

## BROKERS AND BANKERS PUT TO THE TEST

# Forecasting honours shared by brokers

Philip Coggan sets out the final state of the players in our analysis conducted with MD Management

Lehman Brothers and Teather & Greenwood share the honours as the brokers that best forecast UK corporate results in 2004, according to an analysis conducted for FT Money and Business by John Mulligan of MD Management.

In January 2004, Mulligan asked 10 brokers and bankers to provide forecasts for a wide range of companies, focusing on their pre-tax profits and earnings per share. He has since calculated the average error.

Lehman was the most accurate in terms of earnings per share and third in terms of pre-tax profits. Teather & Greenwood was ranked second in both categories.

Numis was the most accurate in terms of forecasting pre-tax profits, but it slipped to eighth in terms of earnings per share thanks to one erroneous forecast for Xstrata, the mining group.

In general, pre-tax profits forecasts tended to be slightly more accurate than earnings per share estimates. The average error was some two percentage points lower. But the forecasts were still quite a long way out; in general, analysts were around 10 per cent wide of the mark.

Traditionally, analysts have tended to be too optimistic at the start of the

## How the brokers fared

Full year 2004

Broker	Pre-tax profits variance (%)	Ranking	Earnings per share variance (%)	Ranking
Numis	6.0	1	12.5	8
Deutsche Bank	9.9	8	17.2	10
UBS	9.2	7	12.3	7
Investec	9.1	6	9.7	4
HSBC	10.9	9	9.9	5
Merrill Lynch	9.0	5	9.2	3
Goldman Sachs	11.3	10	14.3	9
CSFB	8.8	4	10.6	6
Lehman	8.7	3	8.1	1
Teathers	7.2	2	8.2	2
<b>Unweighted average</b>	<b>9.0</b>		<b>11.2</b>	

Source: MD Management

year. Subsequent events force them to revise their forecasts downwards. That was not really the case in 2004, when many companies matched or beat profit expectations.

Another way of analysing the numbers is to see how investors' portfolios would have performed if they had acted on the basis of the forecasts. Mulligan has devised the Star stock-picking system based on profit predictions.

The system culls, from a group of stocks, the quartile (25 per cent) with the lowest prospective price/earnings ratios. From these, he selects the companies with the fastest earnings growth.

He applied the system to the forecasts of each broker, using their predictions as

the basis for 10 and 20 stock portfolios.

Oddly enough, there seemed little correlation between the accuracy of the forecasts and the success of the portfolios. Teather and Greenwood's portfolio was ranked last (Numis did not make enough forecasts to qualify).

Deutsche Bank, which ranked last in earnings per share predictions, had the best performing 20 stock portfolio.

However, with the exception of Teather and Greenwood, all the portfolios assembled using the system beat the FTSE All-share index over 2004, indicating that it often makes sense to pay attention to analysts' forecasts even when they are wrong.