KPP FINANCIAL

3-26-15

Wall Street Analysts Are Always Wrong

Wall Street analysts are always wrong, however; they play an important part in expected sales and earnings for companies. The average investor could not evaluate companies without the experts. Analysts tend to dig deep into industry and company trends to identify the likely sales and earnings for the upcoming year or years. Analysts do a pretty decent job of landing in the ballpark. However, there are areas in which the experts consistently miss the mark.

Not only do analysts project earnings, but they also make recommendations and place a price target on a stock; be very skeptical. First, recommendations are usually biased to the buy-side as negative ratings can hurt the investment banking relationship the company may have with the parent. Not only that, but most recommendations follow the herd as vastly varying opinions are rare on Wall Street. Second, the price targets are extremely subjective, and other factors such as overall market performance can have a big impact as to whether that stock reaches its supposed value.

The most troubling part of the analyst culture however, is the upgrades and downgrades. Analysts frequently change their recommendation and price targets, but it is always very curious about the timing of these changes. Often when a stock price has run up dramatically, in a short period of time, analysts start raising guidance on that investment. The only thing that has likely changed is the price so, why would an analyst change his recommendations based only on the price movement? If you own that stock that is the time you need to begin thinking about taking profits. The same can be said when analysts downgrade a stock after a large price decline. That may be the time you should buy the deep value play as long as the company still has sound prospects. The price of a stock is not a reason to upgrade or downgrade. The cause of its move could be, but too often analysts change their calls just because the stock price moved.

This phenomenon happens over and over. In late 2007, Google's stock price had been on a rocket ship over $700 a share. Analysts were tripping over themselves to raise their price targets to well over $1000 a share. It soon began its multi-month decline and bottomed out around $250 a share. In early 2008, as oil approached $150 a barrel Goldman Sachs and many other big firms put out a price target of $200+ a barrel within a year. Soon after that oil turned around and sank below $40 a barrel at its bottom in 2009.

The take away is analysts are notoriously wrong about the timing of their recommendations, and you should always take them with a grain of salt. The time to buy a stock is usually not tipped off by a Wall Street analyst. Rely on your own analysis of the charts and fundamentals and only use Wall Street analysts as a guide to future earnings. Anything beyond that and their value becomes suspect, except maybe as a contrary indicator. Always keep in mind who pays them and what is their bias.