

AHEAD OF THE MARKET

The Zack's Method for Spotting Stocks Early – In Any Economy

MITCH ZACKS

MITCH ZACKS is a portfolio manager at Zacks Investment Management. He also writes a weekly finance column which is published in the *Chicago Sun-Times*. Mr. Zacks is a graduate of Yale University (a degree in economics) and the University of Chicago (an MBA in analytic finance). Prior to joining Zacks Investment Management, Mitch Zacks worked as an investment-banking analyst with Lazard Freres in New York.

The Web sites for this book are at www.zacksadvisor.com and www.zacks.com.

SUMMARIES.COM is a concentrated business information service. Every week, subscribers are e-mailed a concise summary of a different business book. Each summary is about 8 pages long and contains the stripped-down essential ideas from the entire book in a time-saving format. By investing less than one hour per week in these summaries, subscribers gain a working knowledge of the top business titles. Subscriptions are available on a monthly or yearly basis. Further information is available at www.summaries.com.

MAIN IDEA

Every year, Wall Street brokerage firms employ more than 3,000 analysts who are paid in excess of \$1 billion to write research reports on various stocks which their companies follow, and to make recommendations as to which stocks to buy and which stocks to sell. Despite that substantial investment, however, many investors dismiss these analysts's reports as little more than reworked press releases on behalf of the companies involved. This may be an oversimplification which is costing individual investors dearly.

So what's a better way to use these research reports as part of an investment strategy? Rather than simply following the buy/sell/hold recommendations made by each analyst, a better approach is to take a big picture perspective and combine the research generated by a large number of analysts. By tracking how this pool of analysts as a whole change their earnings forecasts and recommendations over time, you have a much better rationale for making intelligent investment decisions. In other words, by combining the work of a large number of analysts rather than picking out one or two gurus to follow, you have a much better chance of getting your timing right and making sound decisions ahead of the market.

In practical terms, this idea translates into four investment strategies:

- | | | |
|---|---|---------------------------------------|
| Four
Analyst
Investment
Strategies | 1 | Watch for earnings estimate revisions |
| | 2 | Buy and sell on earnings surprises |
| | 3 | Use a composite strategy |
| | 4 | Use recommendation changes |

"On a daily basis, Zacks Investment Research processes and analyzes thousands of research reports written by over 3,000 equity analysts employed at over 250 brokerage firms across the United States and Canada. For the past twenty years, we have been going through the research produced by Wall Street firms with a fine-tooth comb. We were the first firm in the country to start tracking the buy/sell/hold recommendations made by analysts. We were the first firm to rank analysts based on their accuracy in predicting earnings and making stock recommendations.

Through twenty years of intensive research, we have determined that the most important driver of stock prices is revisions to analysts' earnings estimates. Ultimately, we have found a single analyst's recommendation and earnings estimates, in and of themselves, are useless. What is important is the following:

- *What all the analysts say about a given stock.*
- *How these views change over time.*

When you combine the two you have what has proven to be one of the best ways of finding stocks that will outperform the market. Some of the results of our analysis are counterintuitive, some are even controversial. In fact, you may be surprised to find that our analysis indicates that the recommendations issued by many brokerage firms are not worth the paper they are printed on. However, the underlying message of all our research points towards one simple conclusion: You should buy stocks that receive upward earnings estimate revisions and avoid stocks that receive downward earnings estimate revisions."

– Mitch Zacks

Investment Strategy #1 – Watch for earnings estimate revisions Pages 2 - 3

This strategy involves buying whichever stocks receive increasing earnings estimate revisions from analysts and selling those stocks which have their earnings estimates revised downwards. Note this strategy works on tracking the estimates of many analysts, not just one or two.

Investment Strategy #2 – Buy and sell on earnings surprises Pages 3 - 5

This strategy is to buy stock in those companies which report sales or earnings better than anticipated and to avoid or sell stock in companies which report earnings or sales smaller than projected.

Investment Strategy #3 – Use a composite strategy Pages 6 - 7

Both strategy #1 and strategy #2 have some advantages. A smart idea is to use both in tandem, by tracking what analysts are saying about the various companies they follow. If you prefer, you can do this manually for the individual stocks of your choice. Alternatively, you can use a subscription service like that offered by Zacks which combines the analysts reports for more than 4,300 stocks into a ranking system for possible action.

Investment Strategy #4 – Use recommendation changes Pages 7 - 8

If you simply buy the stocks that analysts rate as a "Strong Buy", you will most probably do well in a bull market but not so well in a bear market. Instead, a better approach is to select stocks on the strength of changes in analysts' recommendations over time. Focusing on changes to the consensus recommendation score to generate buy and sell signals is the emphasis of this strategy.

Summaries.Com

The Ultimate Business Library



We condense **300+ page** business books into **8-page** summaries.

By reading summaries, you'll get the **key ideas** in **30 mins**, so you can spend more time turning your ideas into **dollars**.

Knowledge is Power — Invest in Your Future

For just **\$2 per week**, you will...

- Learn from the mistakes and success of the smartest people in business;
- Get fresh ideas, strategies & motivation that could be worth millions to you;
- Follow emerging trends, so you can catch the wave before your competitors do;
- Catch up on the classics you always wanted to read.

1,000 Top Business Book Summaries

Our catalog includes summaries on a range of topics for aspiring entrepreneurs, managers, and consultants.

BUSINESS PLANS

MANAGEMENT

PRESENTATIONS

SALES

LEADERSHIP

MOTIVATION

STRATEGY

AND MORE

