# Analysts As Coincident Indicators

People in the financial services industry might think of themselves as Masters of the Universe, but the universe seldom returns the sentiment. Entire segments, such as credit rating services and sell-side research analysts too often find themselves in that Rodney Dangerfield "No Respect" situation.

My rejoinder here is on the lines of, "So what?" It is like Congress as a whole getting a single-digit approval rating: As long as 90%+ get reelected, they could care less, and as long as credit raters and analysts find their opinions in demand they will continue to make a good living.

**Tough Job**

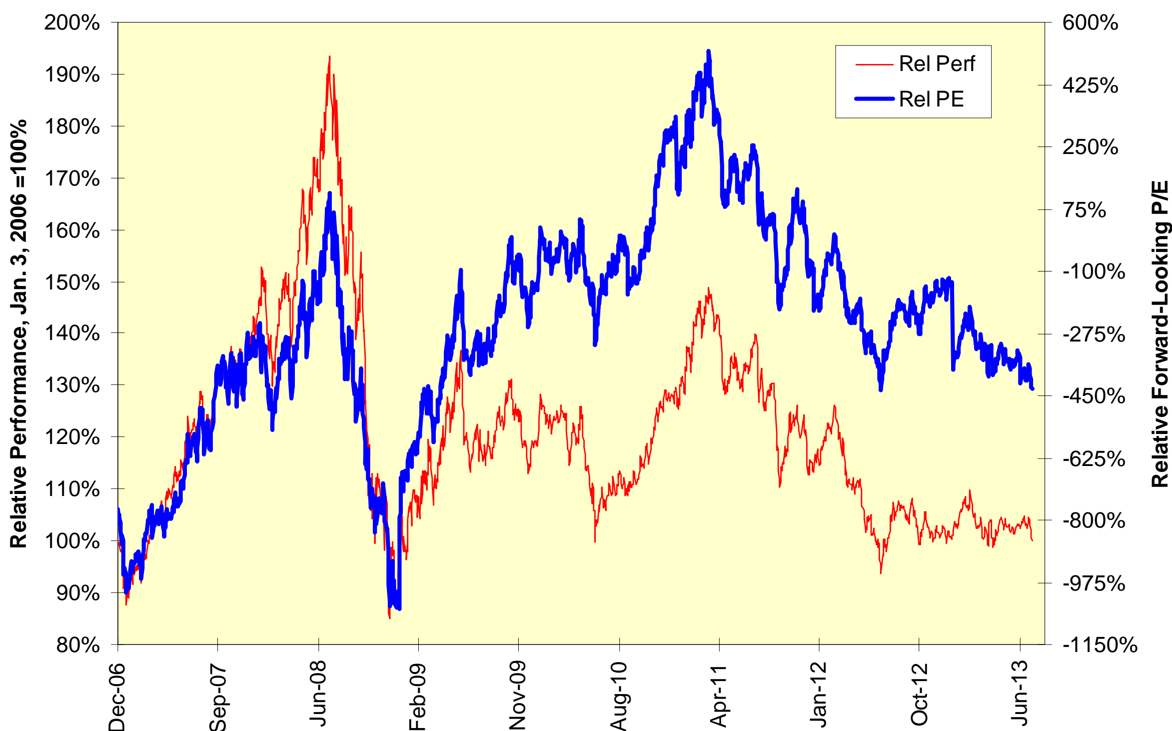
The job of an analyst always has been a difficult one. I used to pose the question to students whether they could predict a stock's price if I gave them perfect knowledge beforehand of the firm's earnings and of interest rates. Their initial impulse was always, "Yes," until we started peeling back layers of the onion and decided too many other variables, such as the market itself, competing assets and the multiples investors were willing to assign would be known.

It really does make you wonder why so many approach investing by first trying to take a top-down look at economic growth and then of sector health and finally of earnings; over the past four years the macro variables have been tepid and both revenue and earnings growth have been lackluster while the market itself has shot to a series of post-crisis highs. Restated, this approach produces some great negative indicators.

**The Oil Service Case**

Let's take the Oil Service Sector (OSX) index as a case study of analyst value-added. This index includes Schlumberger (SLB), Halliburton (HAL), Baker Hughes (BHI) and Transocean (RIG) amongst other heavyweight firms. Like all firms whose business tends to be "lumpy" in the sense it is affected by a few large contracts, their forward-looking price/earnings ratios tend to be volatile. Analysts have to be on top of each firm's pipeline, no pun intended, and they also have to stay on top of a commodity-driven sector.

How have they done over the past six and one-half years? Either very well or miserably, depending on your standard of judgment. If we map the relative performance of the OSX against the S&P 1500 Supercomposite against the relative forward-looking P/E of the OSX against the S&P 1500, we find neither measure leads the other. Restated, if you know the OSX' relative performance, something you can pull off a quote screen, you know how the analysts' opinions have been changing and vice-versa. While this may sound like a lame performance, it also can mean the analysts' judgments are being reflected near-instantaneously in prices in a paean to the much-maligned efficient market hypothesis.




The entirety of the sample above has been extracted in the post-Regulation FD (fair disclosure) world established in the aftermath of the dotcom implosion when Sarbanes-Oxley and not Dodd-Frank was the law to make the world safe for investors once again. Reg FD was designed to impede favored analysts from getting ahead of their peers; it instead has succeeded in making them coincident indicators.

Is this a national tragedy? Not really; if we go back to that efficient market hypothesis, your long-term investing goals are served far better by wide diversification and proper asset allocation than by issue selection. This is not as much fun as stock-picking or active trading and maybe not even as entertaining as darting in and out of the Market Vectors Oil Service ETF (OIH) in the present case. But if the oil services case noted here is indicative, the gains from trying to beat the market's prices are going to be few and far between. Just as the late Rodney Dangerfield was considered a comedian's comedian and had the respect he could want, maybe it is time we give the analysts a little love for making the market so efficient.