

OUTSIDE THE FLAGS

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JUNE 2016

Broker Bingo

Have you ever played Bingo? This game of chance requires players to mark off numbers on a card as they are drawn randomly by a caller. Whoever completes their card first shouts 'Bingo!' It's a bit like trying to follow broker calls on stocks.

One Australian research house helpfully offers investors a list of all the stocks in the benchmark S&P/ASX 200 index alongside their key financial variables and a summary of the recommendations on each stock from seven major brokers.

If you've ever played bingo, scanning this document feels familiar. Multiple variations of "buy", "hold", "sell" for each stock spill across the page in a tiny font that sends even the keenest-eyed reader into head-spinning confusion.

For instance, retailer Woolworths was rated a buy by one analyst, a hold by two others and a sell by the remaining four. Private hospital group Ramsay Health Care was rated as a buy by two brokers, a hold by three and a sell by two.

In the materials sector, there is a similar level of divergence. BHP Billiton was rated a buy by three analysts, a hold by another two and a sell by the remaining two. Among the banks, ANZ had three buys, three holds and one sell.

What's remarkable is the lack of consensus on the list. Recommended buys and sells frequently balance each other out, or the difference is split among holds. Commonwealth Bank has two buys, two sells and three holds, for instance.

Figure 1 shows some of the most popular stocks and recommendations for them from seven investment bank analysts, as at June 2016.¹

¹. Analyst Recommendations, Mason Stevens, 2 June 2016

Figure 1 INVESTMENT BANK ANALYST RECOMMENDATIONS (as at June 2016)

Stock Name	Broker 1	Broker 2	Broker 3	Broker 4	Broker 5	Broker 6	Broker 7
ANZ Banking Group	Buy	Hold	Buy	Buy	Hold	Sell	Hold
BHP Billiton	Hold	Hold	Sell	Sell	Buy	Buy	Buy
Commonwealth Bank	Hold	Hold	Sell	Sell	Buy	Hold	Buy
Computershare	Hold	Buy	Hold	Hold	Hold	Sell	Buy
Origin Energy	Hold	Buy	Sell	Hold	Sell	Sell	Hold
Ramsay Health Care	Hold	Hold	Sell	Buy	Hold	Sell	Buy
Rio Tinto	Sell	Buy	Buy	Hold	Buy	Hold	Hold
Santos	Sell	Buy	Buy	Sell	Hold	Sell	Buy
Woolworths	Hold	Hold	Sell	Sell	Sell	Sell	Buy

One of the few stocks to have unanimous buy recommendations was poker machine maker Aristocrat Leisure. Its stock recently hit eight-year highs and its price has risen six-fold in five years.

But does that mean it will continue rising? Obviously the brokers are confident. But what happens if there are regulatory changes in the gaming industry or a competitor overtakes it or it loses key personnel?

These are idiosyncratic risks related to one particular company and industry that no analyst can quantify. The price of the stock today reflects what we already know, but we can't account for what might happen in the future.

Ultimately, broker calls are only opinions about a stock's prospects. That there are differing opinions about securities is not surprising given analysts will use varied methodologies and put more or less weight on different risks and variables.

Fortunately for end investors, all those broker opinions are public and already reflected in the prices of stocks, which represent the collective view of market participants about a company's future cash flows. Are you going to follow the collective view or that of an individual?

The risk of doing the latter is that few people consistently get it right. How do we know that? Each year, information group Thomson Reuters hands out awards to the top analysts covering various industries and based on the performance of their picks.

Over the past five years of awards, from 2011-2015, Thomson Reuters named the top three stock-pickers in a dozen sectors. What's striking about the results is how the names change year to year. Rarely do champions maintain their position.

Figure 2 breaks out the top three financial services award winners each year. You can see that only one name repeats in this period.

Figure 2 THOMSON REUTERS ANALYST AWARDS - FINANCIAL SERVICES

Rank	2011	2012	2013	2014	2015
1st	Lachlan Parker	Scott Manning	Siddharth Parameswaran	Martin Crabb	Nicholas McGarrigle
2nd	Matthew Davison	Brett Le Mesurier	David Bailey	Jan Van Der Schalk	Brian Johnson
3rd	Siddharth Parameswaran	Bill Stacey	Jonathan Mott	Ts Lim	Lafitani Sotiriou

A similar level of variability is evident across the other sectors for stock pickers, with few (if any) names repeating year-to-year.

So what are we to make of all this? Firstly, broker recommendations can vary enormously for single stocks. If you were to base an investment strategy on these recommendations, whom would you follow?

Secondly, there is little commonality in the lists of the top stock pickers in each sector from year to year. That suggests that at least some of their success is due to luck or perhaps reflects a high turnover of analysts.

Thirdly, what advisor has the time or the inclination to base their clients' investment strategy on scanning broker recommendations for each and every stock? And, in any case, how can we tell to what extent the ratings are already reflected in prices?

Finally, why not base your strategy on the information already available in prices? We have seen that this reflects the aggregate opinions of all participants, whether bullish, bearish or indifferent.

And why not lessen the impact of idiosyncratic risks by diversifying across names, sectors and countries?

You can scan as many lists as you like, but investment really shouldn't be like a game of Bingo.



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