The Stan Clark Financial Team's

# PERSPECTIVES

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Investing

## More than just our own firm's research analysts

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**Previously, we discussed how the Internet has lots of investing information, such as stock quotes, charts, fundamental data, research and discussion forums. It all looks good, but we determined that the information is not the most reliable, for a number of reasons. For example, it could be out of date, biased, unverified or simply not what we're looking for.**

Here, we'll discuss our data sources in more detail – specifically, how we rely on more than the research analysts at our own firm.

At first, it might seem strange that we would use research from analysts outside our firm. After all, why would other firms share their data with us? In fact, their research is available to us through one of our data vendors, who compiles research from most of the major firms. The other firms allow this because most of their reports are available to their clients. So, the reports are already circulating among the public.

Through our data vendors, we have access to almost every analyst who covers the stocks that we want information on. This means that hundreds of analysts, from over 45 Canadian and 300 U.S. firms, provide us with a starting point to get clean, reliable and timely data.

Analyst research data is a big part of our stock selection process. This includes variables such as earnings expectations, earnings revisions and earnings surprises. However, we're always aware that individual analysts are subject to many of the pitfalls from emotional biases. Fortunately, we have a method of dealing with that, too. By using the research of multiple analysts for the same data, we reduce the effect of their biases through diversification. We average the different analysts' numbers and come up with a consensus. This reduces the individual biases, resulting in more reliable information.

Let's look at an example for a typical Canadian company. We have access to 11 different analysts for this company.

Their earnings estimates for the next quarter range from $2.66 to $3.30. That's a pretty wide range of estimates, about 24 percent different. How can we explain that difference? All the estimates are current. Sure, some analysts are better than others, and others may have different resources. But let's not forget that their estimates are based on their personal forecasts, too. We know from our behavioral finance discussions that, analyst or not, most people are not that good at forecasting. So, it's better for us to use an average, or consensus, estimate. In this case, the consensus is $2.90. Using this number takes away most of the personal biases.

**Earnings Estimates for Company ABC**

| | |
|---|---|
| Analyst 1 | 3.28 |
| Analyst 2 | 2.80 |
| Analyst 3 | 2.71 |
| Analyst 4 | 3.30 |
| Analyst 5 | 2.90 |
| Analyst 6 | 2.75 |
| Analyst 7 | 2.84 |
| Analyst 8 | 3.00 |
| Analyst 9 | 3.13 |
| Analyst 10 | 2.66 |
| Analyst 11 | 3.26 |
| Median | **2.90** |

There's a lot of other analyst data that we use, too. Back to our example, the recent earnings results were six percent higher than the previous average expected earnings. In other words, this is an *earnings surprise*. As a result, eight of the 11 analysts revised their next quarter's estimates upwards, based on the most recent company results. This is known as an *upward earnings revision*. These are all positive characteristics, indicating that the stock should do well in the short term.

In summary, using analyst data from multiple sources enhances the quality of the data. And this, in turn, should help our stock selection strategies.

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