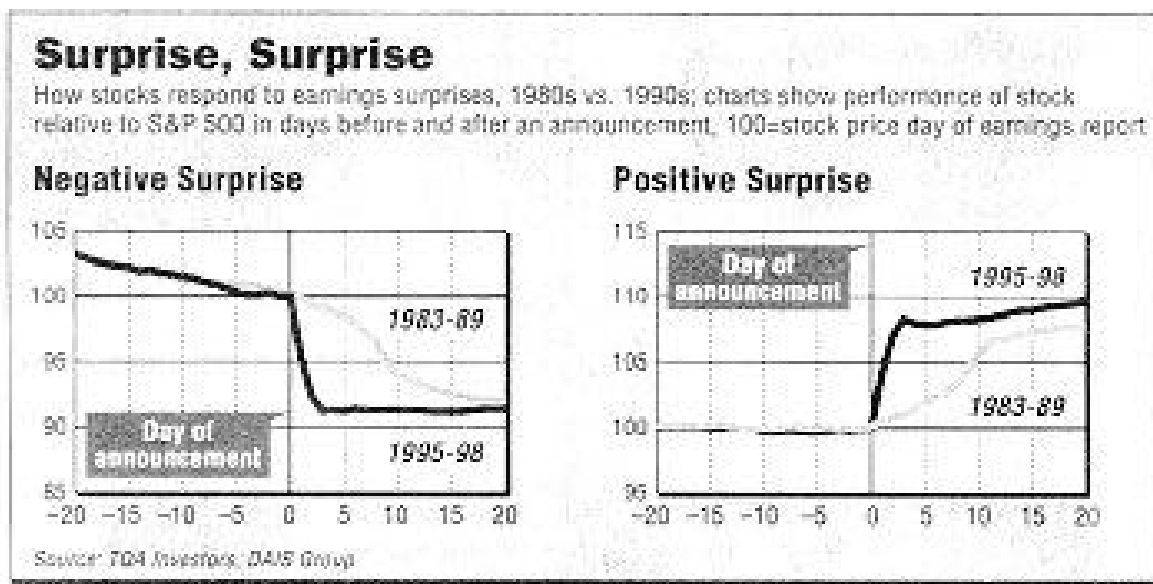


Enclosed is a recent article from the Wall Street Journal. The chart at the bottom of this page appeared in the article.

- 1 Looking at the 1983-89 period what can you say about
 - Market efficiency before the earnings are announced
 - Information leakage before the earnings are announced
 - Market efficiency after the earnings are announced

For each answer support your arguments with data from the chart and discussions in the article.
- 2 Looking at the 1995-98 period what can you say about
 - Market efficiency before the earnings are announced
 - Information leakage before the earnings are announced
 - Market efficiency after the earnings are announced

For each answer support your arguments with data from the chart and discussions in the article.
- 3 What did the analysts forecast as profit growth for the first quarter of 1998 ? Did the market behave in an efficient manner in the first quarter of 1998 ?
- 4 Did the market behave in an efficient manner when the potential accounting irregularities about Centant were discovered by the market ?
- 5 Did the market behave in an efficient manner when Ikon Office Solutions reported its earnings per share?



Big News on Your Stock? Better Hold On to Your Hat

By GREG IP

The Wall Street Journal Interactive Edition -- April 27, 1998

There hasn't been a one-day crash in the stock market in years, but one-day crashes in individual stocks have become frighteningly routine.

It now takes little more than a day, and often less, for investors to pound a stock down dramatically when bad earnings news is released, compared with the several weeks that were typical in the 1980s, a new report shows. Stocks also rally much more rapidly on good news.

The trend to much faster stock reaction, which many investors have long suspected, has been fed by faster information flow and a proliferation of hedge funds and so-called momentum investors -- investors who rapidly move in and out of stocks based on how fast earnings, sales or stock prices are moving.

That's a big reason why investors are paying increasingly rich valuations for big, blue-chip growth companies with a track record of not disappointing. They're afraid of being caught holding a "torpedo" stock, that is, a stock that can blow a huge hole in an otherwise solid portfolio.

Robert Butman, president of TQA Investors LLC, a New York hedge fund, looked at how thousands of stocks react to worse-than-expected earnings (negative surprises) and better-than-expected earnings (positive surprises) from 1995 to 1998, then compared that with an earlier study of similar reactions from 1983 to 1989.

In both periods, the stock price on average fell about 8%, relative to the Standard & Poor's 500-stock index on a negative surprise. That means that if the S&P 500 dropped 2% in that period, the stock fell 10%. But while that drop usually took three to four weeks in the 1980s, it now occurs within two days. Similarly, with positive surprises, stocks typically gained 8% between three and four weeks after the report in the 1980s, but in the 1990s, it took less than three days.

"The impact of news events is being absorbed by the market almost instantaneously," says Mr. Butman, who used data and methodology supplied by DAIS Group.

That sudden and powerful impact is one reason companies try so hard to manage investors' expectations. And those management techniques are working: While the companies in the S&P 500 to report so far had first-quarter profit growth of a measly 3.3%, the reported profits were still 2.9% above analysts' much-reduced estimates, according to First Call Corp. The "better-than-reduced-expectations" reports helped drive stock prices to records last week before Friday's pullback.

There are several explanations for the much more rapid response of stock prices to news. One is improved technology. In the 1980s, "earnings were first released in The Wall Street Journal, then you would wait to get a mailed press release," says Beth Cotner, manager of Putnam Investment Management's Investors fund. Many fund managers didn't even call the company until several days after it announced earnings, she says. "Now you get it faxed instantaneously or e-mailed or you can go onto the company's web site." Services like First Call enable managers to see instantly whether a company met, beat or disappointed analysts' expectations and by how much, she adds.

Another factor is the size of positions investors now trade, adds Jamie Atwell, head of Nasdaq trading for growth-fund manager Nicholas-Applegate Capital Management. Fund managers now typically own one million shares of a company instead of 10,000, he says. So a manager trying to get in or out of a stock moves its price far more.

"You have more and more people in this momentum game," he adds. Fund managers like Nicholas-Applegate and AIM Capital Management were among the first to build a reputation for moving aggressively into fast-growing stocks and out just as quickly when that growth faltered. Now, numerous managers employ such techniques and surveys show that trading on earnings surprises is a favorite stock selection style. Finally, there are thousands of hedge funds now that trade instantly on news. Though they may only trade 5,000 or 10,000 shares, enough of them together will move the price quickly, Mr. Atwell says.

The past few weeks have seen several instances of this phenomenon. One of the most notable was when Cendant Corp. said after the market closed April 15 that it had discovered "potential accounting irregularities" in its core membership-club operations which would reduce 1997 earnings and hurt this year's earnings. The next morning, the stock opened on the New York Stock Exchange at 18 3/4, down 48% from the previous day's Big Board close of 36. It closed at 19 1/16 on the Big Board, with more than \$14 billion lopped off its market capitalization.

The cavernous move caught both professionals and individuals by surprise. Ms. Cotner, whose fund held Cendant, says she might have sold some on a smaller drop but given the size of the collapse, decided to add to her holdings instead, noting Cendant didn't have a typical earnings disappointment, but, it appears, a one-time adjustment. Cendant closed Friday at 22.

On the other hand, Eugene Weissman, a Seattle management consultant, sold some Cendant that morning and is kicking himself for it. Already leery of the stock, he had placed an order to sell even before Cendant's news came out, then left on a trip. His stock was sold at the opening on the Big Board. He should have instructed his broker not to sell the stock below a certain price when he placed the order, he says. "I learned a very expensive lesson. I would never sell with the herd. You'd be nuts to do that."

Similarly, when Ikon Office Solutions reported earnings per share a few pennies short of estimates early Wednesday, it opened that day at 25, down 29% from the previous day's close. It closed Friday at 23 3/4 in Big Board composite trading.

Volume often soars on such events, but a lot of the trading is driven by hedge funds and rapid-fire "day traders" trying to make a quick buck. Georgeson & Co., a New York shareholder analysis firm, estimates that on most days, about 50% of a large-capitalization stock's volume is accounted for by people who buy and sell within the same day. But on occasions when volume spikes dramatically, that share soars to between 75% and 90%.

Stocks move so quickly it's often impossible for an investor to act on news before it's fully reflected in the price. But some try to anyway, which has given rise to much more after-hours and pre-opening trading. Mr. Atwell, for example, says he will often buy or sell before the regular market opening if news makes it necessary. "My job is to out-trade my competition and to hopefully be the first one pulling the trigger."

On April 16, for example, about 12 million shares of Cendant traded between 9:30 a.m. EDT and when the Big Board opened the stock at 11:04 a.m. after clearing a "sell" order imbalance. Most of that early trading was through "third-market" brokers like Jefferies & Co., and Cantor Fitzgerald & Co., and through Reuters Holdings' Instinet, at prices ranging from 17 to 21 1/2.

