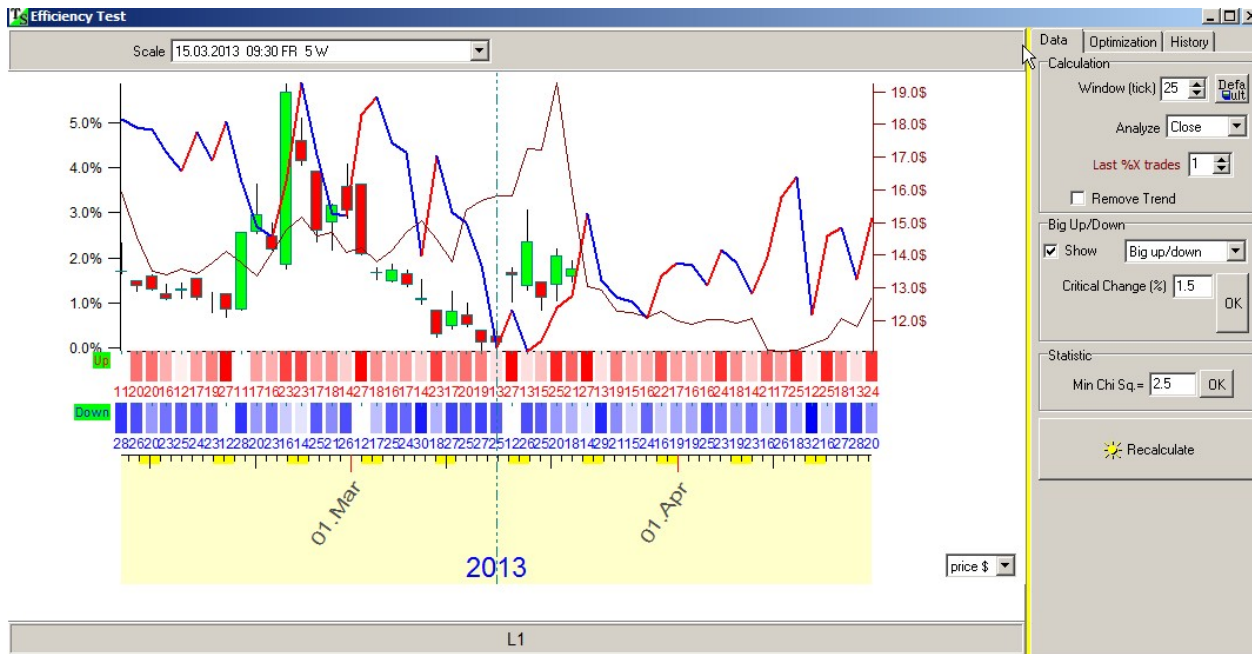# Earnings Season Tendencies

My previous article highlighted the tendencies either side of the monthly **options expiration** and included analysis of the four times a year, "triple witching" event.

An Update: The most recent Triple Witching just occurred and the tendencies have held true:

In my opinion, all the neural nets in the world cannot "out-predict" these tendencies which are driven by market mechanics. The options expiration article attempted to make the point that there are specific market forces involved with the transition from one expiration month to the next that lead to a contraction in option pricing (Implied Volatility) going into expiration along with a rise in equity (stock) prices. These market forces are directly tied to the unwinding of options/futures positions and the rolling into the next period. These market events recur over and over. When exogenous forces are in play, the tendencies may not occur, but there is a reversion to the stated tendency when the market normalizes from the effect of said, extraneous event(s).

Another event worth studying in Timing Solution is the four times a year **earnings season**. Earnings season in truth starts in early Jan, Apr, Jul and Oct and lasts for 3 months so a logical question would be: Why study an ongoing event? But, the earnings season does have a more finite portion that begins with the announcement of Alcoa Aluminum (AA) and culminates about 30 days later when virtually every major company or a proxy for each industry has announced. "A proxy for every industry" means that within a few weeks of the eighth of Jan/Apr/Jul/Oct, every company "type" has announced their earnings and these early announcements tend to mute the volatility for like kind companies since it is assumed that the other companies will be in a similar situation with respect to current earnings and future company guidance. So EBAY becomes a proxy for AMZN (to some extent) since EBAY announces first. Further, if you break down the earnings season sequence of announcements you tend to find that the inaugural, AA announcement on or around the 8th of Jan, Apr, Jul and Oct is the "wake up call" for everyone as it represents the "kickoff" as well as an indication of manufacturing and a basic materials industry (aluminum). But, the fireworks usually wait until the second week when JPM and WFC announce earnings. Over the next 7 days most every major financial company announces. Since banks are a major portion of the Dow and the SP500, these announcements create a **picture of the whole economy**. The average date for the JPM announcement is the 12th. The following week contains a plethora of industries and includes huge companies such as GE and GOOG.

The following week (third week) contains AAPL and AMZN along with many other tech names. For the last few years AAPL has perhaps been one of the most anticipated announcements and has tended to move the market one way or another-both before and after. AAPL tends to announce around the 24th (give or take a couple days). Soon thereafter the overall effect of the earnings announcements tends to fade as the "cat is (mostly) out of the bag" in terms of the overall, net market effect. This doesn't mean that individual companies don't have big moves, but by the end of the third week of the season these companies will tend to move *without necessarily moving the whole market*.

In its most basic form, here is the calendar to watch for:

AA 8th (Basic Industry and materials)

JPM   12th (Banking which covers aspects of the whole economy)

GOOG, IBM   18th (Tech and Online Advertising)

AAPL   23$^{rd.}$ Tech/Retail (AAPL has been the 'big daddy' for the last few years.)

AMZN   25th Retail

(Note: Every date is +or- a couple days due to weekends and the fact that few companies ever announce on Fridays)

You can add other companies such as the early announcers in the mining, heavy equipment, oil and so forth. But, look for the 'first in type' to announce. If COP announces before XOM, it is likely that the first of the two will be the telling one. COP does, in fact announce 3 days before XOM.

So the question becomes: Can we find ways to trade based on recurring tendencies relative to earnings? And can we do this for the overall market (SP500, DOW, Nasdaq, etc). Can we do this sort of analysis for individual companies like AAPL, AMZN, GOOG, FB, GS and so forth? Yes we can!

As with options expiration, I would ask: How can we not pay attention to these important market forces? It would seem to me that the aggregate forces on the market would start to show an effect in the weeks prior to earnings and would culminate with the AAPL and AMZN announcements 3 weeks after the AA start of the "season." The old market adage, "Buy the rumor and sell the news" is evident more than ever during the earnings season. This is true for the whole market during the critical three weeks and true for individual companies throughout the extended earnings season.

In Timing Solution we can create a set of dates manually. This is done as follows:

1. Go to ULE

2. Hit "Edit"

3. Under "Own Fundamentals" hit "Single Events"
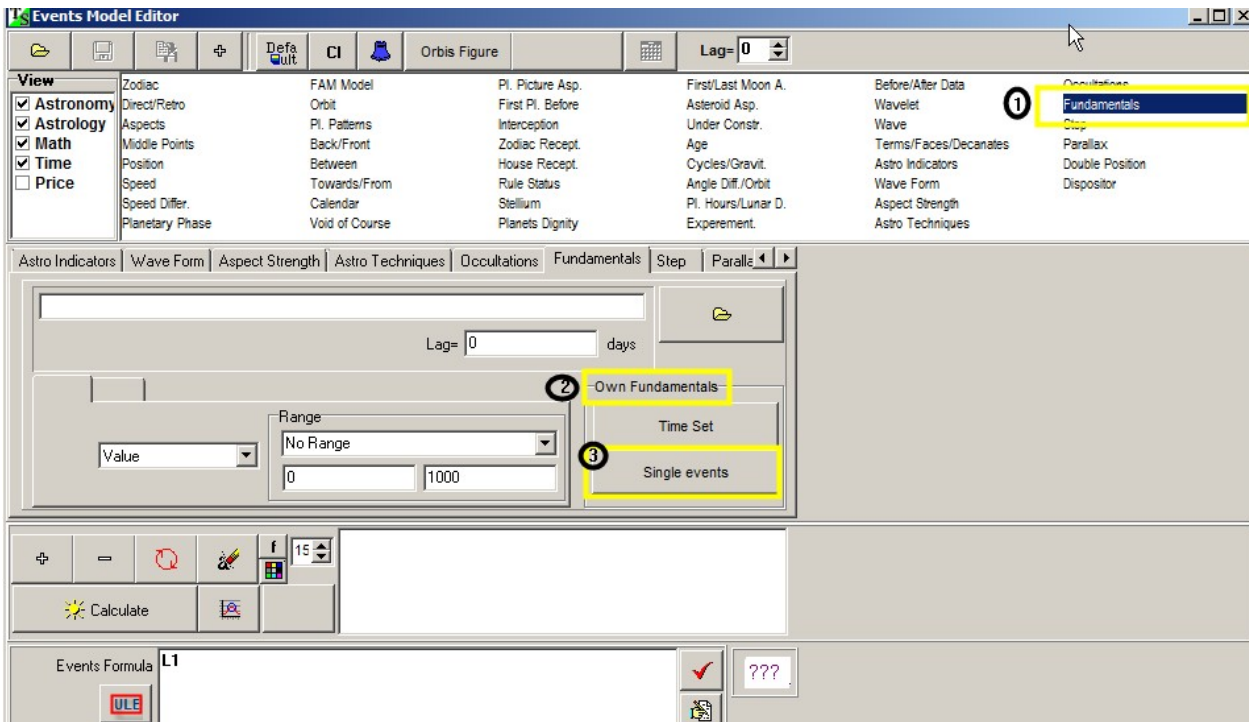
Now start putting in dates manually. Sergey has made this easy. Simple select the dates (Step 1) and (Step 2) hit "Add" or type in the dates in the proper format. This will populate the list and create a .fnd_d file for you to access in ULE under Fundamentals.
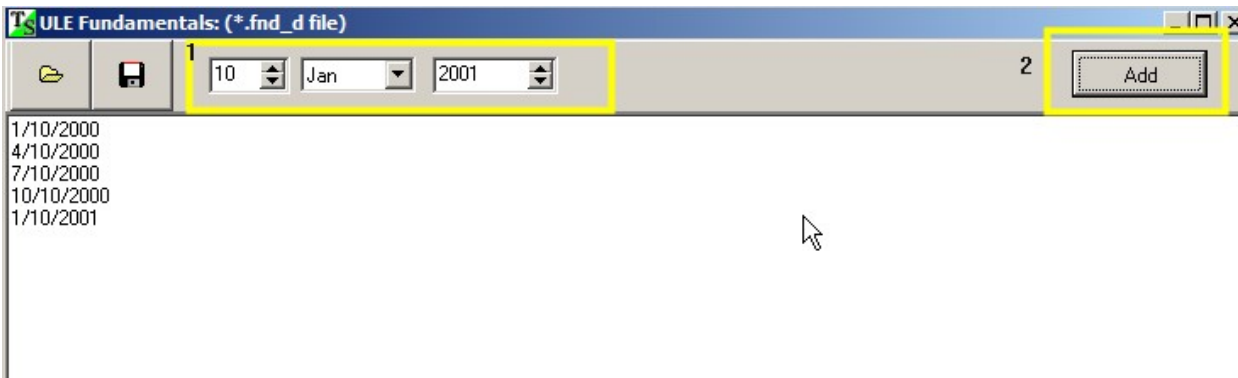

I experimented with the start date of the 8th (AA) and the 12th (JPM). Keep in mind that the 12th is likely the best estimate of when the market will become reactive.   But, given the fact that the dates for the individual announcements are not set in concrete, you might consider simply using the midpoint of these two dates for analysis of the SP 500. This would have us using the 10th. Another idea would be to key on JPM and use the 12th and then examine the movement of JPM itself or examine the movement of the XLF which is the ETF for the Financial sector.   Personally, I believe the big banks really set the tone along with AMZN and AAPL.   AMZN and AAPL represent an important combination of tech and retail. This narrows the core earnings period to about two weeks. WMT (Wal Mart) may be a big company, but it rarely moves the whole market and it announces six weeks after AA. We are looking at the companies that move the market

and the aforementioned "biggies" are the ones I emphasize in my actual trading. In ten years, we may have other companies that move the market. Perhaps it will be Facebook (FB) which currently does not seem to be a market mover. Perhaps it will be a company that we have never heard of. All we should concern ourselves with for now is what is currently working.

In this light, I have examined the 25th quite a bit and then examined AAPL as well as the QQQ where AAPL is the largest component.

The total time to create a set of Earnings start dates in ULE is about 5-10 minutes so perhaps various Earnings Date series would make sense. These files are under Fundamentals in T.S. and there is no limit to how many files you can create. I choose to only go back to 2000. Going back fifty years for this type of work makes little sense.

You should populate the *future earnings dates* about a month in advance of the earnings season so that you can observe the tendency vs. real time action as it develops.   It is easy to add dates to your files and save the appended file(s). Now that you have the up to date file, you can perform Efficiency Testing. Here are the steps:
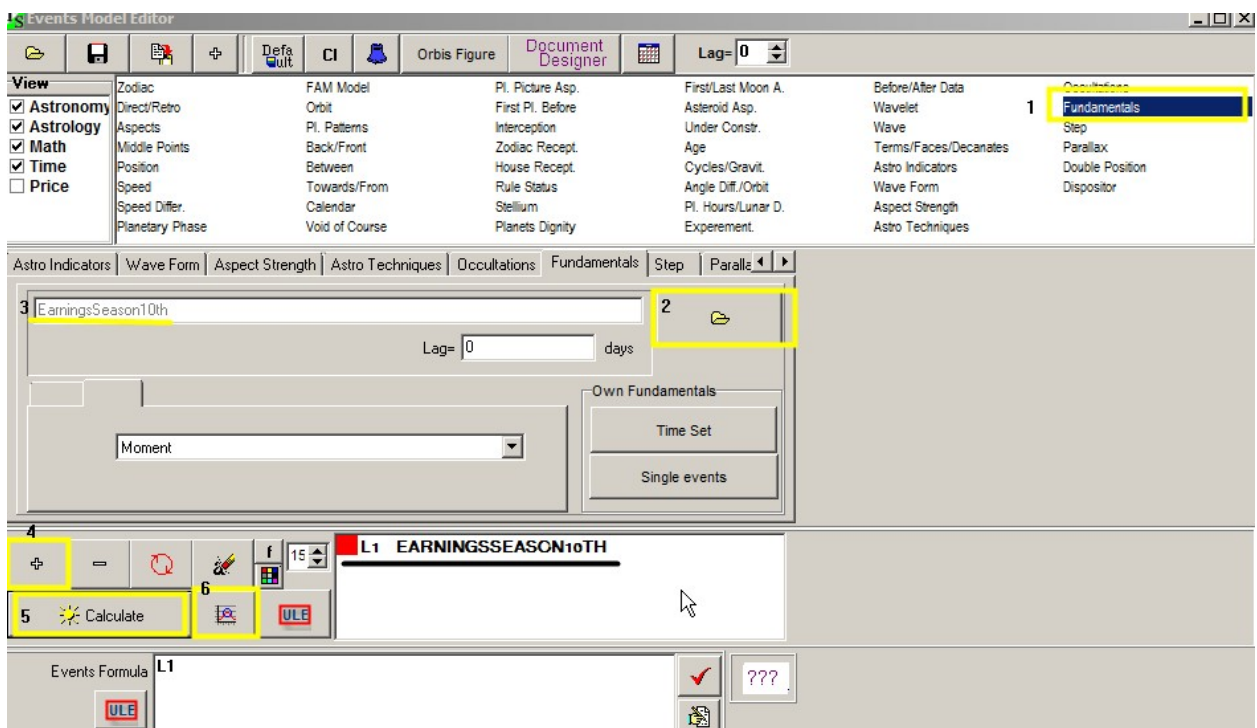
When you get to step #6 above you will get this:
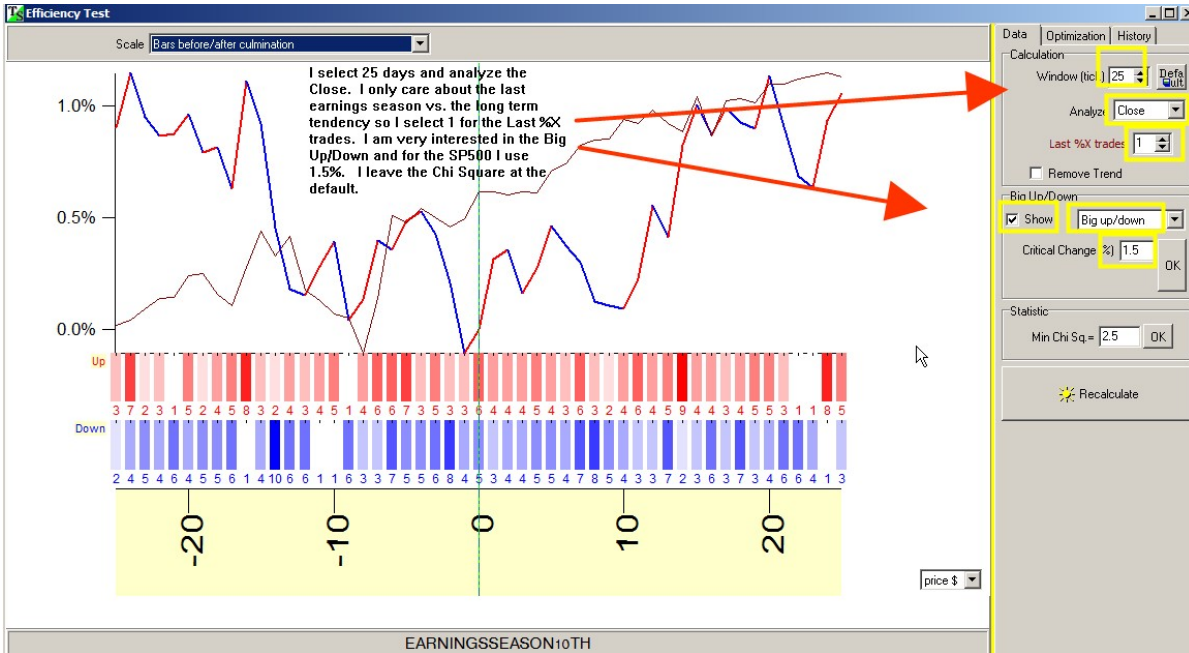
One can easily see that there is a tendency for stocks to fall two weeks before the 10th and rise afterward.   The Big Up and Big Down provide some interesting visual data and will highlight important data points either side of the date you have chosen to work with. Again, given the fluctuation of the key earnings dates, I am not sure that this can be precisely interpreted so look for the bigger picture.

One can utilize the **Optimization** Tab and click on Optimize:
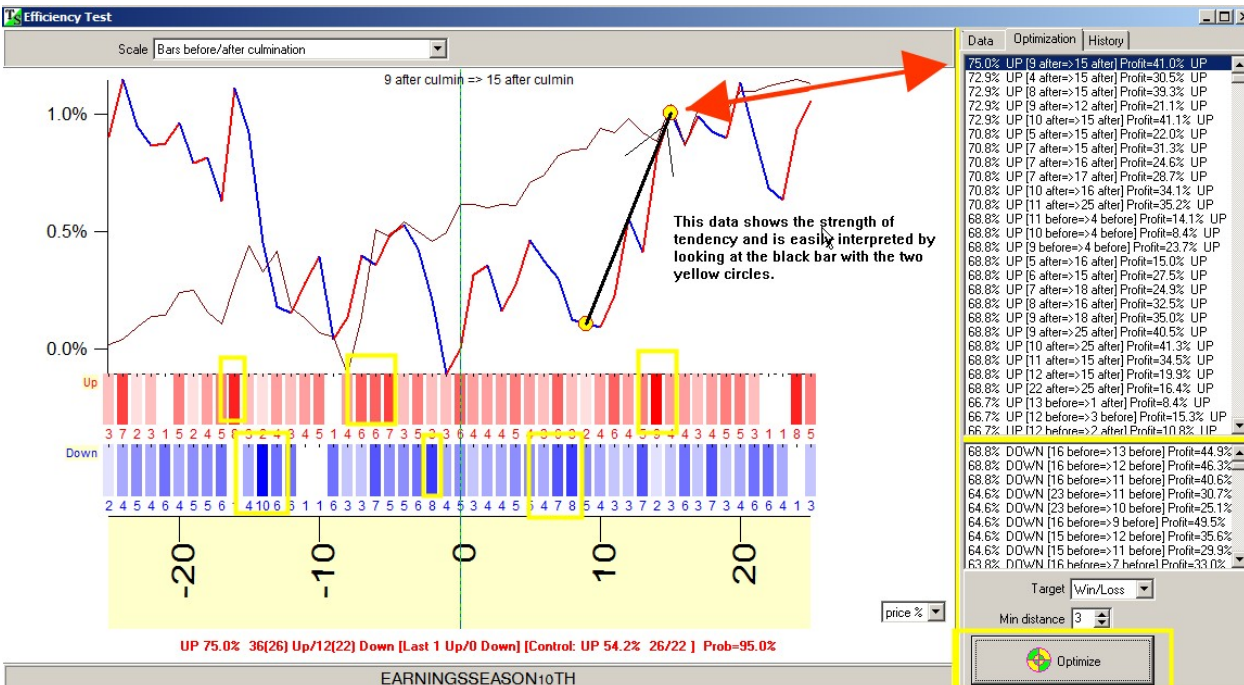
This will highlight the optimal periods to be long or short.   This said, I still believe that we should really look at the overall tendencies vs. trying to pinpoint things too precisely.

We can then select individual dates in the past or examine the current approach to the Earnings Season 10th date.
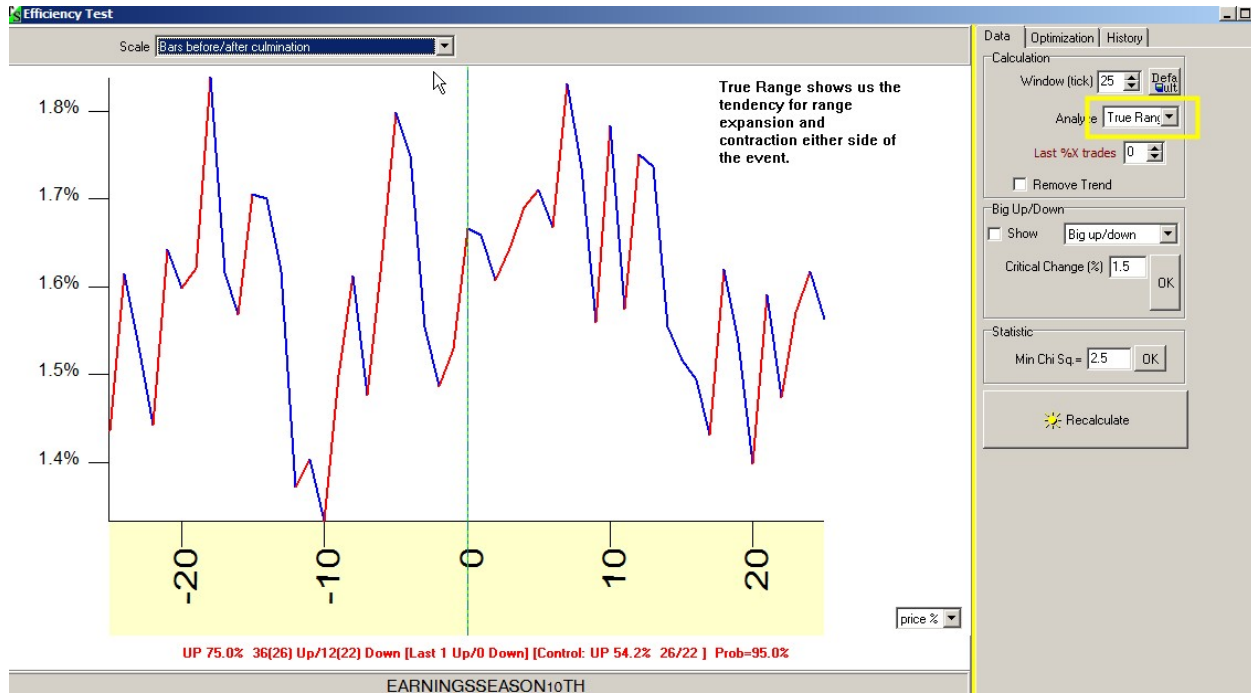
Here is the 4th quarter, 2012 earnings period that started to announce on 10 Jan 2013:
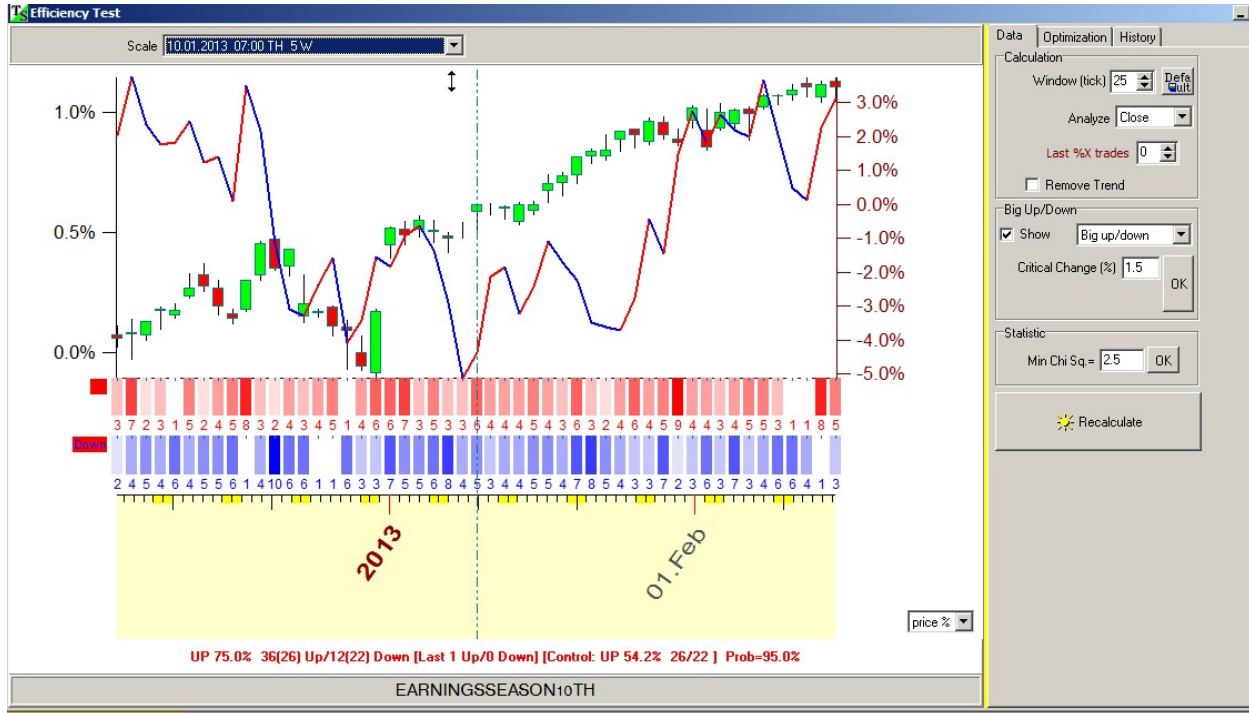
Here is where we are as of Friday, Mar 22nd 2013: (It predicts an overall sideways week next week.)
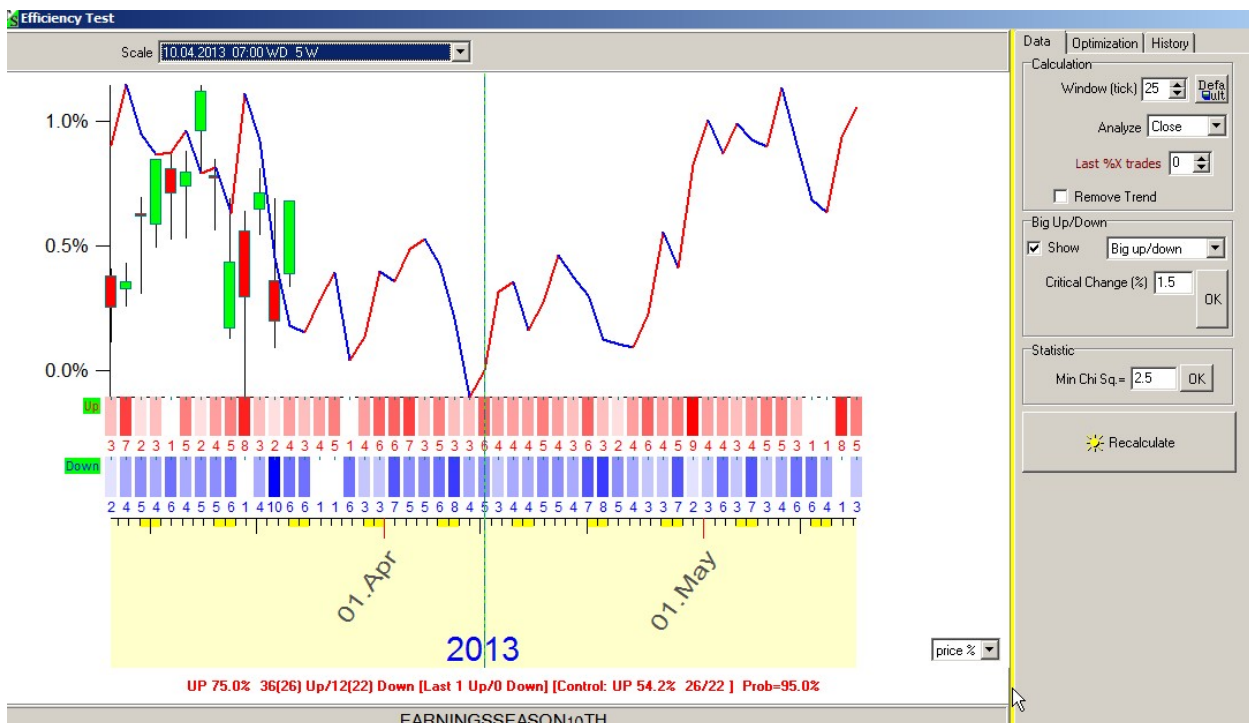
Finally, we can select True Range to see if there is a tendency for range to expand and contract either side of the event:

This shows that there is a "calm before the storm" at the end of the month prior to earnings months. Then there is an expansion in the first week of Apr, Jul, Oct, and Jan. Then there appears to be a slight calm directly in front of the Banking announcements which clearly cause range expansion. Prices continue to be all over the charts in terms of range until they settle down into the AAPL and AMZN earnings where they again start to expand in range.

Finally for people like myself who trade AAPL options more than any other option (underlying), I have created a date of the 23rd for Jan, Apr, Jul and Oct. I then examine AAPL tendencies either side of the 23rd to look for opportunity:
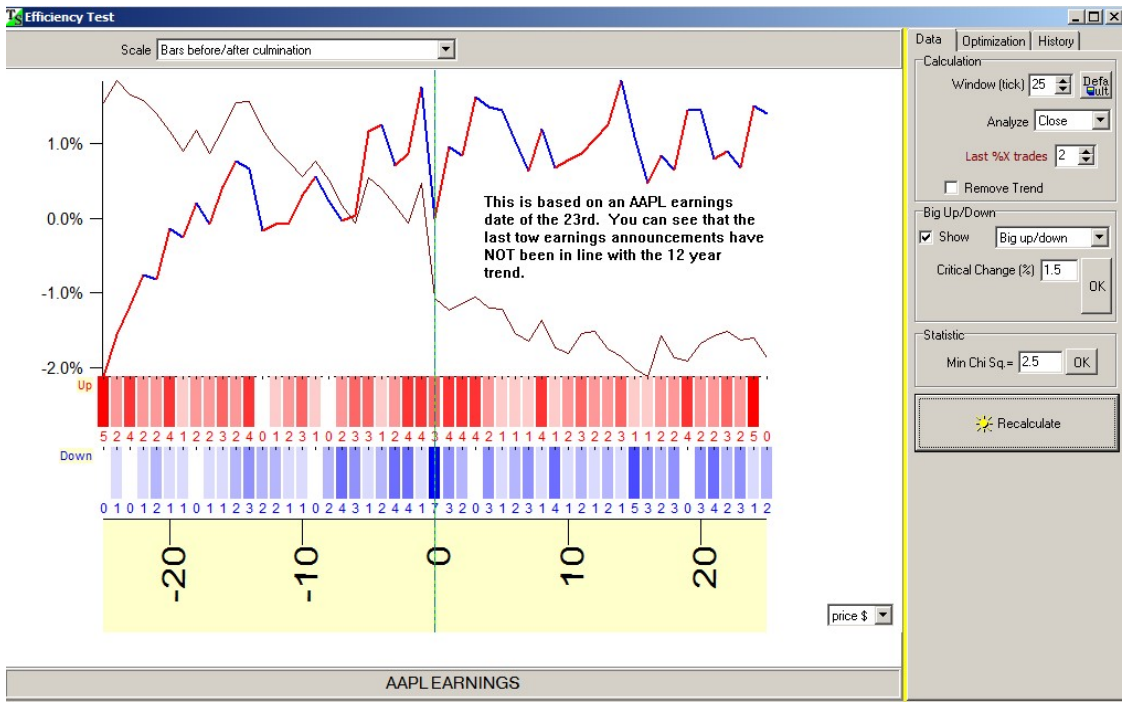
This is an important slide since it shows that nothing is perfect. The last two cycles were not in line whatsoever with the longer term tendency. But, perhaps the approach to earnings on Jan 23rd, 2013 was trying to tell us something:

As with all cycles, they sometimes fail, but the very failure gives us clues that tell us if a stock is "sick" or turbocharged.

So let's take a look at the upcoming earnings for AAPL. First, I appended the data to include the date of Apr 23rd 2013. An easy way to check on the upcoming earnings announcement is by going to www.earningswhisper.com Type in AAPL and examine the data for the release of earnings.

2nd Quarter Ending March 2013

Earnings Whisper ®:	N/A
Consensus Estimate:	$10.58
Surprise Expectation ¹:	
Release Date: [not confirmed]	4/23/2013 After Close
Expected Time ²:	4:35 PM ET
Conference Call:	N/A

This says that earnings will be announced after the close on Apr 23rd and that this date is yet to be confirmed by the company. Earnings Whisper is free for the basic usage. Decent trading platforms such as Thinkorswim by TD Ameritrade show the dates directly on the chart. Most large companies like AAPL, AMZN and GOOG are fairly good about supplying accurate release data to the public. *GOOG did make an error a few months back and released the earnings data accidently during the trading day. This was an anomaly…not the norm.* Append the file by returning to the Single Event module mentioned above. Simply add the date. I believe you will need to exit T.S. and then re-open the program to have the new data available.

Now you can see how things are looking for the next AAPL earnings:
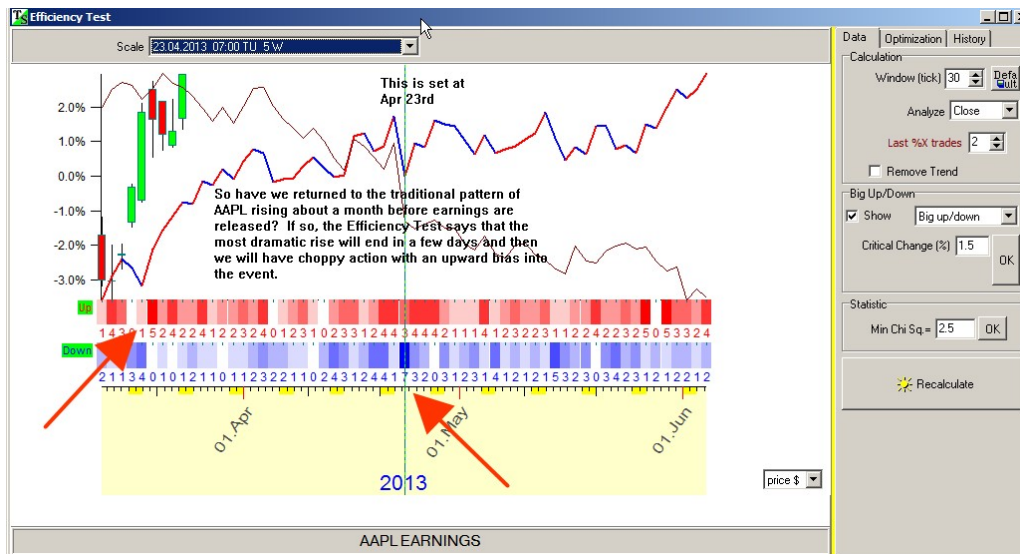
In the above instance, note that I set the window tick to 30 days. From my trading experience, earnings effect can start 30 days in advance and last for up to a month after the announcement. Most of the reaction occurs in the week following the earnings release. This varies from one stock to another.

The long term tendency is clearly back in place. Does this guarantee anything? Of course not, but it would seem to offer us some important clues.

Trading strategies for the earnings event is the topic of another article, but I will share this much: Given the uncertainty of earnings, there will always be a rise in option pricing (Implied Volatility) which will collapse (revert to the mean) once the news is out. One important note is that when the previous earnings period had a large move, the next period tends to have a lesser move and vice-versa. This is why when trading the earnings announcement itself I will examine the last period and then lean toward the opposite reaction and trade accordingly.

In the case of AAPL, it behaved very poorly in January of 2013 before and after earnings. AAPL was down massively immediately after the announcement. I would expect that this may lead to very high option pricing the next time around in April. Implied Volatility in AAPL will probably build over the next 4 weeks. The actual announcement on Apr 23rd will likely not be as bad and the stock will stay within whatever expected move the options are pricing in. The bottom line is that most traders don't remember back any further than the last similar event. They then trade accordingly and get burned. I try to be on the other side of these sorts of situations—betting that they will be mistaken. So assuming we get that rise in option pricing for AAPL, I will likely sell a Strangle just before the announcement. If AAPL underreacts (up or down), I will make money on that trade. If we don't get the build in IV, I will not likely take this type of trade.

In conclusion: Analysts, newsletter writers, CNBC hosts/guests, seminar hosts, online writers and so forth can tinker forever with forecasts, but traders cannot fall in love with a projection for more than a nanosecond. That said, there are tendencies that set up in advance of binary events such as option expiration and earnings announcements. These tendencies can offer traders (particularly options traders) the opportunity to know when to trade lightly vs. seeing that the "pot odds" favor a more significant allocation of capital. One cannot view the markets or an individual stock without some sort of context and the only thing that you can count on in the markets is this: The markets will confound the greatest number of retail traders possible. The Timing Solution software gives us the unique ability to see basic tendencies and we can then decide how we should proceed with our trades.

From my perspective having looked at predictable, recurring events such as option expiration and earnings, I believe that these events create vastly more trading opportunity than any other sort of analysis. Thanks to Sergey for creating the Efficiency Test and the ability to create our own key dates in the ULE.