
The Triangle of Guidance, Revisions and Surprise From A Practitioner's Perspective

Northfield's 22nd Annual Research Conference

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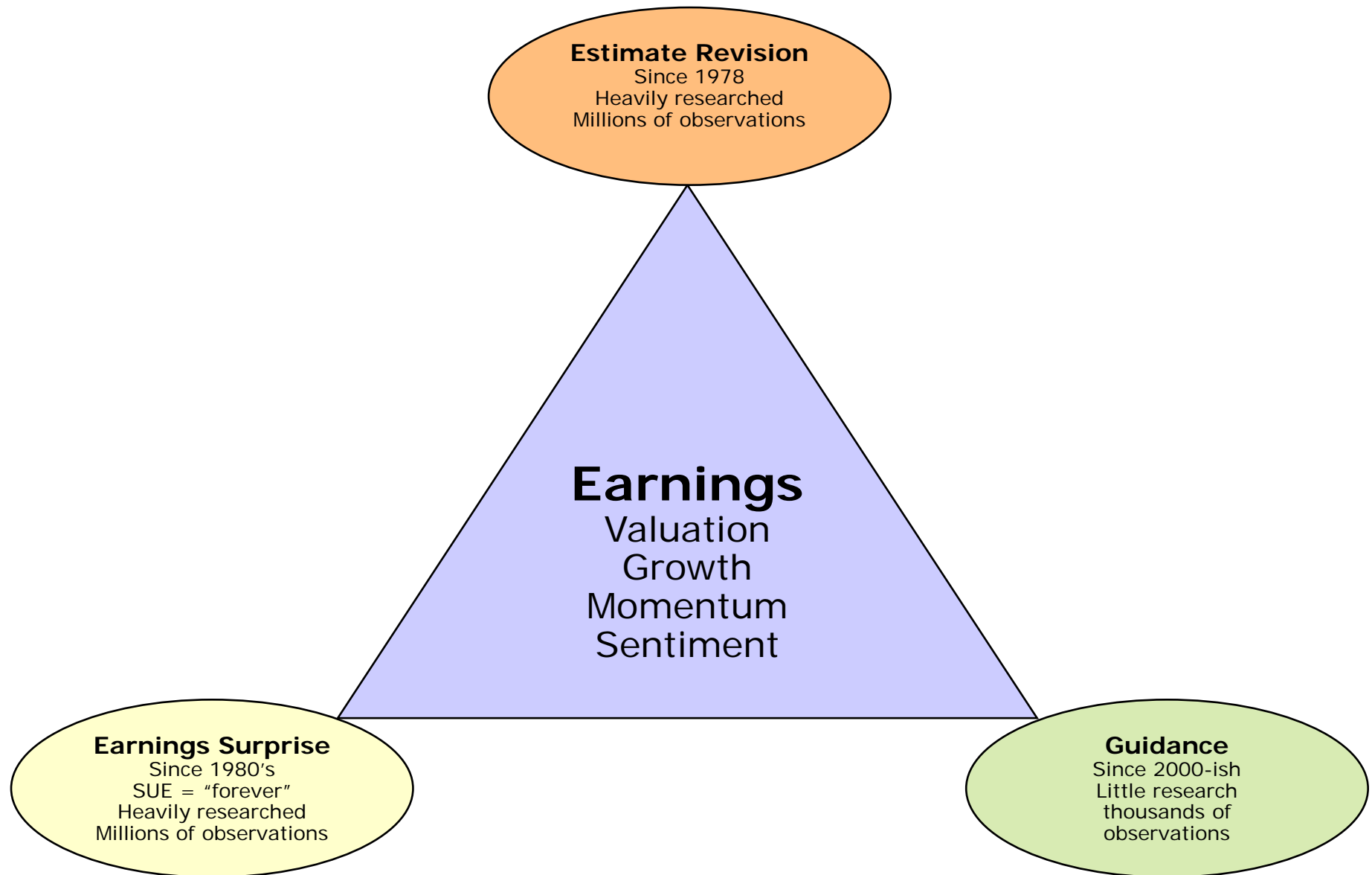
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Guidance Research Agenda

- Definition
- Academic review
- Dataset
- Fundamental feedback
- Characteristics of “Guiders”
- Guidance – univariate return findings
- Guidance – interactions and return findings
- Conclusion

Revisions, Surprise and Guidance



Academic Review

- Sparse and mostly stale
- Small datasets or “derived” guidance
- Management behavior
 - Litigation, option awards, insider buys and sells, reputation, changing guidance behavior
- Analyst behavior
 - Accuracy, range, herding
- Market behavior
 - Pre, during, post, capital markets, behavioral issues
- Regulation
 - Pre vs. Post Reg FD, conference calls
- See Appendix A

Academic Review - Findings

- Negative more likely than positive
- Bigger market reaction to negative vs. positive
- Street estimates tighter for guidance issuers
- Guidance between reports more important

Data Set - Sources

- First Call “CIG” database
- Capital IQ
- Factset Earnings Estimates
- Thomson/Reuters
- Bloomberg
- Quinton “hack”

Data Set – This Research

- Chose CIG
 - Best history – length and breadth
 - Cross-checked with others
- Messy
 - Sparse data
 - Non-standard format: what and how
 - “Wordy”
 - Different fiscal periods

Fundamental Feedback

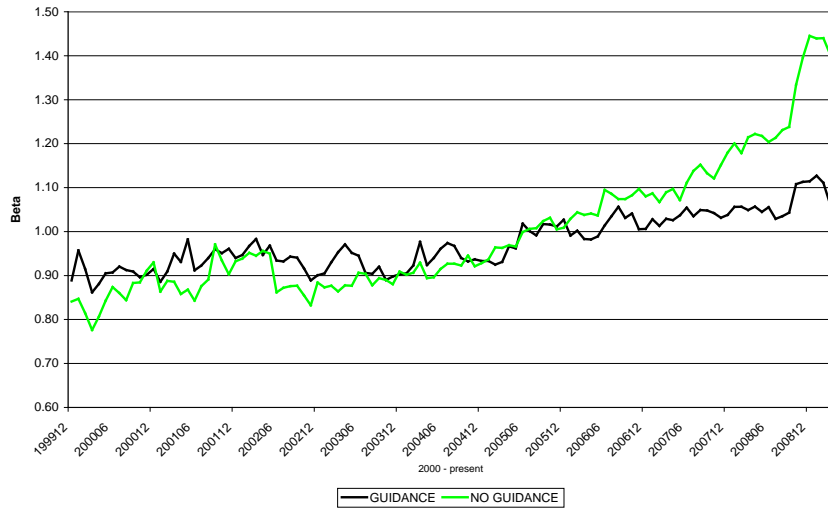
- I polled my analysts
- Generally agree with:
 - Tighter street numbers
 - Critical for opaque end markets and operating decisions
 - Increased post Reg FD
 - Can supersede earnings announcements
 - Negative more important than positive
 - Management reputation key

Characteristics of “Guiders” Study

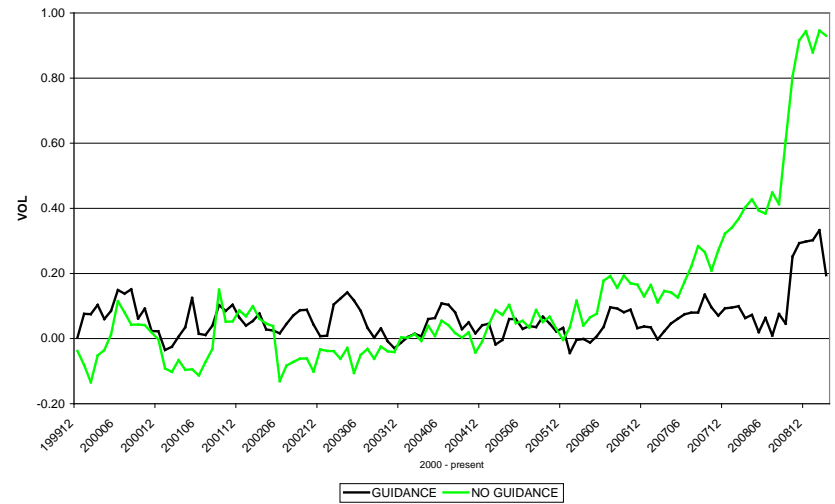
- Russell 1000 companies
- Monthly at month-end
- FY1 or FQ1 guidance issued w/in the last 90 days
- Median observations

Risk Characteristics

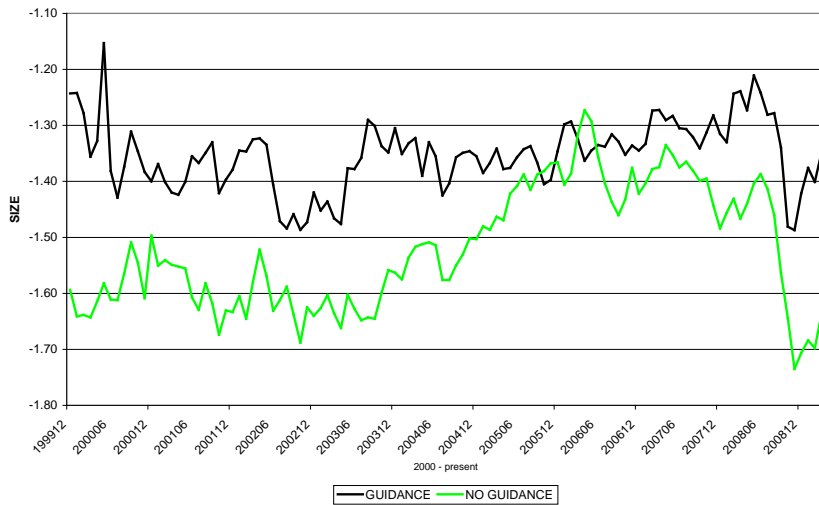
Barra Predicted Beta



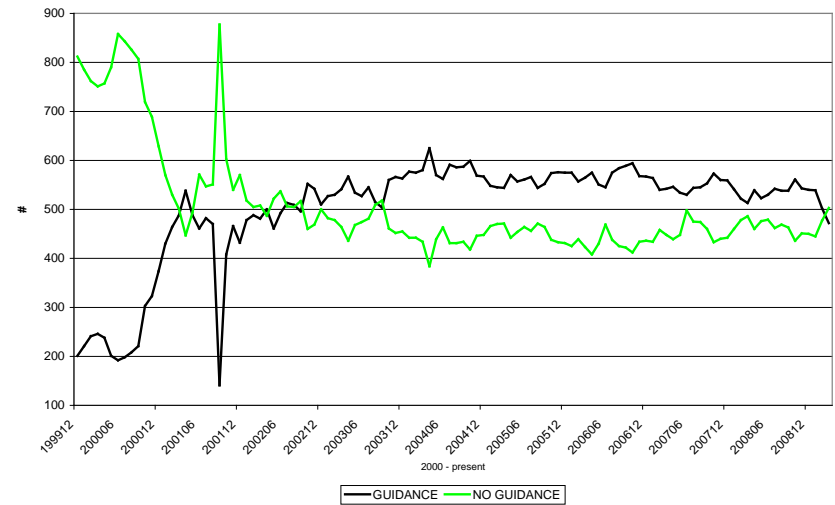
Barra Volatility Factor



Barra SIZE Factor

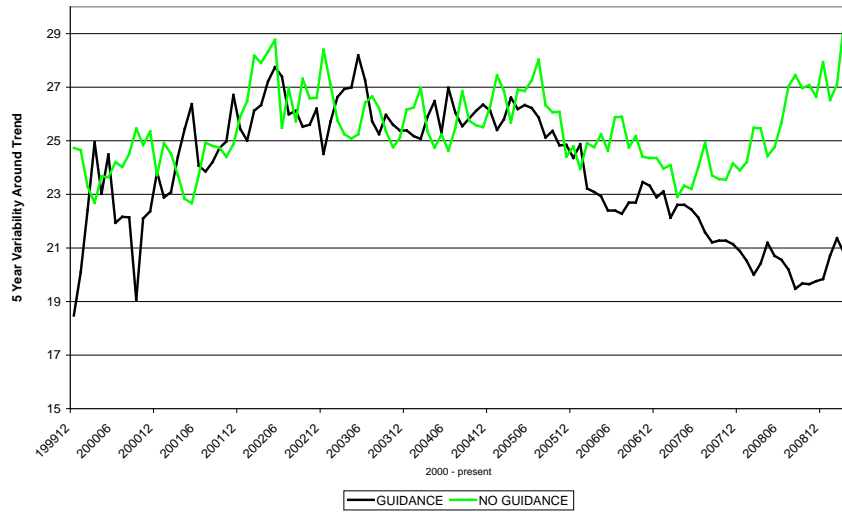


Number of Companies

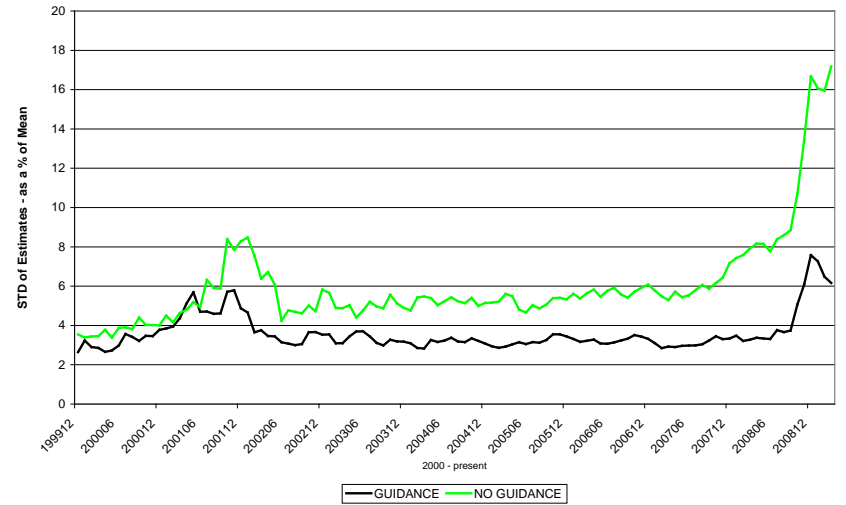


EPS Characteristics

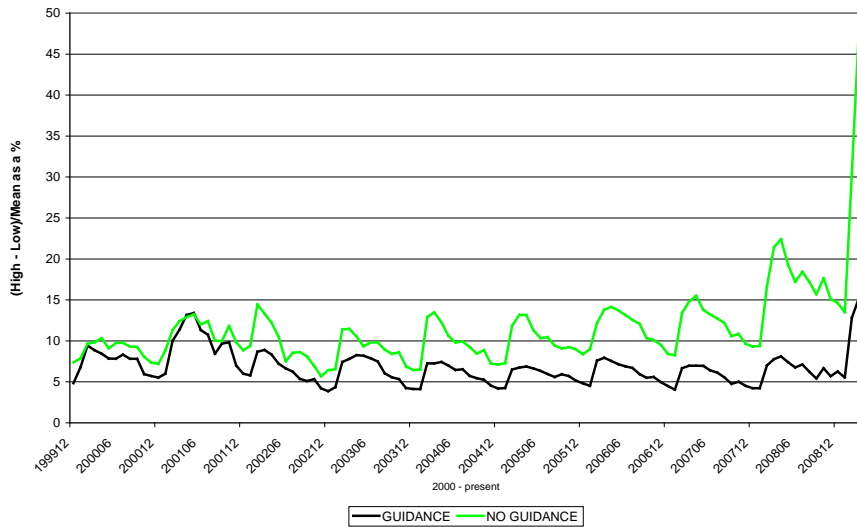
EPS Variability



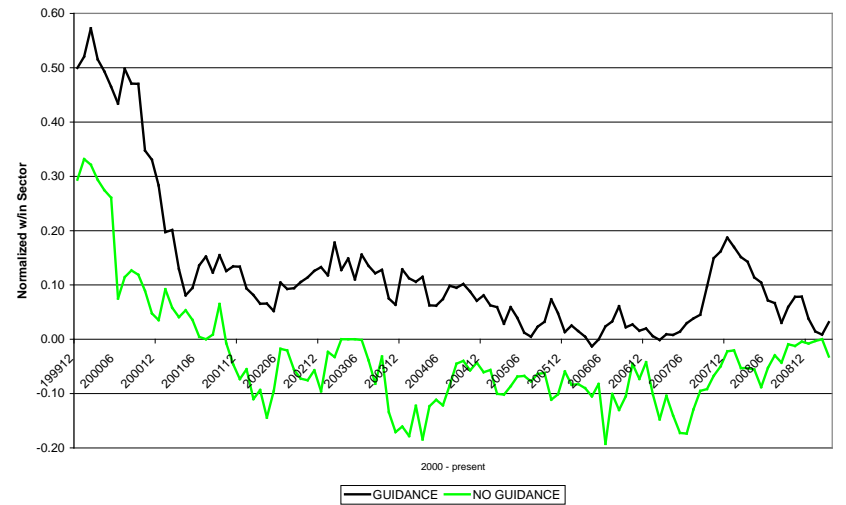
Earnings Dispersion



EPS Range



Forward Earnings Yield



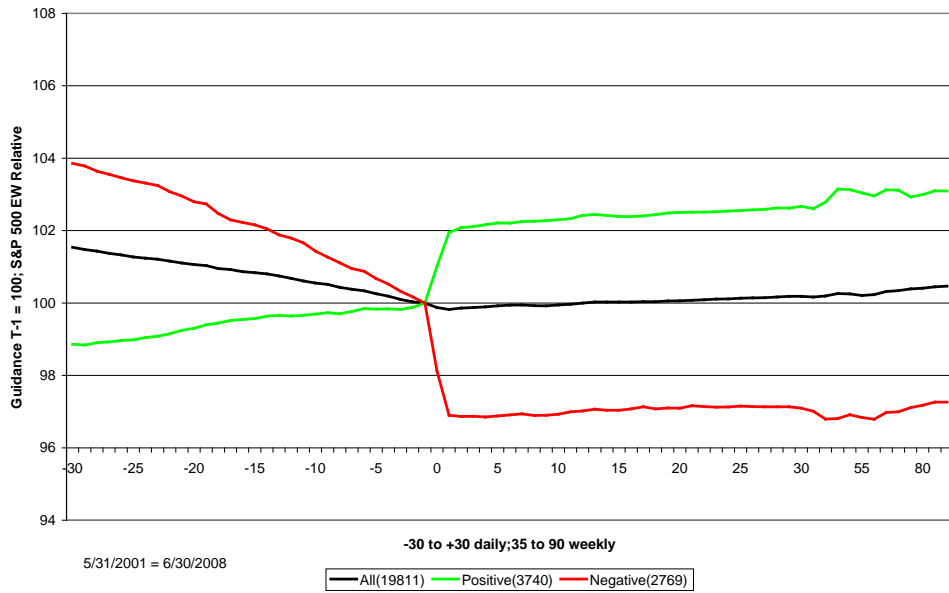
Characteristic Summary

- “Guiders”
 - Less volatile EPS and Price
 - Tighter consensus forecasts
 - Bigger size
 - Lower Beta
 - Cheaper
- Watch for divergences:
 - Number of guiders/non-guiders
 - Valuation

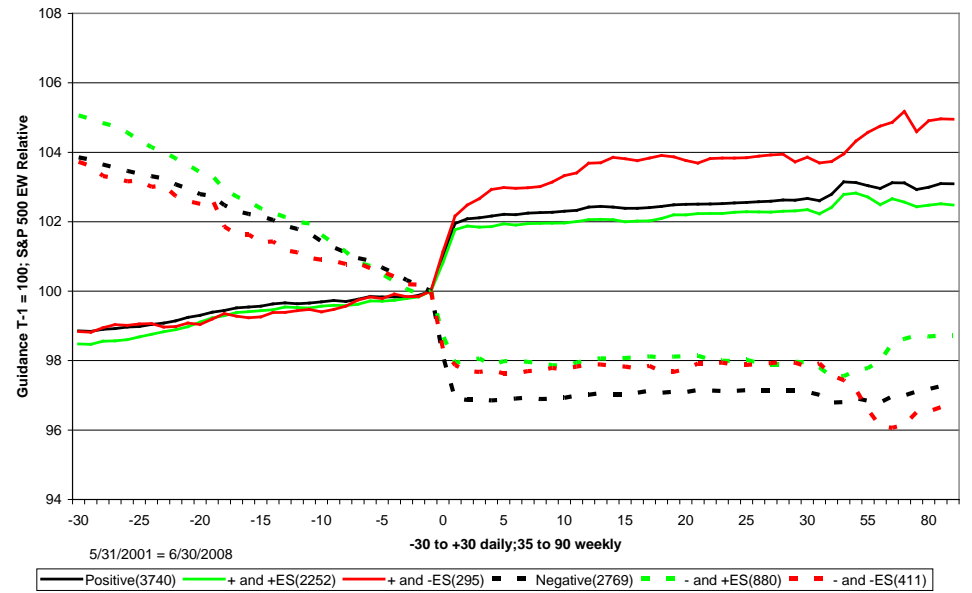
Univariate Return Findings

- Fairly short-term effect
- Prices lined up announcement date -1 day; indexed to 100 and computed relative to an equally-weighted S&P 500
- -30 to +30 days is daily; 35-90 is weekly (trade days)
- Show average values for various groups
- Usually red represents a category with negative prior beliefs; green positive
- Usually solid lines are positive guiders; dashed lines are negative
- 5/31/01 – 6/30/08 daily

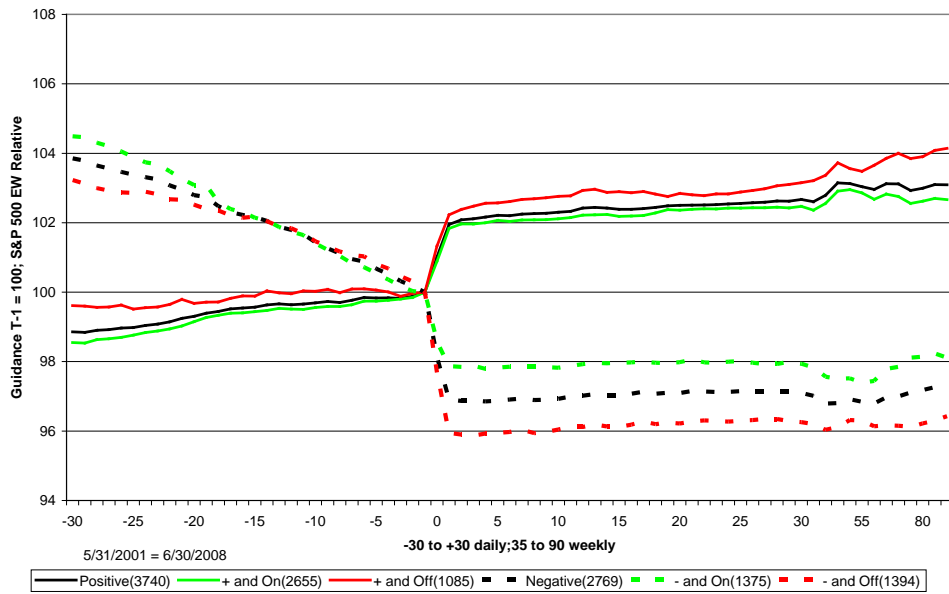
Positive Versus Negative Guidance



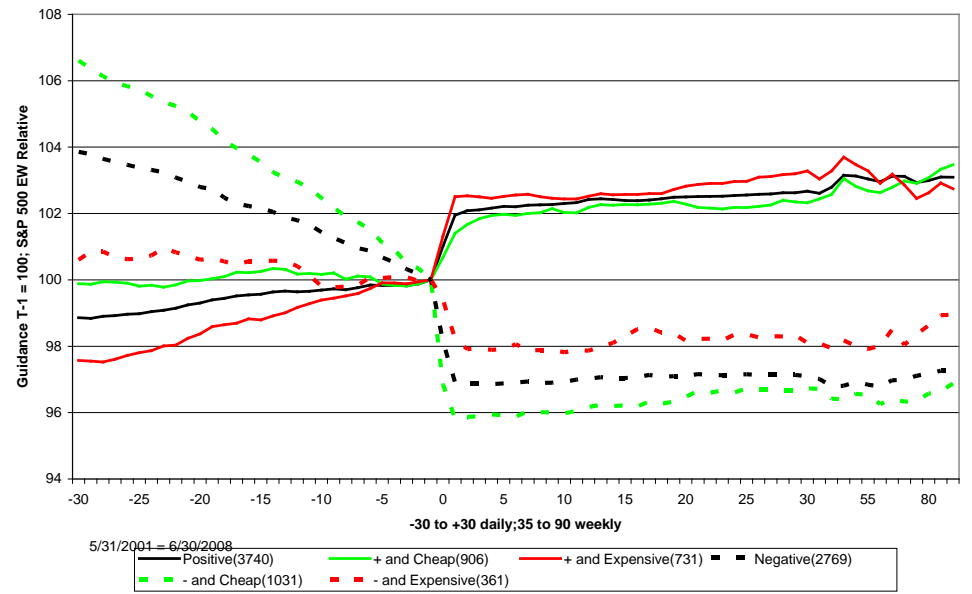
Guidance and Earnings Surprise



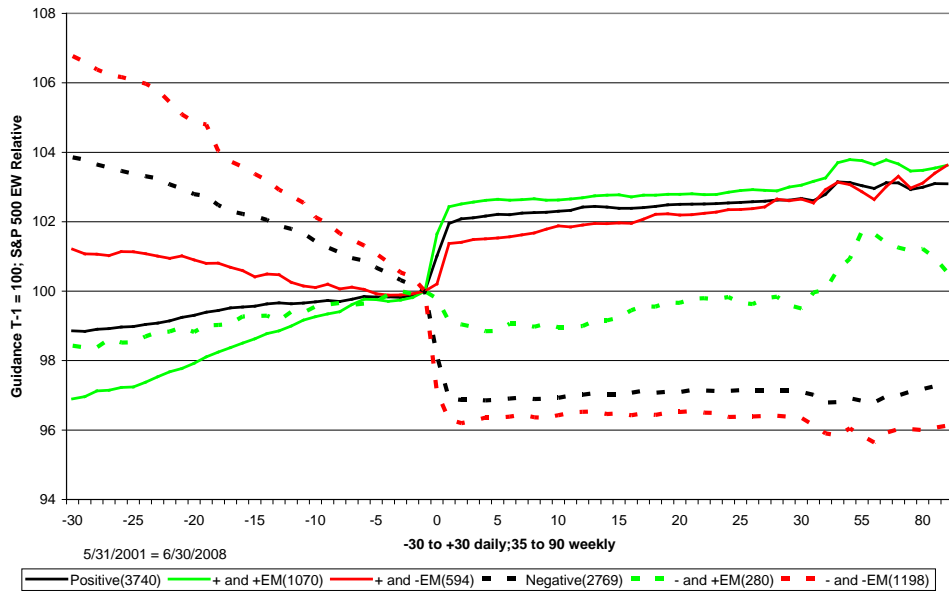
Guidance and Earnings Cycle



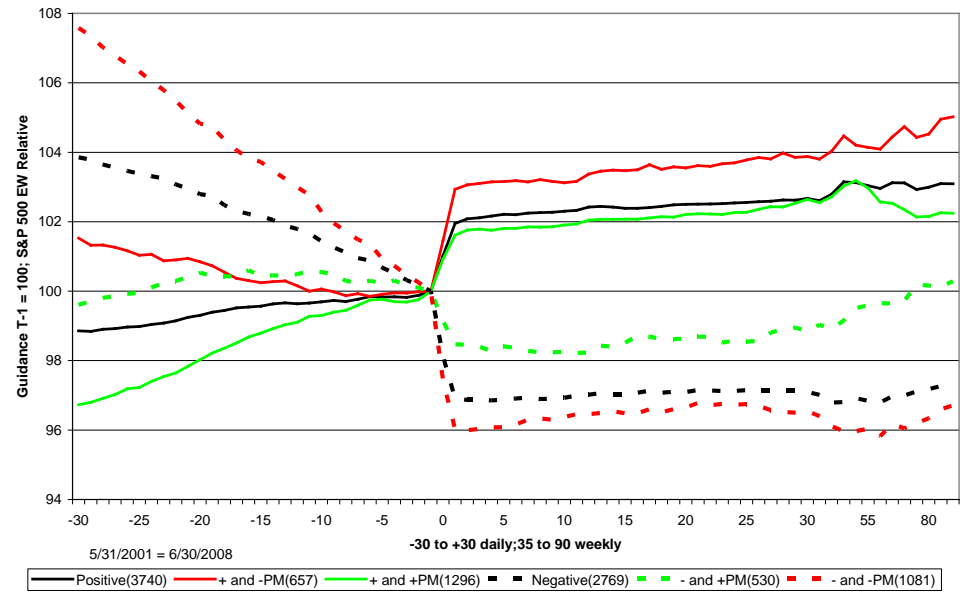
Guidance and Valuation



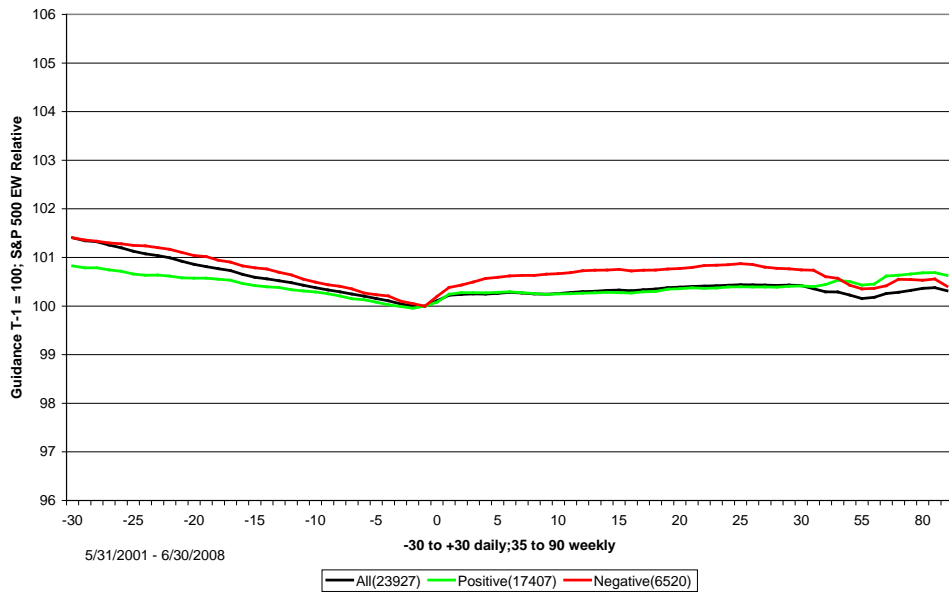
Guidance and Estimate Revision



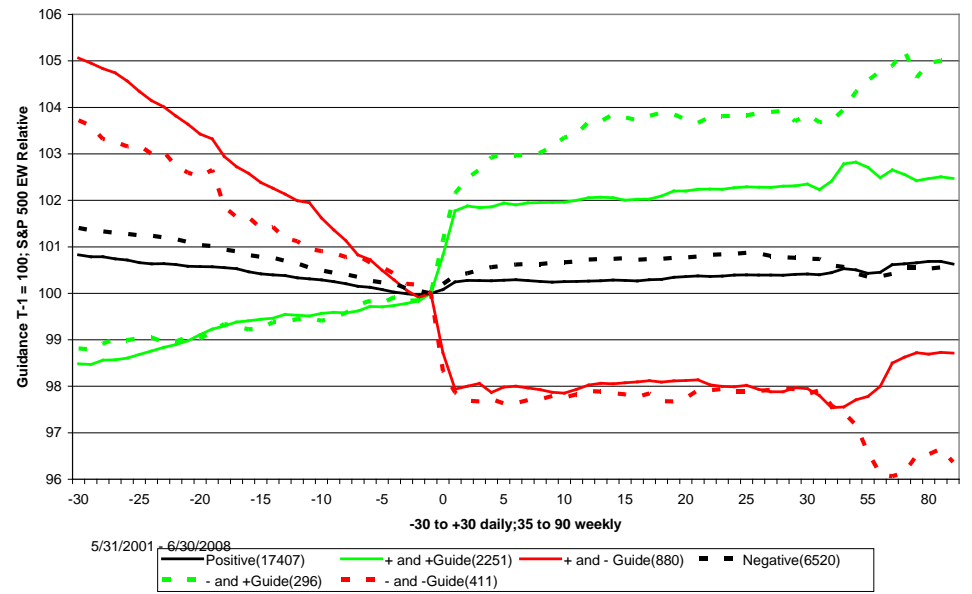
Guidance and 9 Month Relative Strength



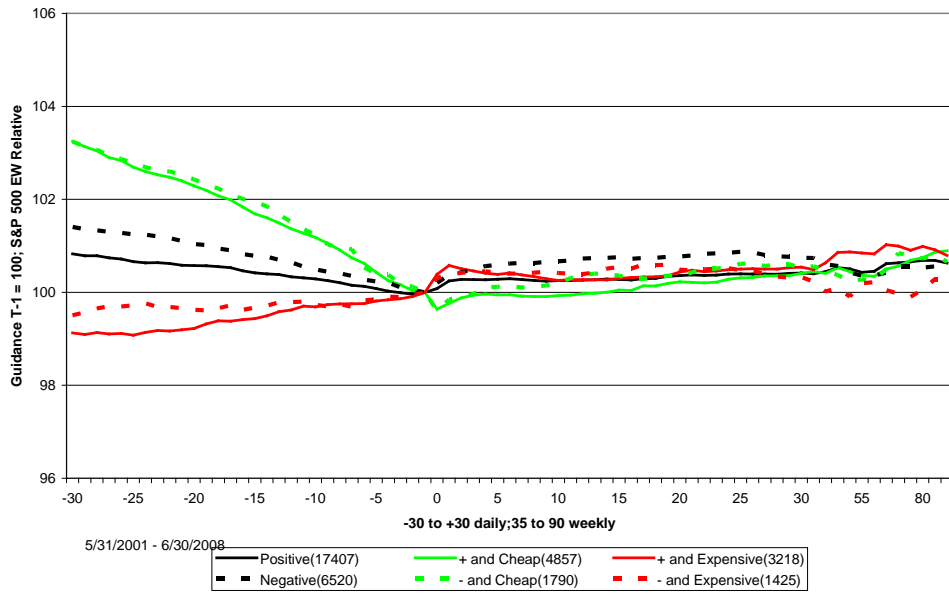
Positive Versus Negative Earnings Surprise



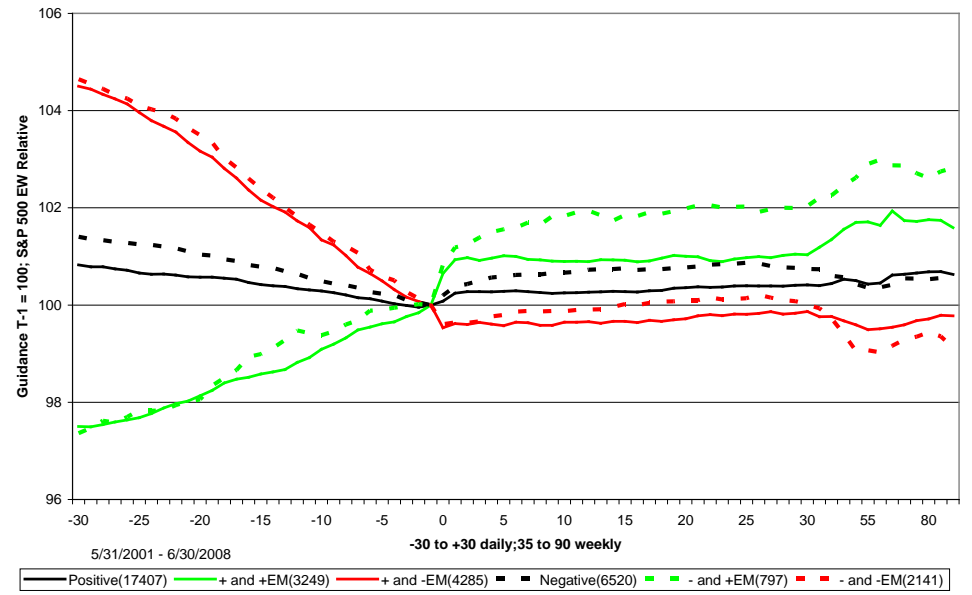
Earnings Surprise and Guidance



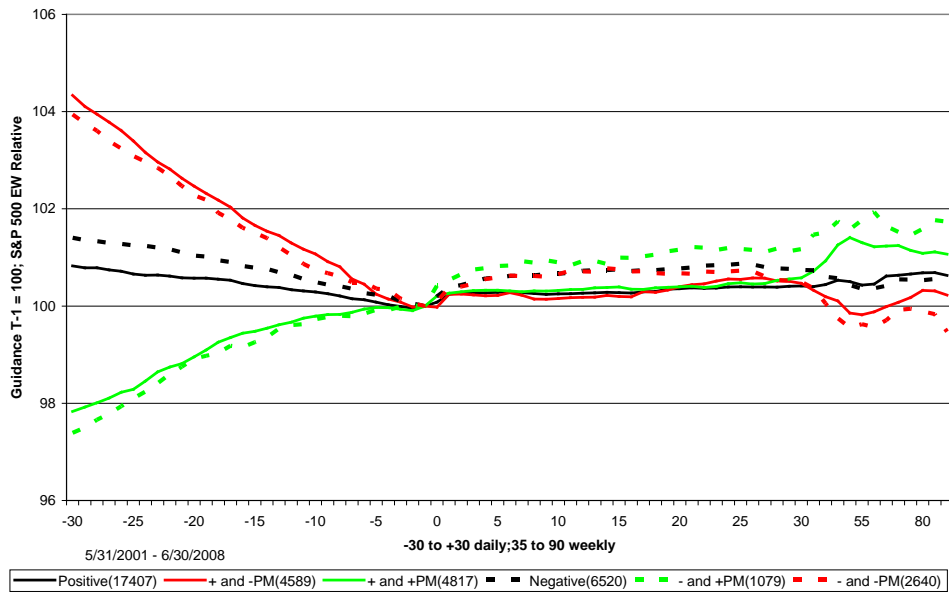
Earnings Surprise and Valuation



Earnings Surprise and Estimate Revision



Earnings Surprise and 9 Month Relative Strength



Guidance Short-Term Return-Related Conclusions

- General:
 - More powerful than Earnings Surprise
 - Off-cycle more important
 - Anticipated by the market in prices
 - Dampened by contradictory Estimate Revision
- Positive
 - Has follow-on performance
 - Bigger + impact on negative Price Momentum stocks
- Negative:
 - More impact than positive
 - No follow-on performance
 - Hurts cheap stocks more (Value traps?)

“Longer Term” Research

- Russell 1000 companies
- More classical month-end observations versus subsequent 1 and 3 month returns relative to the R1000
- 5/31/01 – 12/31/08
- Guidance changed (+ or -) for either FQ1 or FY1 during the prior month
- Interactions with:
 - Estimate revision: head counting
 - Relative Strength: 9 month
 - Valuation: forward earnings yield
 - QMODEL: my multi-factor sector neutral quant model

Guidance “Longer-Term Return-Related” Results

- Positive vs. Negative:
 - +41 bp over subsequent 1 month; +71 bp over subsequent 3 months
 - With confirming Earnings Surprise: +61 bp and +127 bp
 - +551 bp during the month (coincident return)
 - With confirming Earnings Surprise: +789 bp (coincident return)
- Little information in guidance vs. Street (Street < company modestly outperform)
- Expensive stocks with + guidance outperform expensive stocks : +56 bp for 1 month; +115 over 3 months
- Negative earnings revision stocks with positive guidance outperform all negative revision names: +75 bp and +104 bp
- Negative 9 month relative strength stocks with positive guidance outperform all negative RS names: +35 bp and +131 bp
- QMODEL Buys with + guidance outperform those with – guidance by +101 bp(1 month) and +150 bp(3 month)
- QMODEL Sells with + guidance outperform all QMODEL Sells by +31 bp(1 month) and +78 bp(3 month)

Future Research

- Aggregate guidance data and market, sector and factor timing
- Guidance Surprise vs. Earnings Surprise
- Other guidance: sales, cash flow, etc.
- Different cap ranges; growth/value; by sector
- Quarterly vs. Annual
- Accuracy
- Off-cycle guidance and the subsequent EPS report
- The death of earnings surprise
- Linear vs. 0/1 effects
- Guidance and subsequent estimate revisions
- Guidance range and risk

Summary

- Validate most academic findings
- Guidance can help with stock picking:
 - On it's own and in conjunction with other factors
- More research to be done

Appendix: Academic Review

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Appendix: Academic Review(continued)

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Appendix: Academic Review(continued)

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