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Michael Brush

Opinion: Here's a roadmap for stocks to own and avoid this earnings season

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By [Michael Brush](#) [Follow](#)

Five lessons about earnings and earnings surprises from an outperforming stock-portfolio manager



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With corporate earnings season just around the corner, Todd Gervasini, a portfolio manager at Wakefield Asset Management, is giving a lot of thought to potential stock-market winners and losers.

Information technology and energy stocks should beat estimates and outperform, he says — especially Meta Platforms **META**, **+1.54%**, Applied Materials **AMAT**, **+1.89%**, Cadence Design Systems **CDNS**, **+2.78%**, Fortinet **FTNT**, **+1.13%** and Marathon Petroleum **MPC**, **-3.65%**.

But be careful with consumer staples, industrials and communications services stocks like telecom and cable company names, he adds.

Why should you listen to Gervasini? For starters, the firm he founded has a great investment track record. Since inception in April 1997 through June 2023, the Wakefield Large-Cap Equity Portfolio gained 11.6% annualized vs. 8.8% for the S&P 500 [SPX](#).

Gervasini also is an expert in earnings and earnings-surprise trends.

Here's a look at five lessons we can learn about investing from how Gervasini gets his edge, and stocks that look attractive to him now.

1. Exploit the psychology of sell-side analyst crowd behavior to find big, unexpected earnings growth:

Job security is fundamental. On Wall Street, this translates into a basic rule of thumb for sell-side analysts: It's better to be wrong with the pack than on your own as an outlier. After all, if you're wrong with the group, you can always say "Well, everyone else got it wrong, so don't fire me!"

This dynamic leads to a way to predict "unexpected" earnings growth not priced into a stock. For instance, if an analyst expects a company's earnings will grow to \$2 per share next year from \$1, but the average forecast is \$1.50, he's more likely to publicly increase his estimate to \$1.50 or \$1.60. This conservative stance tells you more upward estimates are on the way. Then, as the company's growth story is confirmed, the analyst will move earnings estimates higher. In short, you want to own companies getting decent upward estimate revisions, because it's likely that more are coming.

Developed in the early 1990s, this stock-selection system is called "earnings estimate revisions analysis." In the vernacular, Wall Streeters call it the "cockroach theory" because when you have seen one upward estimate revision, there are probably more where that came from.

Revisions analysis is at the core of Gervasini's investing approach. "We are trying to take advantage of sell-side behavior," he says. "It is predictable behavior and you can get into stocks before future revisions happen."

the shares are up 138% so far this year, Gervasini still likes Meta because it continues to rank well in his estimate revisions model. A more recent purchase that ranks well is Marathon Petroleum, which he bought in August.

2. Find companies that will continue to surprise on earnings: Gervasini's model here tells him when earnings surprises are on the way. Key factors include the size of a recent surprise in the absolute sense, and relative to the average for both the company's sector and the market overall. The model also favors surprises that are reversals from prior disappointments. Companies with good estimate revisions may also likely surprise.

A prime example here is insurer Arch Capital Group **ACGL, +3.21%**. Gervasini and his team bought this stock in May because it had posted a series of earnings surprises, including a big 59% surprise last February. He still owns the stock because it has continued to surprise and rank well in his estimate revisions and surprise models. This suggests it may surprise again when it reports on October 24.

Caterpillar **CAT, -1.46%** is another example. The company missed slightly on fourth-quarter 2022 earnings and then surprised nicely in the following two quarters.

3. Take the emotion out of investing: The sell decision always seems to be much harder than the buy decision. Why is this? It's all about emotion. "If you have a company that has done unbelievably well, it is hard to sell. You fall in love with the company," Gervasini says. The same thing can happen in the opposite direction: Too many people hold on to losers because it is hard to admit they made a mistake.

Gervasini avoids these pitfalls in two ways: If a holding no longer ranks well in his estimate revisions, surprise and valuation models, he sells. He uses position size as a guide. He likes positions to be around 3.3% of the portfolio. When they grow to 4%, he trims. If positions fall to 2.1%, he adds.

"This forces us to sell what has done well and buy what is highly ranked but has not done well. It takes the emotion off the table," he says. One stock that looks buyable because it has fallen to around 2.1% of the portfolio (but still ranks well) is Hershey **HSY, +0.88%**.

4. Buy what is out of favor: To understand Gervasini's tactics here, you need to recall the difference between the market-cap and equal-weighted S&P 500. The equal-weight S&P 500 index owns all stocks in the index in equal size. In the market cap weighted index, bigger market-cap names have a proportionately larger representation.

This difference offers a way to stay out of extremely popular names that are probably overvalued because the crowd loves them, and favor names that investors do not like. The trick is to keep your portfolio sector neutral relative to the equal-weighted version of an index. This gives you a relatively a

ot favor groups.

Let's take an example. Because the "Magnificent Seven" tech names including Microsoft **MSFT, +1.78%**, Alphabet **GOOGL, +2.12%**, Nvidia **NVDA, +1.20%** and Meta have performed so well, computer and technology stocks recently accounted for 35% of the market-cap weighted S&P 500. If instead you owned the 15% they represent in the equal-weighted S&P 500, you have relatively low exposure to this group compared to the S&P 500 market-cap weighted index. Meta Platforms is the only stock Gervasini has in this group, because it still ranks well for earnings revisions and surprises and is still arguably cheap.

The same tactic gives you an overweight position in unliked groups, such as financials. Match the equal-weighted index by having 17% of your portfolio in financials, and you are overweight the group relative to their 10% representation in the cap-weighted S&P 500.

"This keeps us out of insane multiples and makes us buy boring stocks that I think will ultimately be rewarded," Gervasini says. "It forces us to look at the sectors that people ignore." In financials, this means owning Arch Capital Group, JPMorgan Chase **JPM, +0.45%** and insurance giant AFLAC **AFL, +0.85%**.

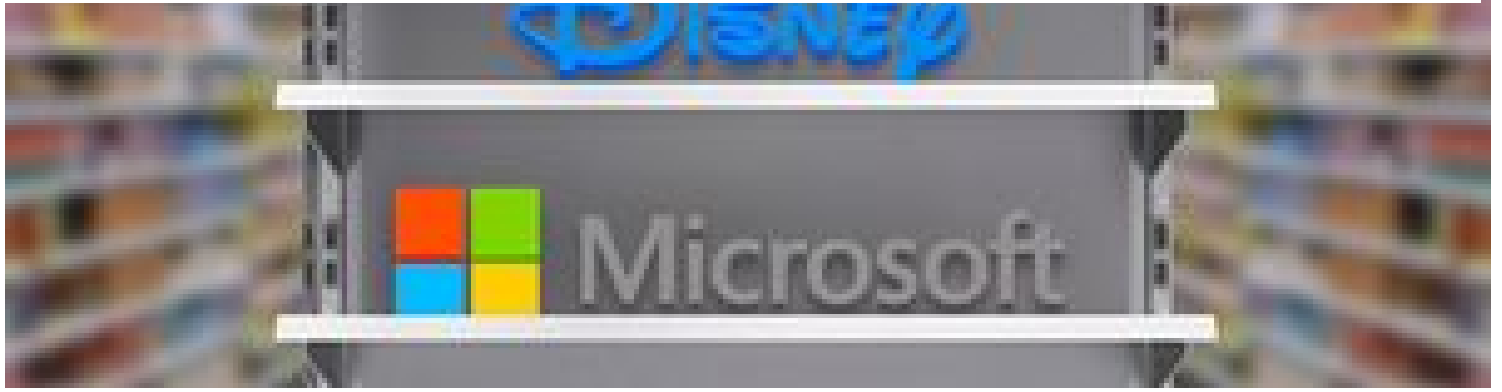
5. Mind the valuations: Another way to invest in out-of-favor names is to own stocks that look cheap relative to their groups. Caterpillar, for instance, trades at a p/e of 15.47 compared to its sector p/e of 48.8, Gervasini says. Meta Platforms trades at a p/e 19.6 vs. 45.8 for its group. Marathon Petroleum has a p/e of 6.0 vs. 18.4, and Arch Capital group trades at a p/e of 13.0 compared to 14.7 for its peers.

Gervasini also likes to keep things simple by using only the three tests described above: earnings estimate revisions; earnings surprise, and relative valuation. He says: "We are all-in on the concepts that we think are very robust. That's where the opportunity to outperform is."

More: [Why stocks are likely to be especially volatile this October](#)

Plus: ['Anxiety' high as stock market falls, bond yields rise — what investors need to know after S&P 500's worst month of 2023](#)





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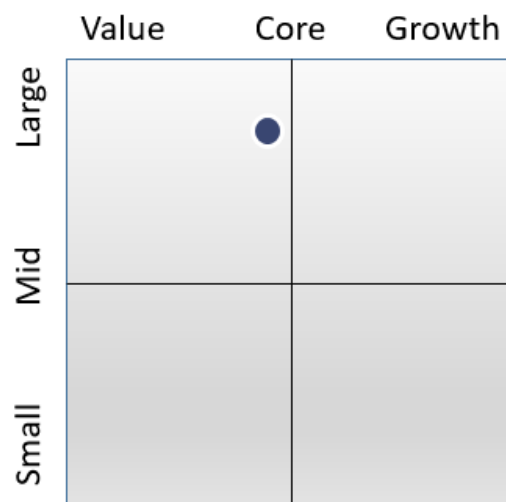
Michael Brush

Michael Brush is a columnist for MarketWatch. He is the publisher of the stock newsletter Brush Up on Stocks. Follow him on Twitter [@mbrushstocks](#).



Wakefield Large Cap Equity

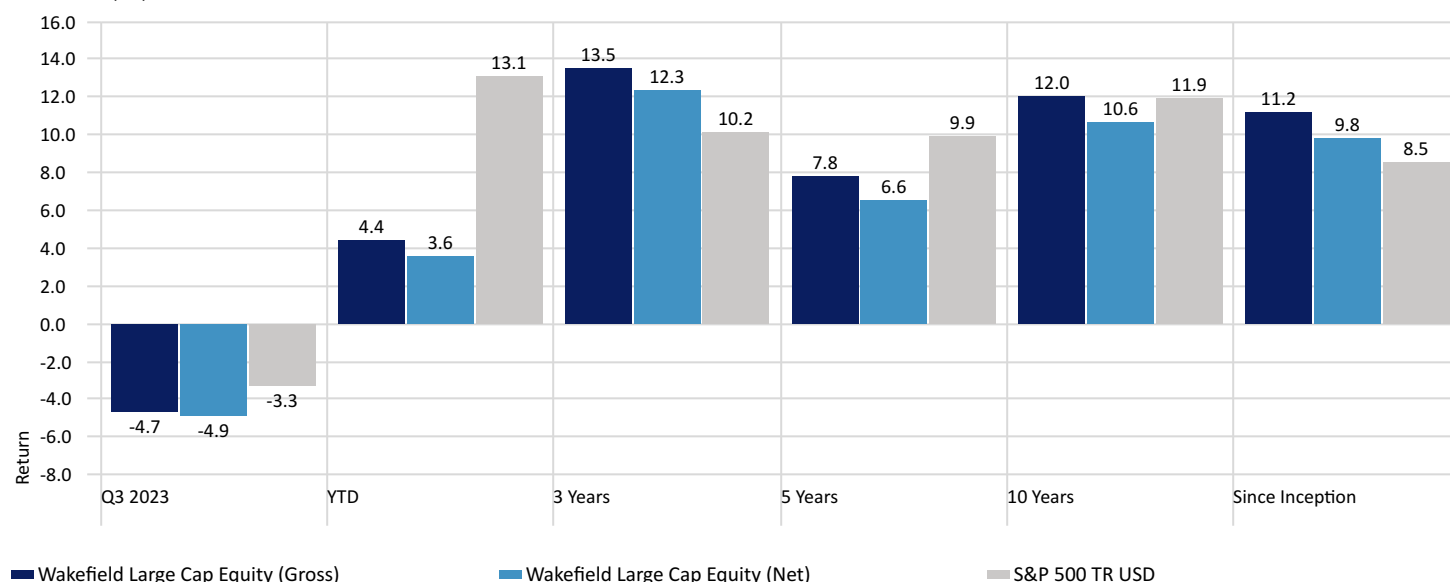
Year Firm Founded	2003
Firm Location	Englewood, Colorado
Global Category	US Equity Large Blend
Portfolio Inception Date	4/30/1997
Portfolio Manager	G. Todd Gervasini
Portfolio Benchmark	S&P 500 TR



While the overall market is efficient, pockets of inefficiency do exist. Wakefield Asset Management offers a unique investment strategy which we believe stands apart from the mainstream investment community. Focusing on proprietary investment techniques that not only identify market inefficiencies, but capture those inefficiencies over time. Wakefield uses a highly disciplined and technologically advanced process for research, security selection, implementation, and monitoring. The resulting portfolios exhibit a unique combination of characteristics with positive near-term expectations that, in our view, will be rewarded by the market in the period ahead regardless of market direction. In our management and research, our goals are Focus, Creativity, Intellectual Honesty, and Continuous Improvement.

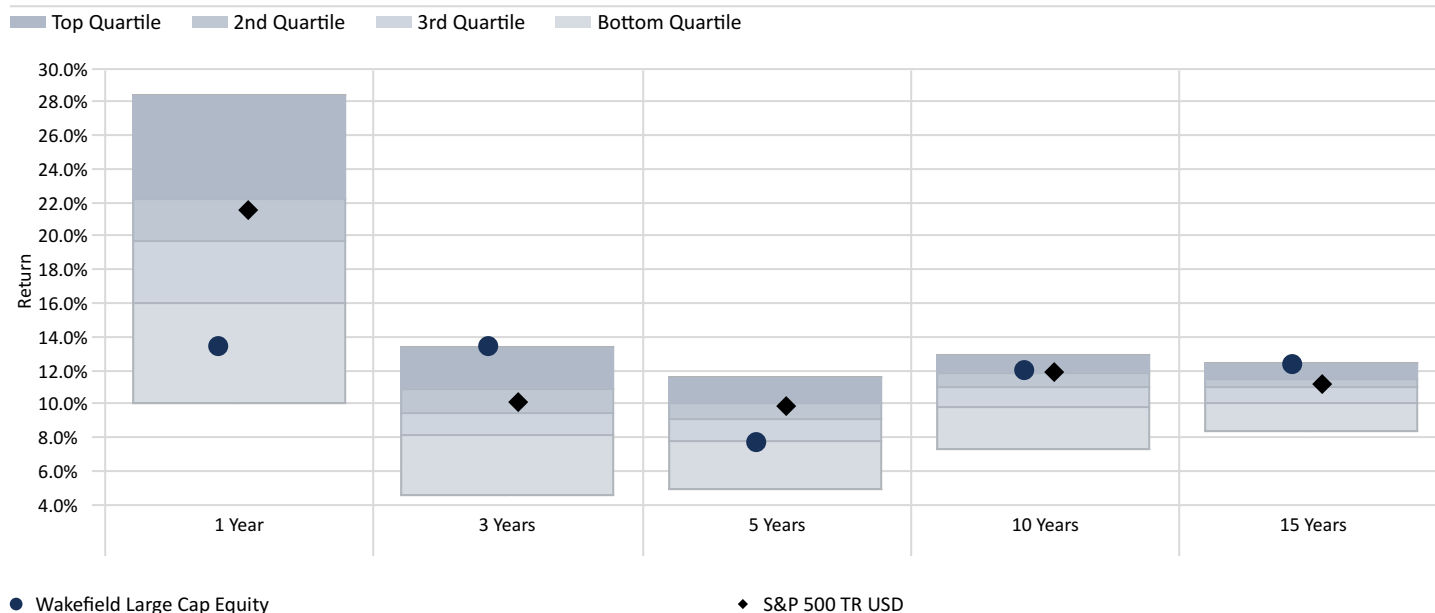
Returns

As of Date: 9/30/2023 Calculation Benchmark: S&P 500 TR USD



Performance Relative to Peer Group

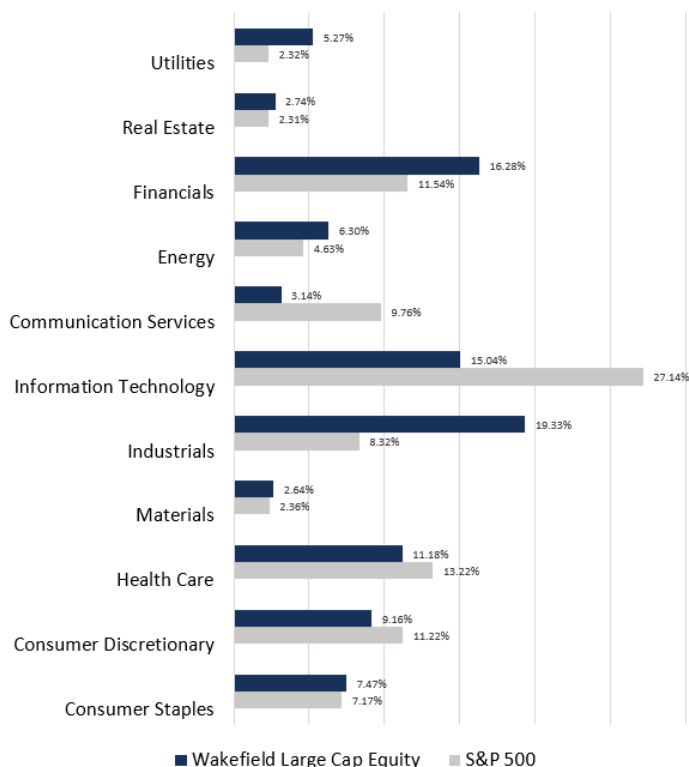
As of Date: 9/30/2023 Peer Group (5-95%): Separate Accounts - U.S. - Large Blend Calculation Benchmark: S&P 500 TR USD



Top Holdings

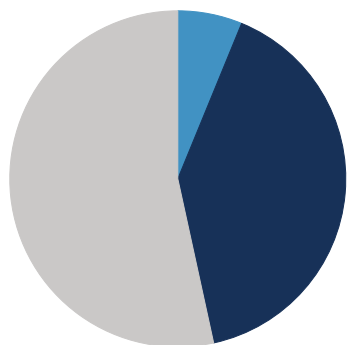
	Symbol	Weight %
PACCAR Inc	PCAR	3.5
Caterpillar Inc	CAT	3.5
Trane Technologies PLC Class A	TT	3.4
Corebridge Financial Inc	CRBG	3.4
Cadence Design Systems Inc	CDNS	3.4
Aflac Inc	AFL	3.3
BILL Holdings Inc Ordinary Shares	BILL	3.3
American International Group Inc	AIG	3.3
Lululemon Athletica Inc	LULU	3.2
Marathon Petroleum Corp	MPC	3.2

GICS Sector Weightings



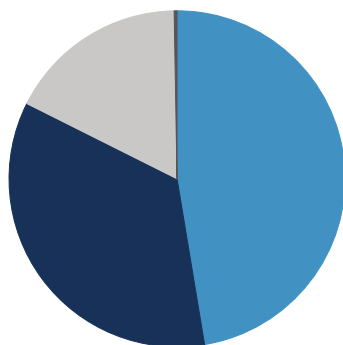
Large Cap Equity Holdings as of September 30, 2023. Holdings are subject to change at any time. Positions, and position size, may vary from account to account. A full listing of investment decisions made in the past year is available upon request. It should not be assumed that recommendations made in the future will be profitable or will equal the performance of the securities presented here. This holdings list should not be considered a recommendation to buy or sell any security. The information on this page is supplemental to the GIPS Report on page 4. Source: Morningstar Direct, Bloomberg.

Wakefield Large Cap



Size	%
Giant	6.2
Large	40.4
Mid	53.4
Small	0.0

S&P 500 TR USD



Size	%
Giant	47.4
Large	35.0
Mid	17.3
Small	0.3

Portfolio Characteristics

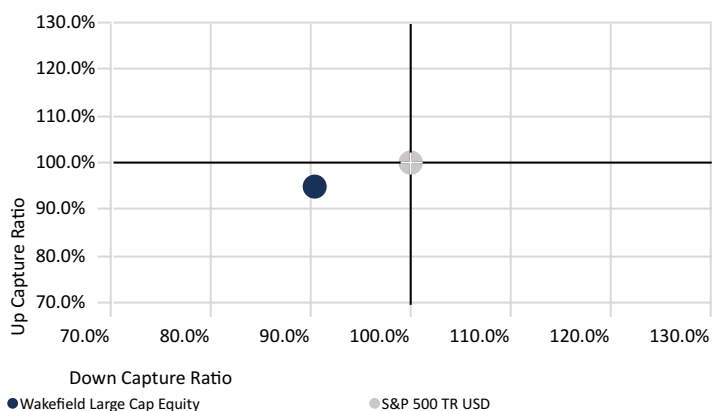
	Wakefield LCE	S&P 500 TR
# of Stock Holdings	33	503
Average Market Cap (mil)	85,097	75,101
Median Market Cap (mil)	40,910	29,983
P/E Ratio (TTM)	19.96	24.59
P/S Ratio	3.41	2.44
P/CF Ratio	16.53	26.72
Dividend Yield	2.26	1.68
Active Share	92.83	—
Strategy Assets	\$428.59 mil	—

Information Statistics - 5 Year

Alpha	-1.39
Beta	0.95
Sharpe Ratio	0.39
R-Squared	85.64
Information Ratio	-0.29
Tracking Error	7.47
Standard Deviation	19.49
Batting Average	46.67

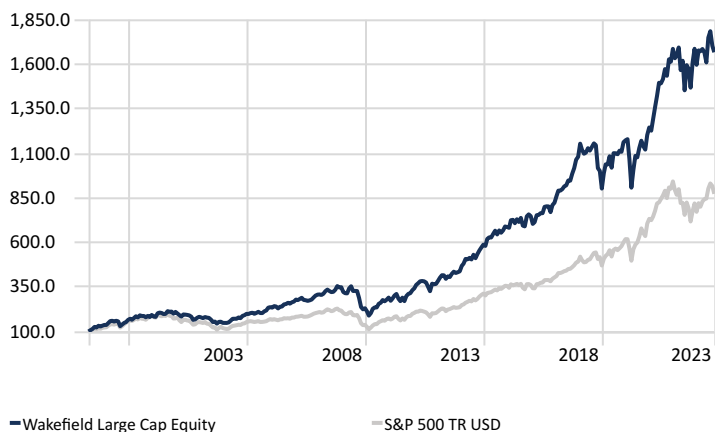
Capture Ratio - 10 Year

Calculation Benchmark: S&P 500 TR USD

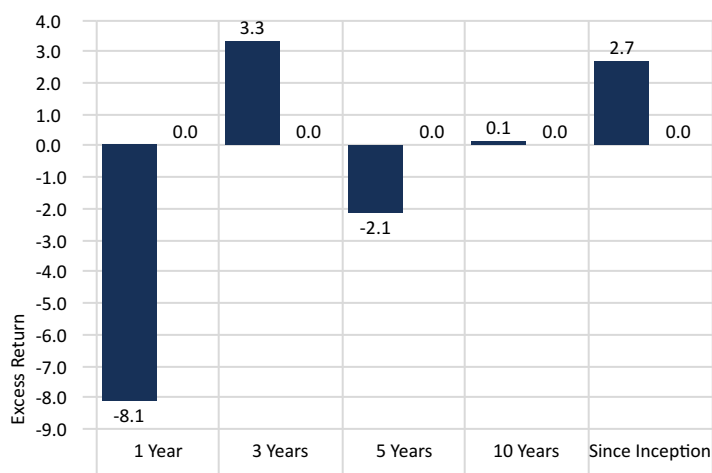


Investment Growth

Time Period: 5/1/1997 to 9/30/2023



Returns Above Benchmark





Wakefield Large Cap Equity

Quarterly Update

3rd Quarter 2023

For the Period Ending	Composite Gross Return (%)	Composite Net Return (%)	S&P 500 Index Return (%)	Composite 3Yr Std Dev (%)	S&P 500 Index 3Yr Std Dev (%)	Internal Dispersion (%)*	Composite Assets with Bundled Fee (%)	Number of Portfolios	Composite Assets (\$M)	Strategy Assets (\$M)	Strategy Advisory-Only Assets (\$M)	Firm-Wide GIPS Assets (\$M)*	Firm-Wide Assets (\$M)	Firm-Wide Advisory-Only Assets (\$M)
Q3 2023	4.42	3.62	13.06	16.49	17.60	-	33	41	18.8	428.5	409.2	-	748.0	448.0
2022	-5.31	-6.25	-18.10	20.16	20.87	0.57	34	44	18.6	445.3	425.9	311.8	779.4	467.6
2021	35.43	34.06	28.72	17.56	17.17	0.74	44	43	20.5	501.8	478.5	351.9	874.5	489.3
2020	6.17	4.92	18.40	19.65	18.53	1.02	42	46	18.1	439.8	419.6	293.3	756.7	428.9
2019	30.00	28.29	31.50	14.36	11.93	0.84	29	77	25.8	701.3	-	278.2	1,001.8	-
2018	-16.53	-17.79	-4.38	13.22	10.80	0.49	71	127	40.7	633.0	-	240.0	864.8	-
2017	31.37	29.78	21.83	10.75	9.92	0.52	77	115	45.8	580.9	-	265.0	840.1	-
2016	10.10	8.58	11.96	11.35	10.59	0.35	92	75	30.3	315.7	-	213.8	518.5	-
2015	8.91	7.41	1.38	11.23	10.48	0.30	89	81	30.6	212.9	-	177.3	381.0	-
2014	16.70	15.03	13.69	10.07	8.98	0.32	88	68	25.4	121.2	-	169.8	285.8	-
2013	34.38	32.54	32.39	13.12	11.94	0.45	89	59	22.2	68.7	-	158.4	225.2	-
2012	19.28	17.59	16.00	16.69	15.09	0.40	76	34	11.3	34.5	-	127.4	164.7	-

*Information not provided for partial year

Wakefield Asset Management claims compliance with the Global Investment Performance Standards (GIPS®) and has prepared and presented this report in compliance with the GIPS standards. Wakefield Asset Management has been independently verified for the periods July 1, 2003 through December 31, 2022. A firm that claims compliance with the GIPS standards must establish policies and procedures for complying with all the applicable requirements of the GIPS standards. Verification provides assurance on whether the firm's policies and procedures related to composite maintenance, as well as the calculation, presentation, and distribution of performance, have been designed in compliance with the GIPS standards and have been implemented on a firm-wide basis. The Wakefield Large Cap Equity Composite has had a performance examination for the periods July 1, 2003 to December 31, 2022. The verification and performance examination reports are available upon request. GIPS® is a registered trademark of CFA Institute. CFA Institute does not endorse or promote this organization, nor does it warrant the accuracy or quality of the content contained herein.

- Past performance is not indicative of future results.
- Returns include the reinvestment of income.
- Partial year returns not annualized.
- Wakefield Asset Management LLLP is a registered investment adviser with United States Securities and Exchange Commission in accordance with the Investment Advisors Act of 1940 with its principal place of business in the state of Colorado. Wakefield Asset Management LLLP is defined as an independent investment management firm that is not affiliated with any parent organization. Policies for valuing investments, calculating performance, and preparing GIPS Reports are available upon request.
- The Wakefield Large Cap Equity Composite includes all fully discretionary accounts over \$100,000 which invest in stocks contained in the S&P 500 Index and/or stocks of issuers with over \$10 billion in market capitalization.
- The benchmark for the Wakefield Large Cap Equity Composite is the S&P 500 Index. Index returns do not include the costs of any trade or transaction fees, investment management fees, taxes or other investment expenses. Investors cannot invest in an index and should not be relied upon as in any way representative of portfolio or investor performance or returns.
- Valuations are computed and performance is reported in U.S. dollars.
- Gross-of-fees returns for non-bundled fee accounts are reduced by trading costs and bundled-fee accounts are gross of all fees including trading costs. Composite and benchmark returns are presented net of non-reclaimable withholding taxes. Net-of-fees returns for non-bundled fee accounts are reduced by trading costs and the portfolio's actual investment management fee. Net-of-fees returns for bundled fee accounts are reduced by the entire bundled fee. The bundled fee may include costs such as: management, trading, custody, and other administrative fees.
- The investment management fee schedule for the composite is 0.75% on the first \$10 million, 0.60% on the next \$15 million, and 0.55% on the remainder. Actual investment advisory fees incurred by clients may vary.
- The composite creation date is July 1, 2003, and the composite inception date is April 30, 1997. Performance results prior to this date represent accounts managed by Wakefield's principal at a prior investment Management firm. A complete list of composite descriptions is available upon request.
- Internal dispersion is calculated using the asset-weighted standard deviation of annual net-of-fees returns of those portfolios that were included in the composite for the entire year.
- Significant Cash Flow Policy: Composite does not exclude accounts due to significant cash flow. From 4/1/2011 through 9/30/2014, Composite's policy required the temporary removal of any portfolio incurring a significant cash inflow or outflow of at least 10% of portfolio assets. The temporary removal of such an account occurred the day in which the significant cash flow occurs, and the account re-enters the composite at the end of the month the cash flow occurred.
- The three-year annualized standard deviation measures the variability of the composite and benchmark returns over the preceding 36-month period. It is calculated ex-post using net returns.
- Investing involves multiple risks, including but not limited to the risk of the permanent loss of capital. Above material does not constitute tax or legal advice; consult your individual tax or legal adviser. Adviser makes no guarantees or promissory representations as to the performance of any investment. Consult your individual financial adviser prior to making any financial decisions.