Misforecasting Earnings: Management Expectations and Capital Market Anomalies

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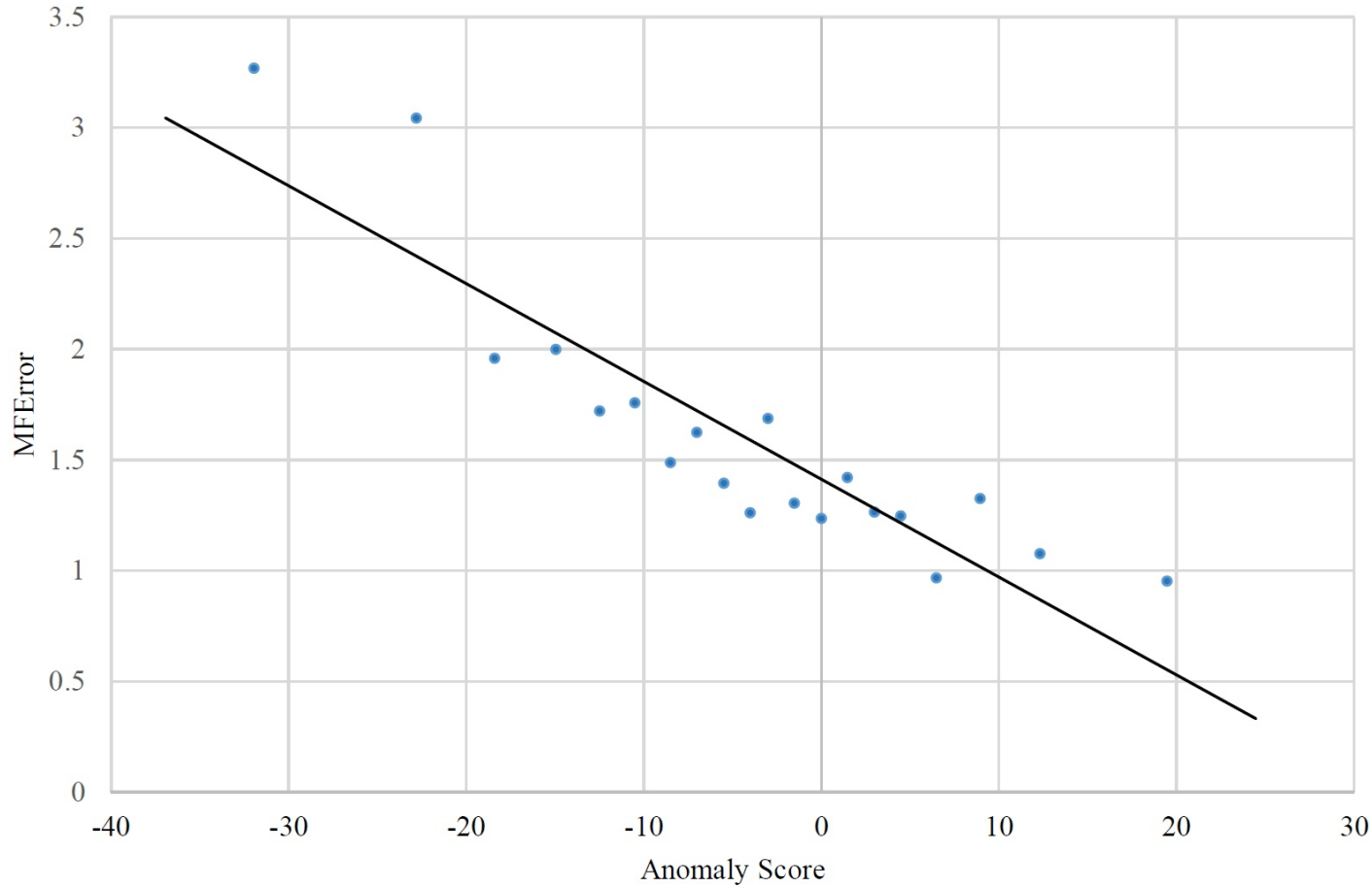
The paper in one slide



- **Inverse relation** between **overvaluation** and management earnings **forecast errors**.

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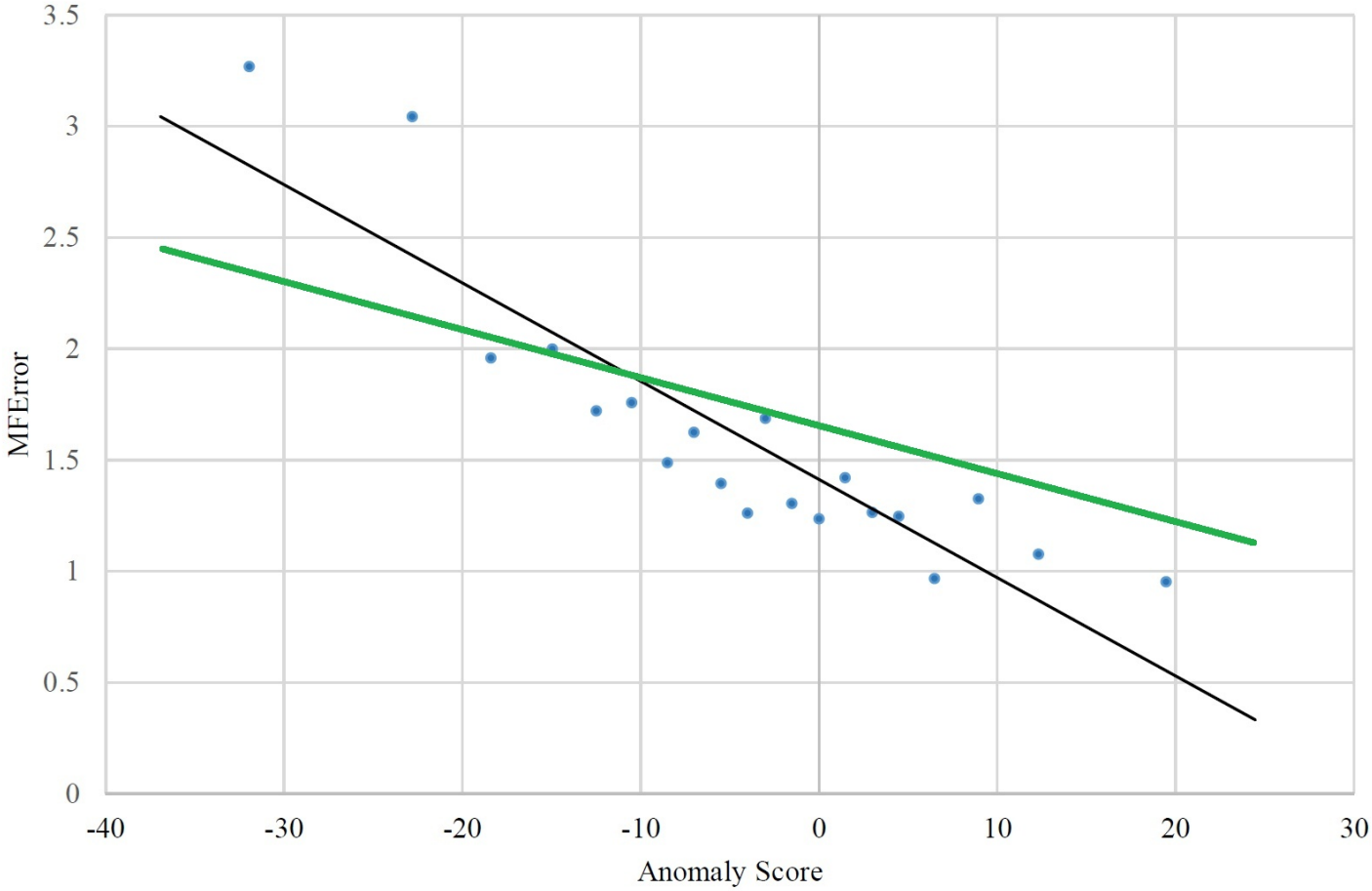

- **Attenuated** for **familiar** anomalies and **post-publication**.

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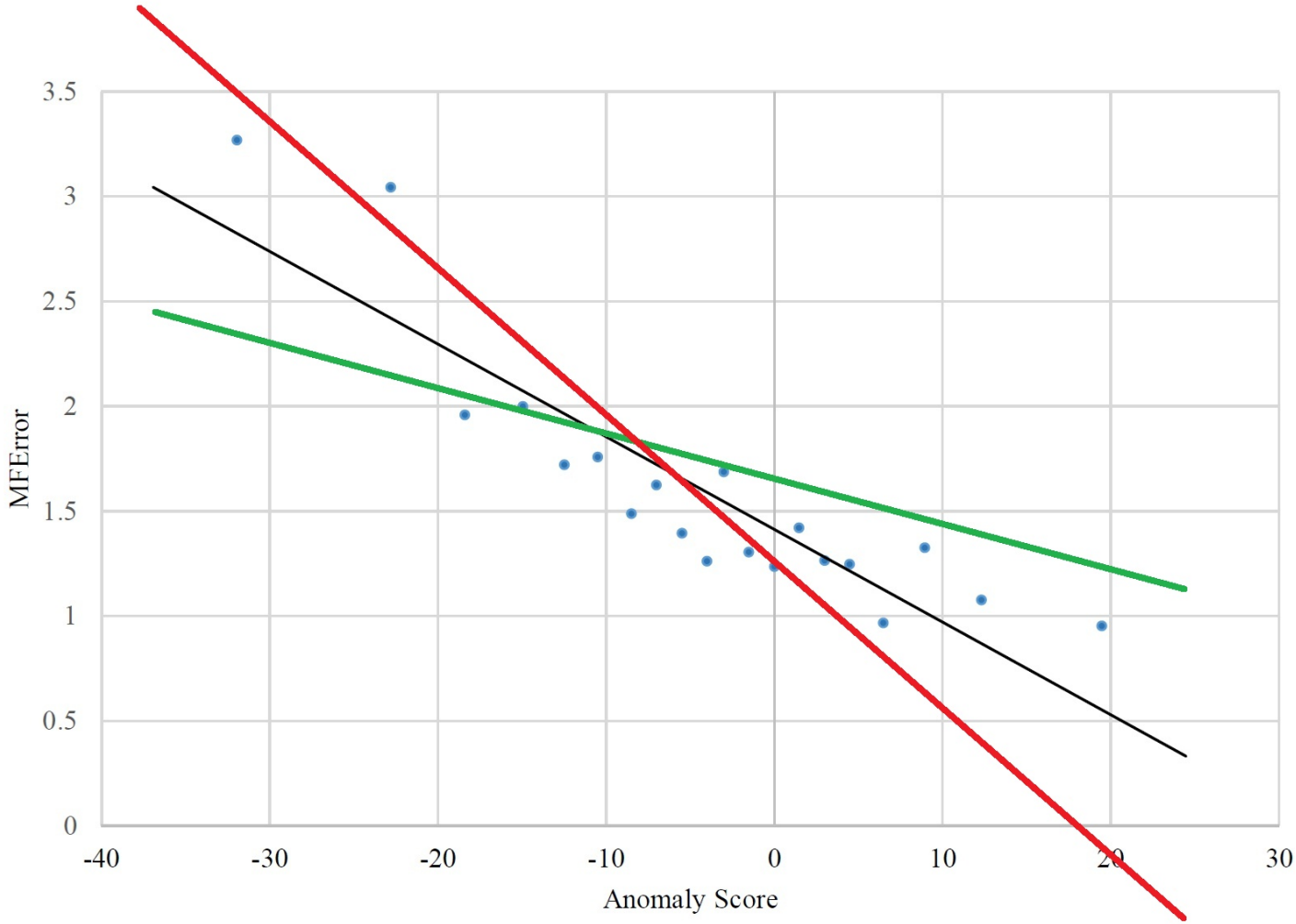

- **Steeper** for **unfamiliar** anomalies and **pre-publication**.

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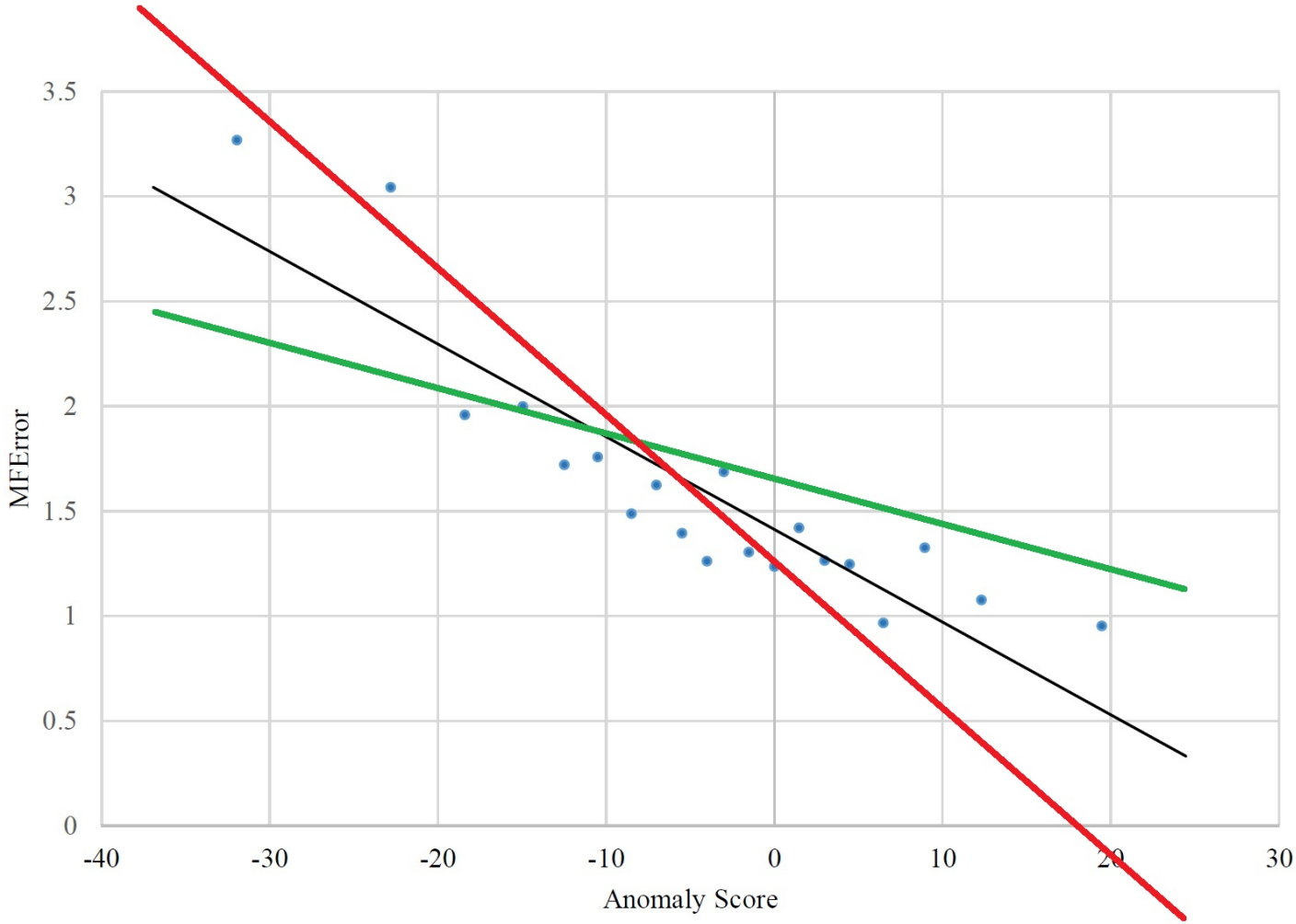
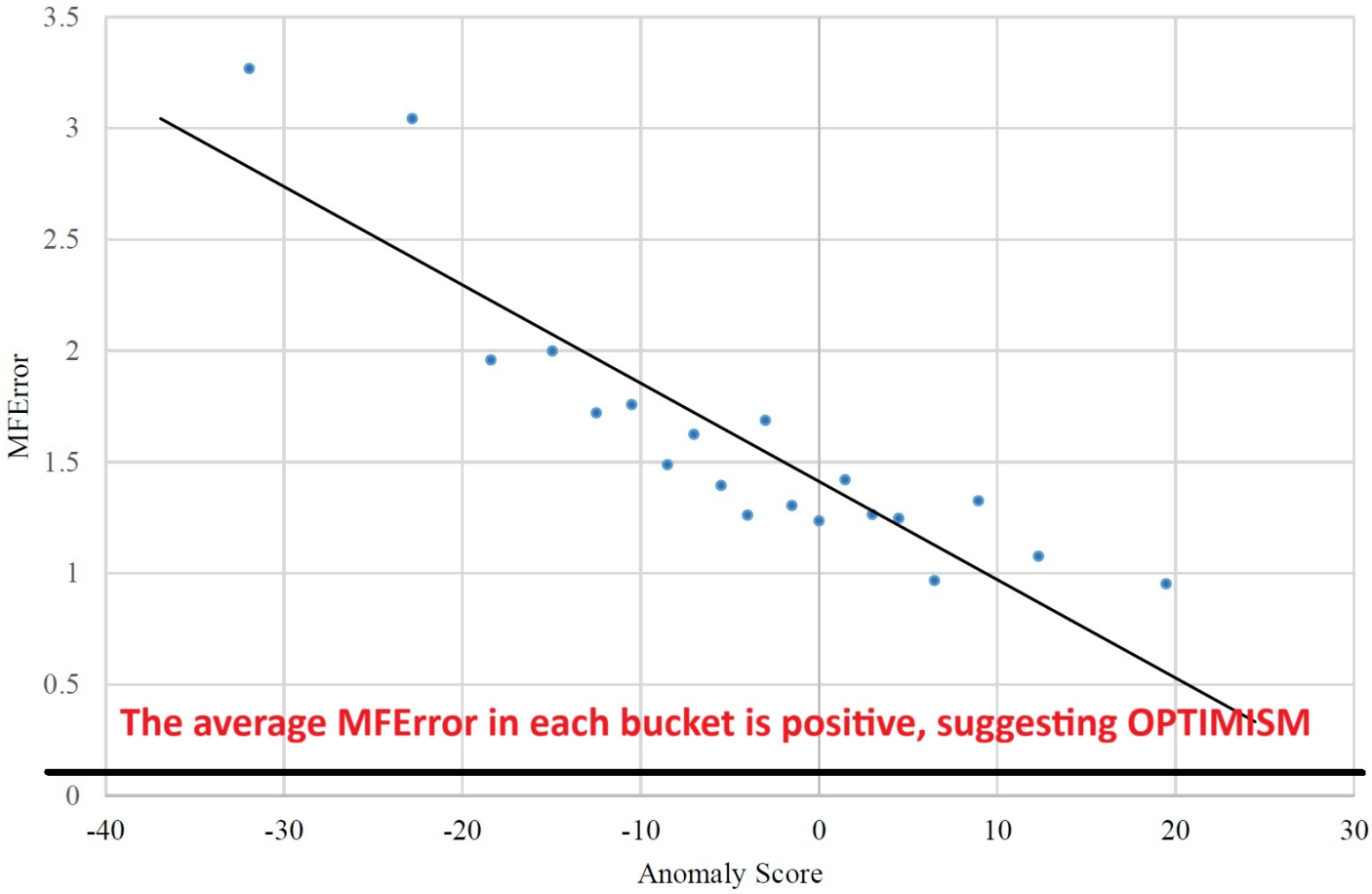


- Results suggest a **behavioral bias (limited attention)** on the part of management.

Major Point 1: Interpretation & Measurement



- It appears that, **on average**, overvalued stocks have **larger** MFErrors while undervalued stocks have **more accurate** MFErrors.

Major Point 1: Interpretation & Measurement

	Observations	Mean	Std Dev.	25th	Median	75th
MFError	136,313	1.574	15.987	-0.726	-0.142	0.108

- The summary statistics also suggest **optimism on average**, but the distribution is highly skewed.

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  - *"forecasts being too **optimistic** for overvalued stocks and **pessimistic** for undervalued stocks."*

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- Finally, the paper uses language such as:
  - *"forecasts being too **optimistic** for overvalued stocks and **pessimistic** for undervalued stocks."*

- But my read of the paper is that:
  - *"forecasts are **optimistic** for overvalued stocks but **less optimistic and more accurate** for undervalued stocks."*

Major Point 1: Interpretation & Measurement

RECOMMENDATIONS:

1. Adjust the interpretation as appropriate, reserving *pessimism* for cases where MFErrors are negative.

2. Show us more detail on *typical* MFErrors.
   - What is the ratio of optimistic-to-pessimistic forecasts in each bucket in Figure 1?
   - Can we scale MFErrors to normalize this highly skewed distribution?

3. Show results (and interpretations) are robust to MFErrors being scaled by earnings instead of price.
   - Watch out for zero or near-zero earnings blowing up the measure.
   - Also consider showing raw MFErrors (no scaling).

Major Point 2: Publication, Familiarity, and Forecasters

TABLE 2: Analyst errors are not as related to anomaly scores as are management errors.

TABLE 6: MFErrors are mostly related to less familiar anomalies.

TABLE 7: MFErrors are mostly unrelated to anomaly scores after anomaly publication.

All great and help tell the story that there is a significant bias (limited attention/cognition) within managers.

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All great and help tell the story that there is a significant bias (limited attention/cognition) within managers.

RECOMMENDATION: It would be really nice to see these three elements in a unified framework with interaction variables!

Major Point 3: Flip the Script

Current Flow:

1. Here is our main finding—MFErrors are inversely related to anomaly scores.
    - Figure 1 and Table 2.

2. Here are some mechanisms that could explain this, but they don't totally explain it.
    - Table 3 and Table 4.
    - Table 5 is sort of in this realm.

3. We think it's a behavioral bias, here's why.
    - Table 6 and Table 7.

Major Point 3: Flip the Script

Suggested Flow:

1. Here is our main finding—MFErrors are inversely related to anomaly scores.
    - Figure 1 and Table 2.

2. We think it's a behavioral bias, here's why.
    - Table 6 and Table 7.
    - A Table/Figure on the unified approach (Major Point 2).

3. Here are some alternative mechanisms that could explain this, but they don't totally explain it
    - Table 3 and Table 4.
    - Table 5 is sort of in this realm.

Minor Points

1. **Anomaly score robustness.** Separate anomalies by type and provide bucketed results (value/momentum/quality/accounting) and consider dropping some anomaly-families and checking results.

2. **More on market-reaction.** The CAR tests are fascinating, but I don't understand them. Post-publication, is the market *discounting* management forecasts when it should be *ignoring* them?

3. **The management-quality tests seem problematic.** Are we measuring quality *ex post*? Does quality affect the ability to generate earnings?
    - Control for the forecast? Forecast compared to previous years?

4. **Calendar effects may matter.** Many anomalies are constructed with stale data; most anomalies are *freshest*, in this setting, during late summer and fall.

Recap

What I like

- **Clear and relevant question:** do management forecasts reflect anomaly signals?
- **Clean fact:** more-optimistic guidance when overvalued and less-optimistic when undervalued.
- **Attenuation where it should be:** *post-publication* and for *familiar* anomalies.

Three major asks

1. **Interpretation & Measurement:** less-optimistic versus pessimistic.
2. **Publication, Familiarity, and Forecasters** in a unified setting.
3. **Flip the Script** to avoid muddying things up early on with the alternative mechanisms.