE LOOK?” EXERCISE**

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# Optimism Bias Mind Trap

- Problem: being too optimistic about your stock's valuation and future earnings potential
- Manifestation:
  - You assume nothing will go wrong
  - You overlook, or fail to investigate, risks of prospective investments
  - You set price targets based on valuations well above historical markers
  - You spend more time thinking of potential gains than weighing potential losses



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# Avoid Optimism Bias Mind Trap

- Research history of your companies and industries (growth rates and multiples). If your forecast is well above historical trends, explain a sound reason for doing so
- Spend as much time identifying risks as opportunities (assume something will go wrong)
- Seek to share your investment thesis with a trusted colleague or investment committee

# Avoid Self-Attribution Bias

- After a big win, review documents you wrote when you recommended the stock to see if your thesis played out or another factor was involved
- When you have a stock loss, ask yourself two questions before blaming others or saying “That couldn’t have been foreseen”:
  - Did anyone else see it coming?
  - What might have been done to detect the surprise earlier?
- Examine constructive criticism or negative feedback to the same degree you internalize positive feedback and praise

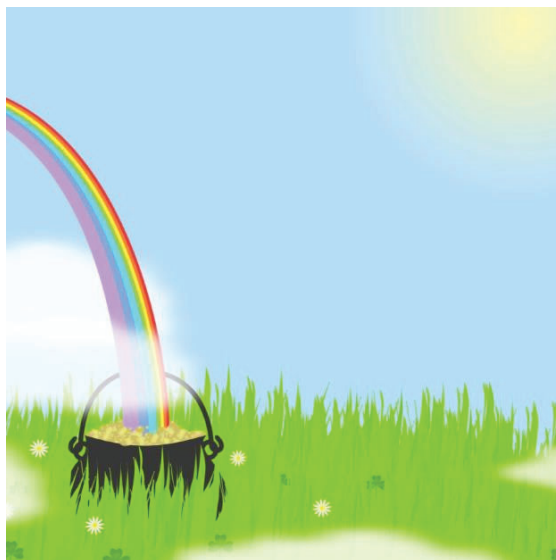
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# Resist Predetermining the Rating

**Will reduce:**

**CONFIRMATION BIAS,**  
which, if unchecked, can  
lead to:

- Seeking only information to confirm your thesis
- Summarily rejecting information that refutes your thesis



# Conviction Should Equate to Probability



- When you differ materially from consensus, focus on developing greater conviction
- Conviction usually increases when you dig deeper into the assumptions by conducting more thorough research

# Weigh Risk as Well as Return

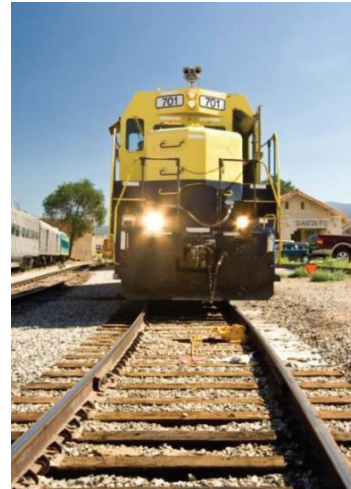
Ensure the risk-adjusted return to the price target is better than alternative investments in the assigned universe

		Returns	
		Low	High
Risk	High	Often the result of poor research -- not identifying the true risks	Exciting, but most PMs don't like to be here
	Low	Tough to add value	Best stock calls -- usually require thorough research

# Ensure No Imminent Danger

## Don't get hit by these freight trains:

- Current quarter's consensus expectations are opposite your long-term view
- A large class of investors are still exiting (growth investors selling after a stock appears to be moving into the maturity phase)
- The current economic cycle appears to be reaching its end
- A large management lock-up is about to expire...



Twitter shares tumble 14% as lock-up period expires

3 Hours Ago



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# Document Your Thesis

Can help reduce these types of mind traps:

- Loss aversion
- Sunk cost
- Momentum
- Self-attribution

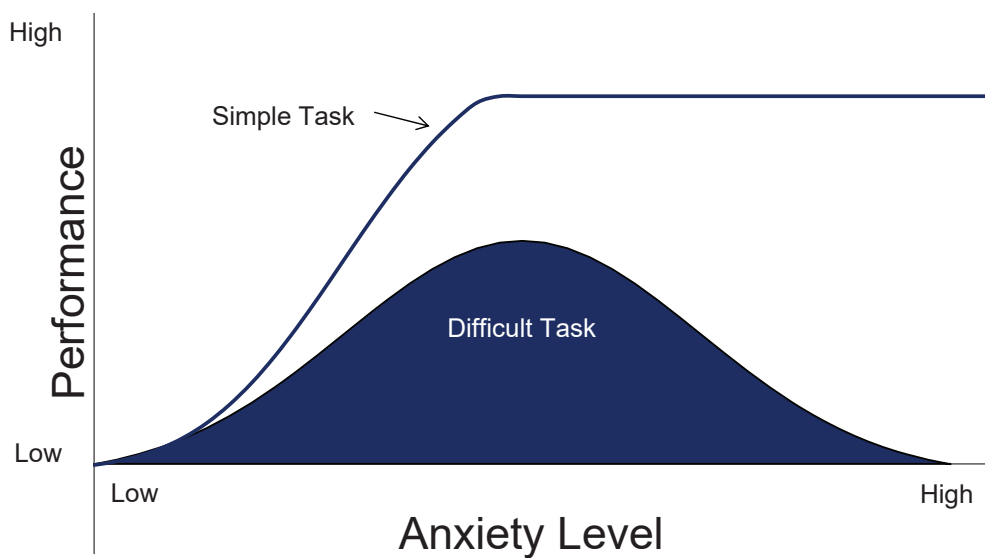


# Sleep On It



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# Yerkes-Dodson Law



# Opening Case Examples Covered in 3A of this Module

- **Best Practices by Robert and Lucas:**
  - Lucas is aware of how his estimate compares to consensus
  - Robert is looking for imminent risks such as a potential disappointment in the current quarter
  - Robert is questioning if Lucas has selective memory, where he revises history to meet his needs
- **Bad Practices by Lucas:**
  - Says he's been wanting to "upgrade SBUX for years" suggesting he has a pre-existing bias that could be clouding his view (aka "Confirmation Bias")
  - Is relying on a basic rule of thumb (heuristic) in terms of buying the stock late in the year to get upside by February, which he doesn't appear to have validated
  - Hasn't considered what could go wrong with his call
  - Doesn't seem to be concerned by the company's potential for falling short of the current quarterly consensus estimates
  - Dismisses prior bad calls to things that were a surprise to everyone even though a sell-side firm had correctly made an accurate call on one of the stocks

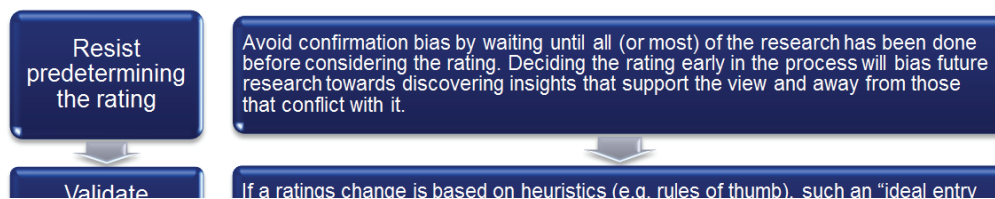
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## Ensure Ideal Entry Point DRC

# Detailed Reference Card (DRC)

### Best Practices for Making Accurate Stock Recommendations

#### Procedures for Ensure Ideal Entry Point (Step 3A of TIER™), Validate Your View



# Step 3B of TIER™: Ensure Ideal Entry Point

Part A: Validate Your View



Part B: Assess and Influence the Market's View



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## Monitor Trading Data

Monitor trading data to understand the motivations of the current stock holders

- Short interest
- Company insider buying and selling
- Changes in the types of investors who own the stock (e.g. value, GARP, growth, momentum)
- Movement of stock compared to company's debt yield or CDS spreads

Investment Style of SBUX Largest Institutional Holders (late 2013)

Holder Name	Investment Style	Market Value (\$)	Position Change (\$)
Fidelity Contrafund	Aggressive Growth	1,195,304,286	521,800
Vanguard Total Stock Market Index Fund	Index	784,760,310	153,094
T Rowe Price Growth Stock Fund	Aggressive Growth	673,005,746	535,800
PowerShares QQQ Trust	Index	603,466,492	275,927

Insider Buying and Selling of SBUX

Trade Date	Participants	Net (\$)
11/15/13	SCHULTZ HOWARD D. ALST	-10
11/14/13	SCHULTZ HOWARD D. ALST	-5
9/30/13	ALSTEAD TROY M. CULVER	
9/30/13	ALSTEAD TROY M. CULVER	
8/19/13	HOBSON MELLODY	
8/2/13	SCHULTZ HOWARD D. ALST	
6/28/13	ALSTEAD TROY M. CULVER	
6/28/13	ALSTEAD TROY M. CULVER	
6/17/13	HANSBERRY JEFFERY	

Short Interest as Percentage

Ticker	Short Interest % of Float
DRI.N	10.1%
DNKN.O	8.5%
NDLS.O	8.1%
BJRI.O	6.1%
RRGB.O	5.6%
SONC.O	5.5%
PNRA.O	5.4%
BLMN.O	5.3%
CAKE.O	4.8%
WEN.O	4.6%
TXRH.O	4.0%
EAT.N	2.5%
BWLD.O	2.3%
MCD.N	2.2%
DPZ.N	2.2%
YUM.N	2.2%
JACK.O	2.0%
CMG.N	1.8%
THL.TO	1.0%
SBUX.O	0.6%

# Know “Consensus” For the Stock

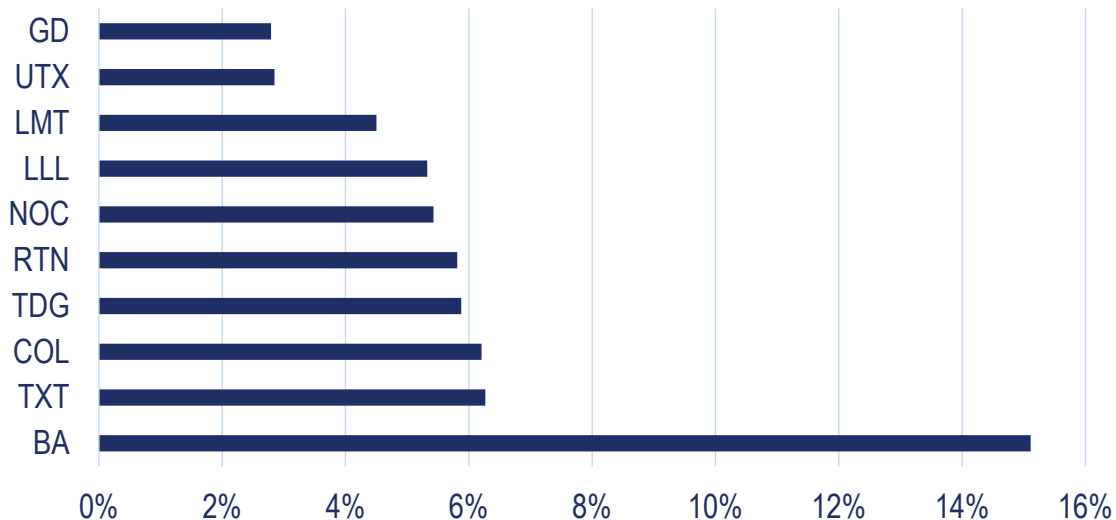
- How many analysts comprise the consensus?
- Where is the “informed consensus”?
- How do their views differ from the broader consensus?
- Are the estimates stale?
- Are there any disagreements about what’s in the number?



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# Investigate “Consensus”

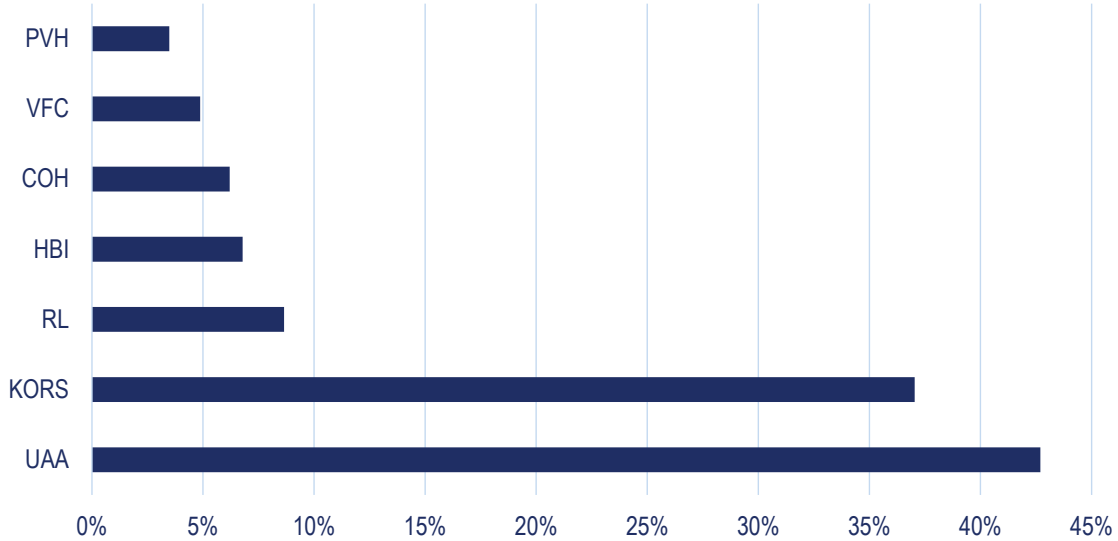
Standard Deviation of Consensus Estimates  
(Aerospace & Defense)



Source: Bloomberg 9-March 2017

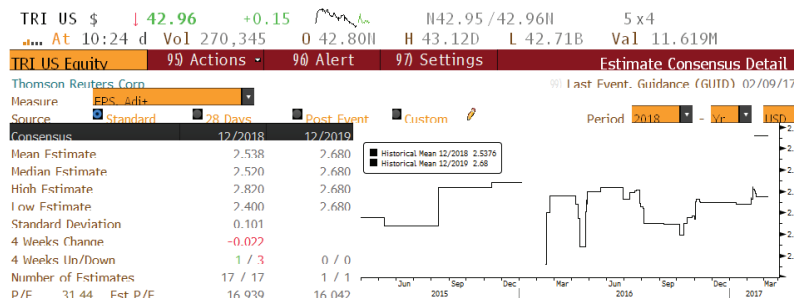
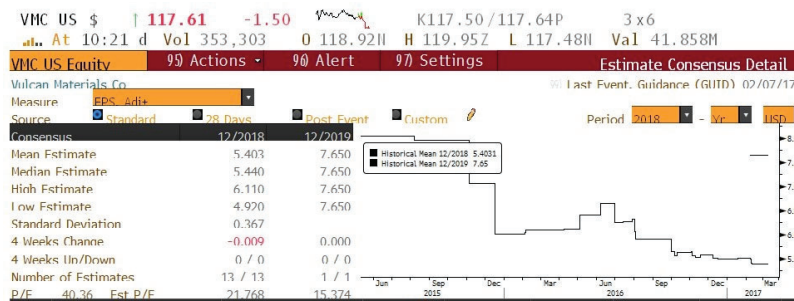
# Investigate “Consensus”

Standard Deviation of Consensus Estimates  
(Apparel, Accessories & Luxury)



Source: Bloomberg 9-March 2017

# Investigate “Consensus”



Source: Bloomberg 9-March 2017

# Survey Market Sentiment

## Speak with market participants:

- Experienced buy-side analysts or PMs who currently own or have owned the stock in the fund
- Sell-side salespeople who have interest in the stock
- Sell-side traders who trade the stock
- The company's investor relations contact
- Sell-side analysts (if you're a buy-side analyst)



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# Ask About...

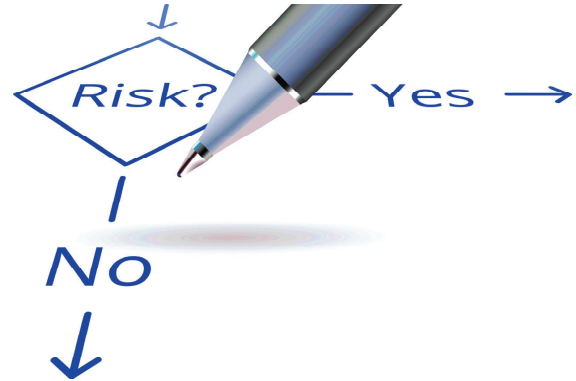
- Biggest investor concerns (may or may not be critical factors)
- Expectations that are above or below the published consensus
- The names and types of stocks receiving the most/least attention (where is everyone spending their time and what's being ignored?)
- General view toward the market (bullish or bearish) and risk (risk-on or risk-off)



# Assessing the Market's Risk Appetite

The market's relative appetite for risk can be gauged by monitoring:

- Treasury yields
- Size of the deal calendar
- VIX
- Recent stock performance of:
  - Weak companies versus stable companies
  - Emerging markets versus developed markets
  - Small cap versus large cap



## Review QRC

# Quick Reference Card (QRC)

### Information Sources Pros and Cons

**Individual Conversation**

Source for Information	Pros	Cons	Confirm or Refute Historical Factors*	Assess New or Emerging Critical Factors	Assess Market Psych.
Buy-side analyst or portfolio manager (as source for buy-	Best place to gauge investor expectations	May not be representative of the larger investor base	□		■

# Complete Your TAP

## Section 4

### Transformation Action Plan (TAP)



**Instructions for the Transformation Action Plan (TAP):**

- Throughout this workshop complete the TAP below
- Apply the key points after the workshop to help you improve your performance
- This will not be collected and so write in a manner that will help you utilize the concepts being learned

### “Circle the Symbols”

#### Exercise

- Review the table of symbols
- For each row, identify the one that you find the most intriguing
- Write down the letter for that symbol

Row	A	B	C	D	E
1.	©		♥	∞	Θ
2.	τ	«	℘	Ẁ	⌘
3.	ℙ	η	℄	ï	Ж
4.	Ⓟ	Ω	₹	√	∞
5.	₯	β	Ϝ	È	з
6.	↓	»	∂	Δ	Π
7.	ℒ	△	≠	ℬ	≡
8.	†	⌘	≥	♪	ϖ
9.	γ	⚡	⌒	☀	⊥
10.	≈	≤	♂	₪	ℒ

Note: those shaded are currently ranked as most intriguing by analysts who have participated in this activity in the past

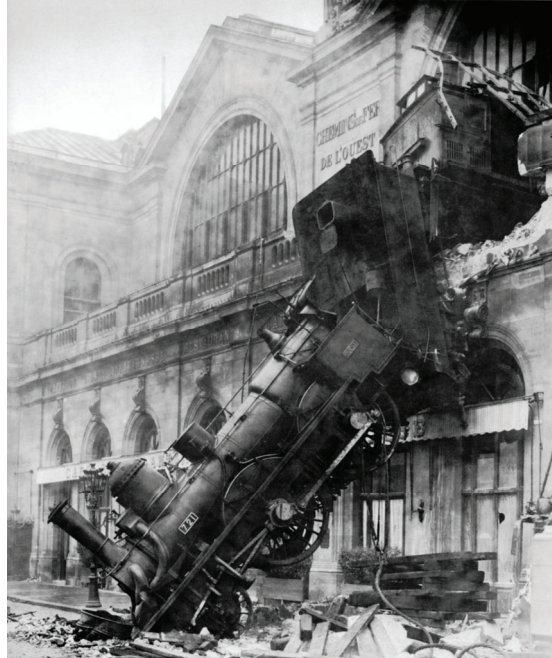
# **“CIRCLE THE SYMBOLS” EXERCISE**

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# Momentum Bias Mind Trap

- Problem: assuming recent trends will continue, even if historical evidence and metrics suggest they are unsustainable
- Manifestation:
  - You assume growth will continue just because a large number of investors are drawing the same conclusion
  - You chase stocks that have already rallied
  - You ignore historical valuation parameters to “make the call work”



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# Avoid Momentum Bias Mind Trap

- If you've missed a substantial move in a stock, be hesitant to chase it such as jumping on the bandwagon. If you're in the same trade as everyone else, ask “Who's going to take the other side of the trade when I want to get out?”
- Research history for your companies and industries, specifically, the growth rates and valuation multiples. If your price target relies on one or both being well outside historical trends, make sure you have a sound reason for doing so.
- When making a change to your thesis, ask where you are in the “greed vs. fear” spectrum compared with consensus. If you're in the same place, you may be following the herd.
- When markets appear to be moving too far too fast for irrational reasons (not based on fundamentals), consider the contrarian view

# Monitor Technical Indicators

## Monitor technical indicators

- Assesses the collective wisdom (including emotions) towards a stock based on:
  - Price
  - Volume
- Seeking trends (technical indicators will not predict inflection points)
  - Uptrend
  - Downtrend
  - Support
  - Resistance
- Don't let technicals bias your fundamental work



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# Influence the Market

**In order to get the consensus' thinking to come around to the analyst's out-of-consensus view:**



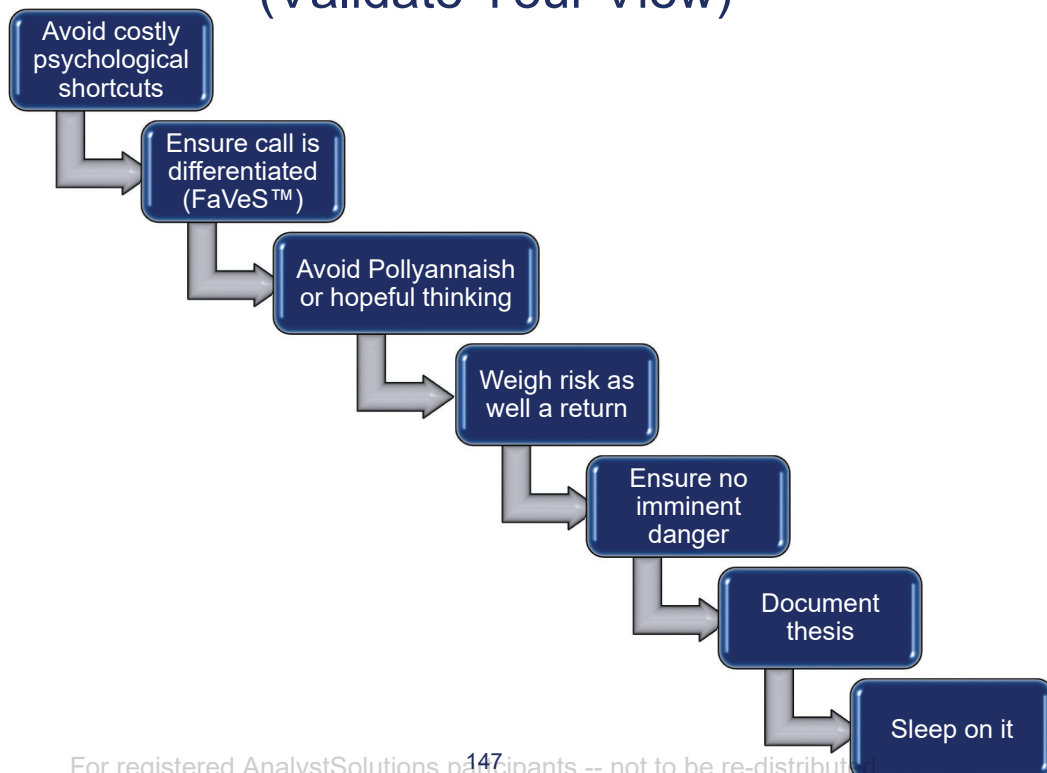
- If allowed by their firm, buy-side analysts should inform the most influential sell-side analysts of their thesis, but only after the buy-side analyst's firm has built a position in the stock
- Sell-side analysts publish their view and influence key market participants

# Opening Case Examples We Covered in 3B of this Module

- **Best Practices by Robert and Lucas:**
  - Lucas is aware of how his estimate compares to consensus
- **Bad Practices by Lucas:**
  - Doesn't know why some analysts value the stock with a PEG ratio while others use P/E ratio
  - Doesn't seem to be concerned with the amount of stock owned by management

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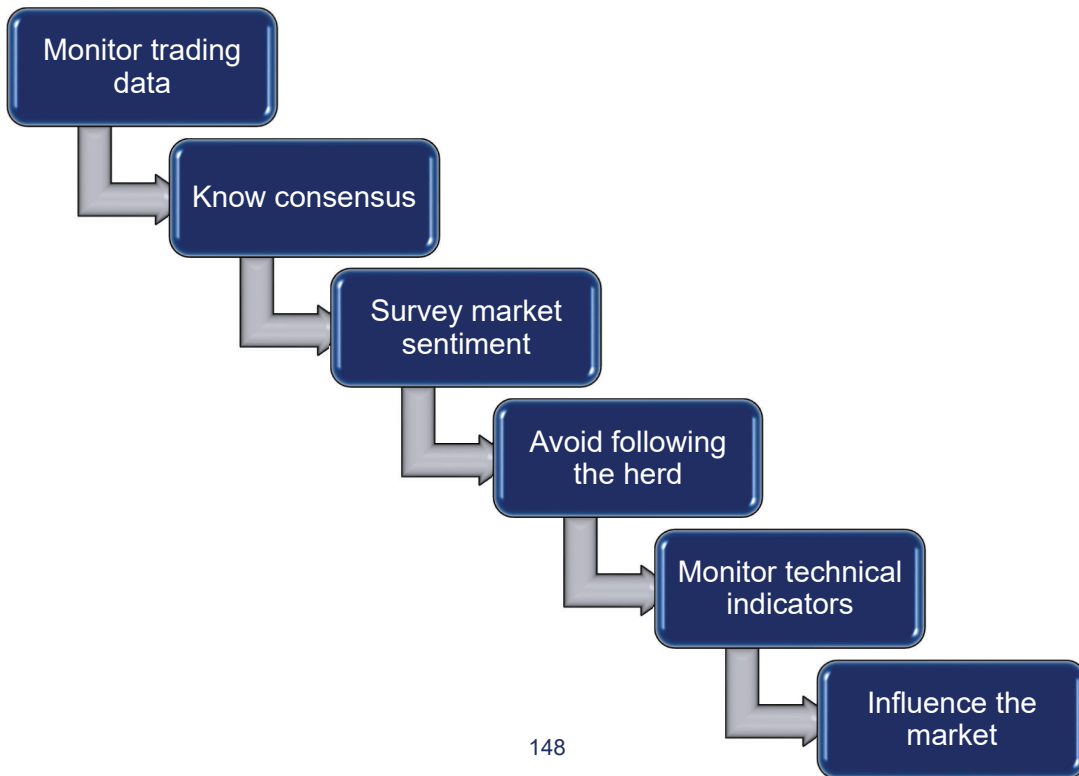
## Step 3A: Ensure Ideal Entry Point (Validate Your View)



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# Step 3B: Ensure Ideal Entry Point

(Assess and Influence the Market's View)

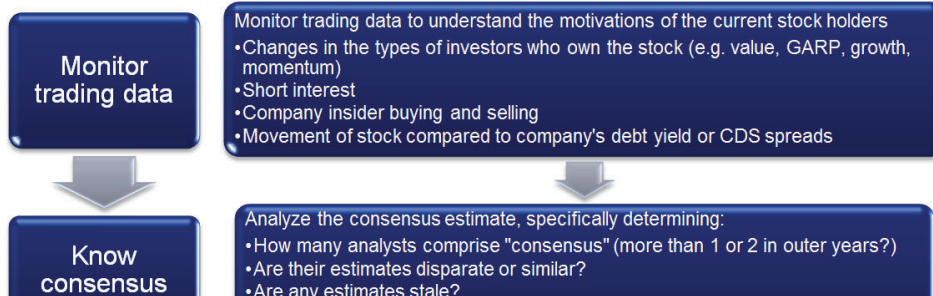


## Ensure Ideal Entry Point DRCs

### Detailed Reference Card (DRC)

**Best Practices for Making Accurate Stock Recommendations**

*Procedures for Ensure Ideal Entry Point (Step 3B of TIER™), Assess and Influence the Market's View*



# Complete Your TAP

## Section 5

### Transformation Action Plan (TAP)



#### Instructions for the Transformation Action Plan (TAP):

- Throughout this workshop complete the TAP below
- Apply the key points after the workshop to help you improve your performance
- This will not be collected and so write in a manner that will help you utilize the concepts being learned

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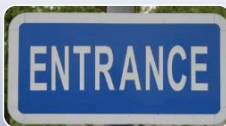
# Test Your TIER™ Knowledge



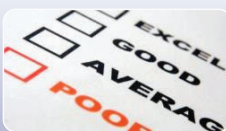
\_\_\_\_\_ r \_\_\_\_\_ p \_\_\_\_\_ (s)



\_\_\_\_\_ & f \_\_\_\_\_ c \_\_\_\_\_ (s)

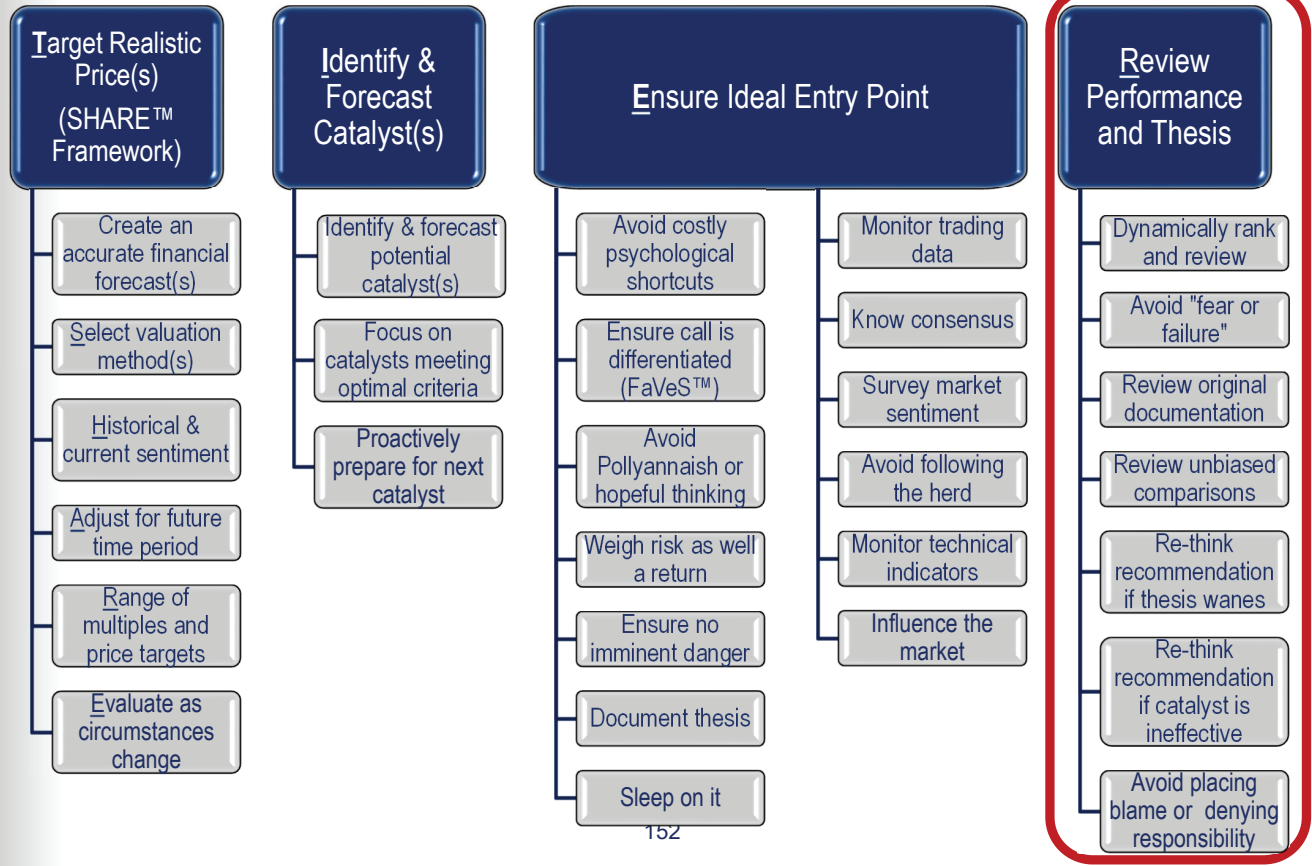


E \_\_\_\_\_ ideal \_\_\_\_\_ point



R \_\_\_\_\_ eview performance and thesis

# Module 4



# Dynamically Rank and Review

## All analysts have comp tables, but does yours:

- Updates stock prices automatically (via a feed to third-party service)
- Updates your forecast estimates (e.g. EPS, CFPS, BV, etc.) automatically from your models
- Includes consensus estimates which are automatically updated (via a feed to third-party service)
- Highlights when your financial forecasts differ materially from consensus
- For stocks you're recommending, shows how much future valuation multiple differs from the current multiple
- For stocks you're recommending, includes upside/downside returns to your target prices
- For stocks you're recommending, includes a column for you to adjust upside/downside for risk/probability
- Includes ranges of historical forward relative valuation (e.g. relative P/E)
- Includes current relative valuation to the market (e.g. relative P/E)
- Include relative valuation metrics (e.g. P/E) for stocks in other sectors with similar prospects
- Includes how your recommendations have performed since the last rating change relative to your universe of stocks and the overall market

# Example Comp Table

Select the image below to launch the Excel file

Descriptors		Trading					
Ticker	GICS SubInd Name	Short Name	Curr Px	Pot Chg on Day	Equity Turnover (trading volume)	Shrt Int Ratio	Price target
7	ARMK US Equity	Restaurants	ARAMARK	\$40.86	-0.7%	\$43,019,010	7%
8	BJRI US Equity	Restaurants	BJ'S RESTAURANTS	\$70.85	2.6%	\$32,152,610	6%
9	CBRL US Equity	Restaurants	CRACKER BARREL	\$151.42	0.8%	\$45,743,140	11%
10	DNKN US Equity	Restaurants	DUNKIN' BRANDS G	\$71.59	-0.2%	\$20,089,120	7%
11	DPZ US Equity	Restaurants	DOMINO'S PIZZA	\$289.40	-0.7%	\$84,363,330	2%
12	JACK US Equity	Restaurants	JACK IN THE BOX	\$88.57	0.0%	\$30,422,870	4%
13	MCD US Equity	Restaurants	MCDONALDS CORP	\$159.05	-0.9%	\$69,819	2%
14	PZZA US Equity	Restaurants	PAPA JOHN'S INTL	\$42.73	0.0%	\$8,550	2%
15	RRGB US Equity	Restaurants	RED ROBIN GOURME	\$40.75	0.2%	\$16,849,950	20%
16	SBUX US Equity	Restaurants	STARBUCKS CORP	\$52.66	-0.3%	\$265	2%
17	SONC US Equity	Restaurants	SONIC CORP	\$34.26	0.4%	\$17,318,790	10%
18	YUM US Equity	Restaurants	YUM! BRANDS INC	\$83.52	-0.3%	\$99,224,660	3%

# Complete Your TAP

## Section 6

### Transformation Action Plan (TAP)

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**Instructions for the Transformation Action Plan (TAP):**

- Throughout this workshop complete the TAP below
  - Apply the key points after the workshop to help you improve your performance
  - This will not be collected and so write in a manner that will help you utilize the concepts being learned
- 

## Best Practices for Building a Comp Table

# Quick Reference Card (QRC)

Best Practices for Building a Comp Table

---

# Review Valuations Regularly

**Look at the valuation levels of your stocks regularly, preferably on a daily basis, but no less frequent than weekly.**

- It can be the catalyst for a ratings change and ensures that current recommendations are consistent with the magnitude of risk-adjusted upside or downside potential
- It helps to prioritize time, namely, to put more effort into places where the most potential alpha exists
- It helps to internalize when stocks are approaching desired price targets, and are thus worthy of a potential ratings change.
- It helps to understand the psychology about stocks, in terms of when certain stocks or subsectors move based on changes in the marketplace or in critical factors

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## “SKI VACATION” EXERCISE

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## Sunk Cost Mind Trap

- Problem: investing considerable time or capital into a given stock prevents you from looking at it objectively
- Manifestation:
  - You lose objectivity on a stock after making a recommendation
  - You hold on to a stock simply because you have sunk in considerable time or capital



## Avoid the Sunk Cost Mind Trap

- When conducting extensive research on a topic, periodically ask, “What will I do if I discover nothing new?”
- Resist the temptation to make changes to your financial forecasts or valuation multiples to “make it work,” in an effort to show more upside/downside than you previously expected
- Be willing to reverse your recommendation when you’ve made a mistake, or your thesis failed to play out
- Set aside time (once a month or quarter), and ask yourself, “If I switched firms tomorrow, would my initial stock recommendations at the new firm match my current ones?” If not, understand why

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## Loss Aversion Mind Trap

- Problem: avoiding selling a stock at a loss
- Manifestation:
  - You are unwilling to admit mistakes
  - For non-performing stocks, you resist reversing your rating or look for new reasons to continue recommending



# Avoid the Loss Aversion Mind Trap

- Ask yourself, “If I switched firms tomorrow, would my initial stock recommendations match my current ones?” If not, understand why
- After beating yourself up over a mistake, embrace it as a valuable lesson learned that will make you a better analyst
- Document thesis and review to keep honest to your original call



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# Best Practices for Eliminating Psychological Biases

## Quick Reference Card (QRC)

### Best Practices for Eliminating Psychological Biases

Bias	Manifestation	Example	Increasing Self-Awareness
------	---------------	---------	---------------------------

# Eliminate Psychological Biases from Your Stock Calls

- Complete thorough research (including valuation analysis) before making a stock recommendation
- Document your thought process (including changes to financial forecast, valuation multiple or method) and review it periodically
- 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

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## Review Original Documentation

**Can be as simple as a few lines found in:**

- Spreadsheet
- Report
- Presentation

**Helps avoid these biases:**

- Loss aversion
- Sunk cost
- Momentum
- Self-attribution



# Review Unbiased Comparisons

**Avoid many typical destructive biases, by periodically:**

- Conducting blind test
- Asking “If I switched firms tomorrow...”



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# Re-think Recommendation If...

**Thesis Wanes**



**Catalyst Is Ineffective**



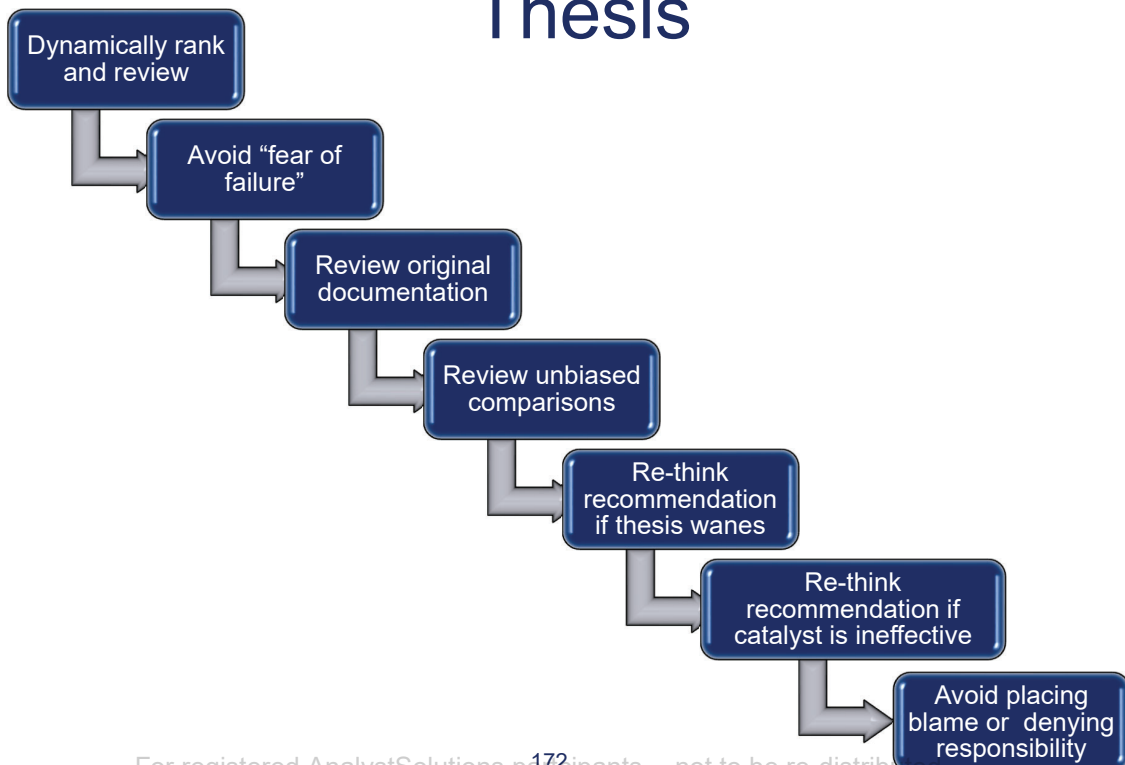
# Avoid Placing Blame or Denying Responsibility

## Coping Strategies:

- Accepting responsibility
- Distancing
- Plan-full problem solving
- Positive reappraisal



# Step 4: Review Performance & Thesis



# Review Performance & Thesis DRCs

## Detailed Reference Card (DRC)

Best Practices for Making Accurate Stock Recommendations

Procedures for Review Performance and Thesis (Step 4 of TIER™)

Review your comparison ("comp") table regularly (i.e. daily or a few times each week). To provide the best analysis, the table should:

- Update stock prices automatically
- Update your EPS (or CFPS) and consensus' forecasts automatically

Dynamically re-  
and review

## Detailed Reference Card (DRC)

Best Practices for Making Accurate Stock Recommendations

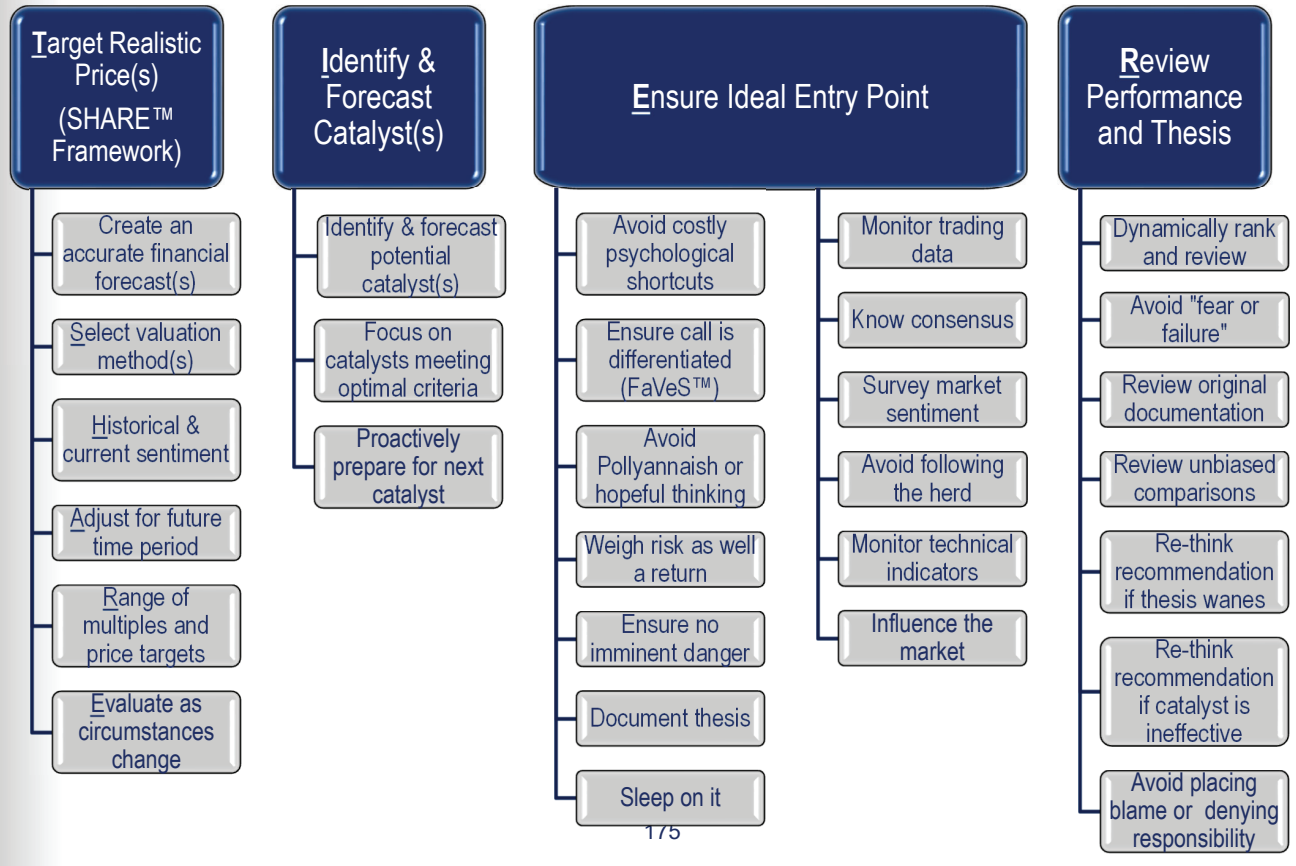
Perspectives for Review Performance and Thesis (Step 4 of TIER™)

Don't mistake good stock picking with a bull market. Always evaluate performance relative to a similar basket of stocks. (This also holds true when evaluating company


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# Opening Case Examples Covered in this Module


- **Best Practices by Robert and Lucas:**
  - Robert correctly notes that most of the upside in the stock this year has been in line with the market's move
- **Bad Practices by Lucas:**
  - Is impressed the stock has moved 18% this year even though this is likely due to the overall market move
  - Dismisses prior bad calls to things that were a surprise to everyone even though a sell-side firm had correctly made an accurate call on one of the stocks




# Test Your TIER™ Knowledge

 T \_\_\_\_\_ r \_\_\_\_\_ p \_\_\_\_\_ (s)

 I \_\_\_\_\_ & f \_\_\_\_\_ c \_\_\_\_\_ (s)

 E \_\_\_\_\_ ideal \_\_\_\_\_ point

 R \_\_\_\_\_ p \_\_\_\_\_ and t \_\_\_\_\_

# Checklist DRC

## Detailed Reference Card (DRC)

### Stock Recommendation Checklist Using the TIER™ System

Step	Question to ask yourself
<b>1. STEP 1 of TIER™ : TARGET REALISTIC PRICES</b>	
1.1. Create an accurate financial forecast(s)	<ul style="list-style-type: none"> <li>• Have you followed the principles of the ENTER™ quality framework (expectational, novel, thorough, examinable and revealing) in deriving a base-case financial forecast more accurate than consensus?</li> <li>• Have you created plausible upside and downside forecasts to stress test the base-case scenario?</li> </ul>
1.2. Select optimal valuation method(s)	<ul style="list-style-type: none"> <li>• Have you identified the valuation method(s) currently being used for the stock and sector as well as any other methods used in the past?</li> <li>• If there was more than one, have you identified:               <ul style="list-style-type: none"> <li>○ The catalyst(s) that caused it to change?</li> </ul> </li> </ul>

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# Review Your TAP

## Transformation Action Plan (TAP)



### Instructions for the Transformation Action Plan (TAP):

- Throughout this workshop complete the TAP below
- Apply the key points after the workshop to help you improve your performance
- This will not be collected and so write in a manner that will help you utilize the concepts being learned

Follow through by continually practicing these three steps...



## Our Tools



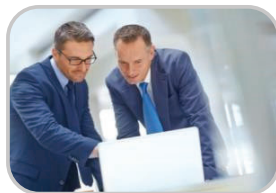
Workshops



One-on-one coaching



Assessments



Consulting



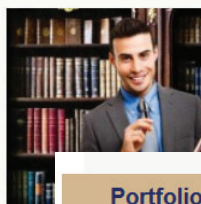
Keynote/offsite presentations

# Workshops that Address Universal Analyst Needs

-  Identify & Monitor a Stock's Critical Factors
-  Generate Differentiated Insights Through Better Discovery, Questioning and Influencing
-  Apply Practical Valuation Techniques For More Accurate Price Targets
-  Master the Stock Call Techniques of Highly Experienced Analysts
-  Communicate Unique Stock Calls Successfully So Others Take Action
-  Maximize Your Time for Alpha Generation
-  Develop and Deploy a Marketing Strategy that Maximizes Wallet-Share

# Best Practices Bulletins

## 10 Steps for Equity Research Analysts to Perform Better



According to Reuters, one of its sister companies, Lipper, finds that roughly 85% of active large-cap stock funds are lagging their benchmarks year-to-date through late November. Investors are voting with their feet as shown by the \$206 billion of inflows into ETFs through the first 10 months of 2014 vs. only \$36 billion for the...

## Portfolio Managers' #1 Frustration With Equity Research Analysts



While I was studying the Japanese language during college, I initially didn't take notice that the word "chigau" (ちがう) is used to convey both "different" and "wrong." But after moving to Tokyo and learning the importance of conforming to the group, I developed a newfound appreciation for why these two English words require only one...

[Read the Entire Bulletin >](#)

# Thank You for Participating!



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