Ahead of expectations

How trading updates drive share price momentum

Stockopedia

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About Stockopedia

Stockopedia.com is a UK-based stock market research company, delivering an online platform that analyses more than 30,000 global stocks for 15,000 private investors. Decades of academic research have proven that selecting stocks with certain quantifiable characteristics, or ‘factors’, is a reliable path to market-beating returns. Stockopedia harnesses this knowledge to compute a set of indicators called the StockRanks, that assess the Quality, Value and Momentum of every stock daily. With more than a decade of market-beating results, these rankings provide a solid foundation for any investor to improve their stock selection and results in the stock market.

Introduction

Every January, a flood of company trading statements hit the Regulatory News Service (RNS) newswire. There are often 25-30 every morning, each providing an early read on each company's sales and profits for their financial year. It feels like a tsunami of information and can be overwhelming to read every one. Most serious investors barely get through a fraction of them.

We see the same phenomenon in July, when companies which report their financial year-end in June provide the market with their updates. And, littered throughout the year there are announcements from companies letting their shareholders know that things are going well, or are forced (by market rules) to inform them that things have gone wrong.

Trading statements are a real cultural artefact of the London reporting environment. In the US, companies report their financials quarterly, rather than every six months as in the UK, so the gaps between announcements are much shorter. UK companies routinely fill this gap with **'Trading Statements'.**

And while these statements are often light on financial information (especially compared to full financial results, or annual reports), they tend to kick off a cycle where analysts revise their earnings expectations upwards or downwards. Buy or sell intent from the investment community then feeds into the market, driving share price trends. As a private investor, getting ahead of these cycles is key, which is why trading statements matter.

New insights from our own research

While academic research from the US is valuable, the UK environment is different. So we kicked off a research project into the value of UK trading statements.

It builds on the research we published a few years ago, which aimed to help investors make sensible decisions in the wake of a profit warning. You can read that full study here, but the main takeaways were that prices can drift downwards for some time after the initial profit warning, and bad news often comes in multiples.

But what about trading updates which provide pleasant surprises?

In this study, our goal is to understand the anatomy of **'Ahead of Expectation'** announcements. How should investors act when companies experience significant single-day price jumps, and can we expect the good news (just like the bad news) to repeat itself?

As part of this project, we've analysed 2,699 trading statements published over the last two years in the official RNS trading statement classification. By identifying exact matches to phrases like *'materially ahead of expectations'*, *'ahead of expectations'*, and *'below expectations'*, we've studied how share prices react on the day of the announcement and in the months that follow.

This project is a work in progress, so we will keep building on it in the coming weeks and months, but we hope these initial findings provide you with some ideas. Especially during the hectic financial reporting season.

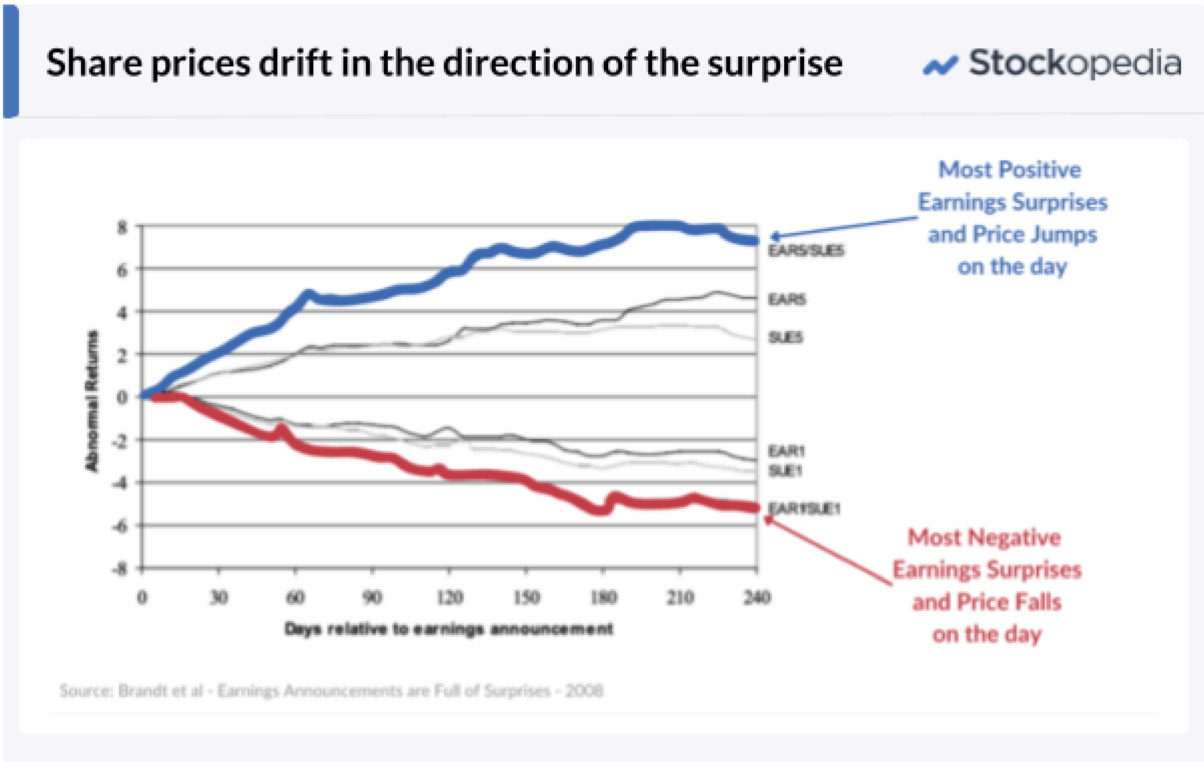
The Catalyst: 'Ahead of Expectations'

Investors that read all the trading updates and results announcements from the RNS are always on the lookout for catalytic moments - and three simple words can mark them: **‘ahead of expectations’.**

For a start, these types of updates tend to enjoy significant share price gains on the day of the announcement. This phenomenon is what we call ‘The Jump’.

But while many investors might be put off by the jump, feeling like an opportunity has been missed, sulking off to find something else that hasn’t risen may be a mistake.

This is because of a second phenomenon that we are calling ‘The Drift’. We have found that share prices tend to continue their upward momentum in the weeks and months after an ‘ahead of expectation’ statement.



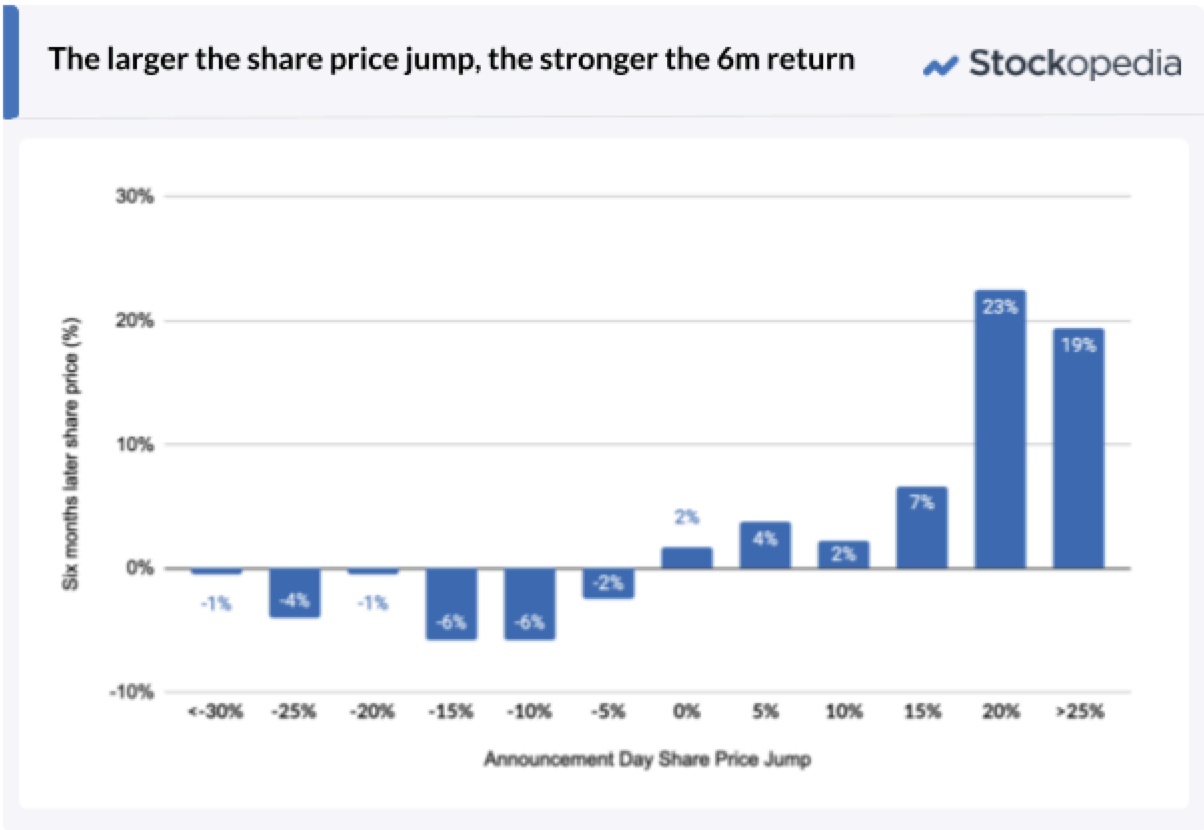
The Jump: What to do when share prices react to trading statements

In these early stages of the study, we have only been able to match 55% of trading statements with exact phrases of significance (such as '*materially ahead of expectations*', '*ahead of expectations*', and '*below expectations*'). But so far the results are compelling.

Here are some key insights:

1. Larger first-day jumps = Stronger ensuing share price returns

- A 5% jump on the day is a leading indicator of share price returns over the next 6 months, but a 15%+ jump even more so.
- Large jumps may indicate that current expectations are wrong. This is regardless of whether the actual company announcement is "inline", "ahead" or "below" official expectations.



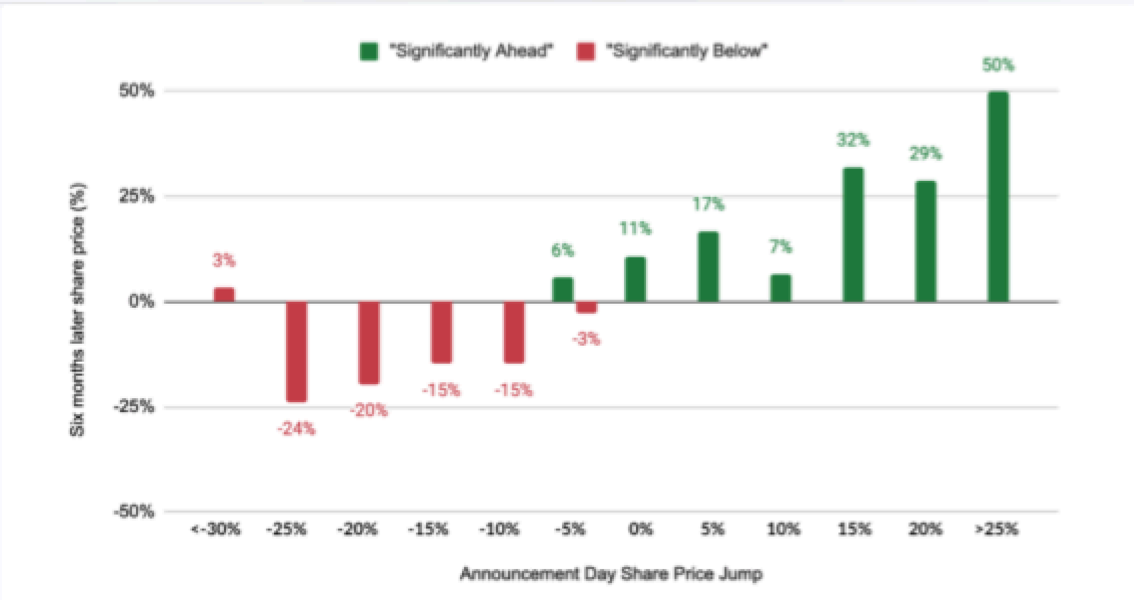
2. Post-announcement share price drift is real

- For stocks with a 15% or more jump on the day, the average return over the next six months (excluding the first day jump) is an additional 14%. This is what academics call the Post-Earnings Announcement Drift (PEAD).
- We found that companies that reported an announcement in one direction (ahead or below) were significantly likely to report another announcement in the same direction following it.

3. "Significant" phrases matter

- Companies reporting "significantly ahead of expectations" on average jump the most on the day, and experience the strongest continued share price drift in the same direction.
- Companies reporting "significantly below expectations" act similarly in the opposite direction.

'Significantly' ahead/below phrases are leading indicators



NB. It's important to note that are small sample sizes in the above chart, as "significant" announcements can be at the extremes. For example, The "significantly ahead > 25%" cohort has only three stocks in it.

The Drift: share prices continue in the same direction

While a day one 'jump' on an earnings surprise is relatively well understood, what is less apparent is why a day one jump is normally followed by a share price trending in the same direction for months, or even years, afterwards.

One explanation is the fact that surprises to the upside have been shown to be serially correlated. This means that one 'ahead of expectations' announcement may be likely to follow another within the next few months. So share prices often jump on the announcement, drift upwards, then consolidate, then do the same thing all over gain. This may start to carve out what Nicholas Darvas, the famous ballet-dancing stock market millionaire, called a "box pattern".

Greencore as a classic example

Supermarket own brand convenience foods group Greencore first announced that its full year operating profits would be "ahead of current market expectations" in October 2023,

That day the share price jumped 22% from 69p to 84p, but over the next few months the shares would drift up and up towards 110p.

Greencore - 14 months later

The company followed up with a couple of positively framed "in-line" trading statements in November of the same year and January 2024, but the outlook grew more bullish through 2024.

A series of three "ahead of expectations" announcements between July and December 2024 powered the shares higher all the way to 211p.

Two key trends: Low expectations and multiple updates

Lower growth companies in sectors which aren't seen as especially exciting are often overlooked by private investors and fund managers chasing biotech and AI stories. But this is exactly the kind of company that the great investors, such as Peter Lynch, would get excited about.

> *"A company that does boring things is almost as good as a company that has a boring name, and both together is terrific."* Peter Lynch.

Contrary to popular belief, it's often inexpensive value stocks rather than premium growth stocks that respond the best to ahead of expectations announcements.

Value stocks typically suffer from low expectations due to suppressed share prices and limited broker coverage. When good news finally comes, market expectations often fail to adjust quickly enough. If you are an "ahead of expectations" seeker, it pays to be a value investor.

The second interesting phenomenon in 'ahead of expectation' research is the fact that these announcements often come in multiples. That is because 'ahead of expectation' updates can be pointers of pending operating leverage - where sales and margins are expanding simultaneously. When this happens, the P/E multiple can expand too.

Small changes across all three factors can generate a "triple whammy" effect on the share price. This is a trend we covered in our *'Makings of a Multibagger'* study which you can read here.

Games Workshop shows the power of serial earnings 'beats'

Games Workshop began its revaluation from a value stock to a growth stock with the words "ahead of expectations". The share price has grown 27x since those three words were first announced.

Using these signals

The real magic of trading statements is in their ability to reveal expectation errors - shares that are just priced wrong. These share price jumps seem to be the best indicators. While these results are just preliminary and only based on two years of data, they do show that share price jumps may be more than just noise. They are actionable.

Some ways you can incorporate these into your own research and investing process include:

1. Pay attention to share price jumps

Watch the market for companies that announce trading statements, and dig into the ones that show significant share price reactions, especially with clearly phrased statements like 'materially ahead' - it may be a leading indicator.

2. Let the share price drift

If you own a stock that announces it's "ahead", and whose share price jumps - don't sell. Stay invested for the next six months at least. When buying on a positive announcement, again, don't trade short term, let the post-earnings share price drift do its thing.

3. Sell on profit warnings

I'm sure by now you don't need me to remind you about this. But these results reinforce our previous research into below expectations announcements. These are profit warnings. "Sell immediately on a profit warning" still stands, unless of course the share price jumps!

Next steps

Going forwards, I'm keen to push this analysis back 10 years, drive the phrase matching percentage up, and also incorporate the StockRanks as an overlay.

Several recent research papers suggest that the returns to quality, value and momentum may be driven entirely by expectation errors. If we validate that, then the StockRanks are ultimately good predictors of companies that will beat expectations.

But beating expectations is generally only seen in news announcements… so if you want to be first in the queue, reading trading statements matters!

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We would like to draw your attention to the following important investment warnings:

- The value of shares and investments and the income derived from them can go down as well as up.
- Investors may not get back the amount they invested.
- Past performance is not a guide to future performance.

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