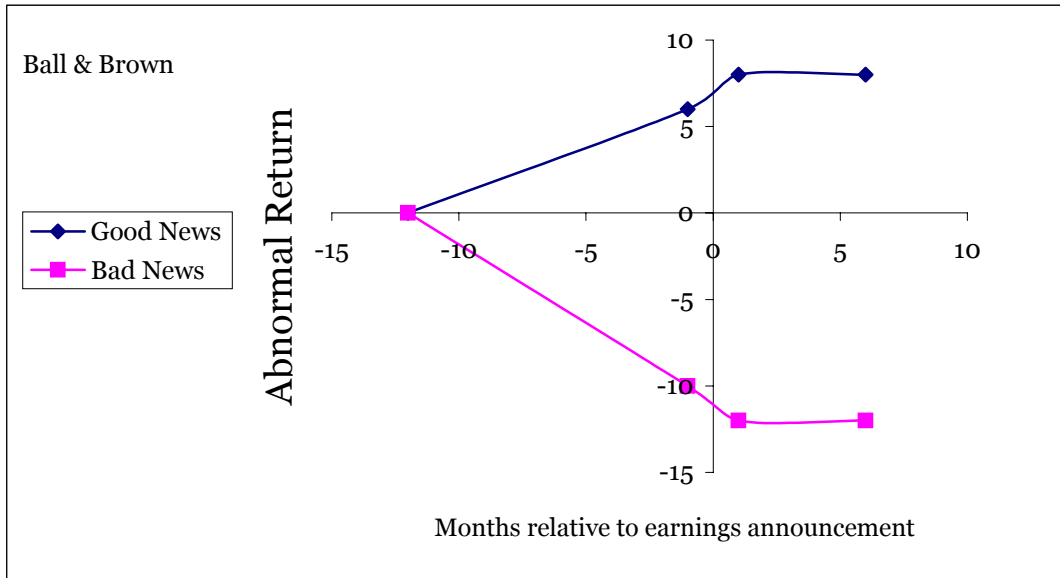
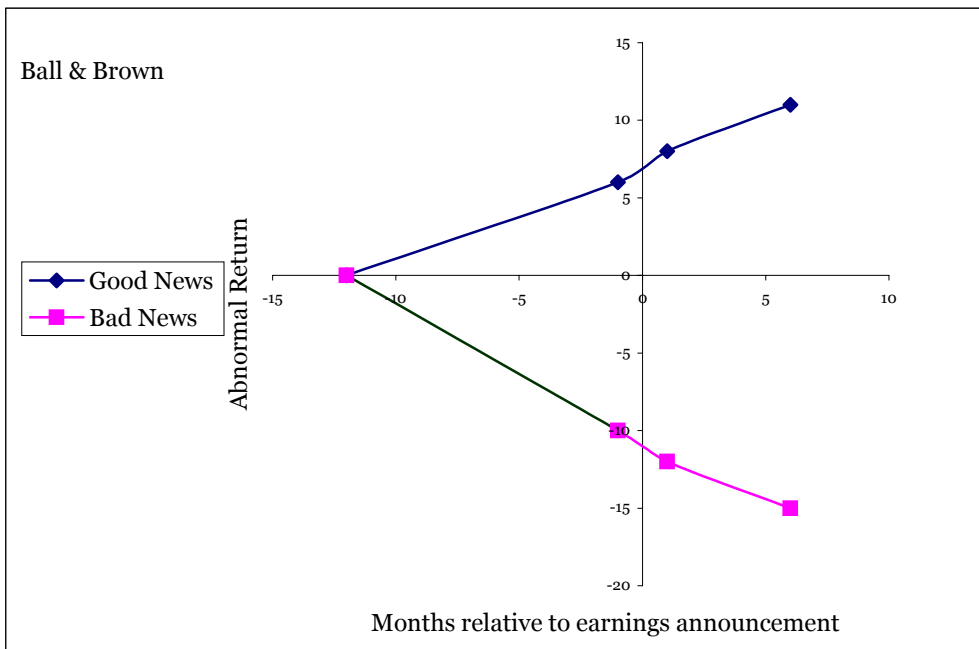


Evidence that stock prices do not fully reflect the implications of current earnings for future earnings

**Expected**



**Actual**



**Time Series Properties of Quarterly Earnings**

Seasonal differences in quarterly earnings are correlated.

Earnings in t	-	Earnings in t-4	are positively correlated	Correlation 0.34
Earnings in t+1	-	Earnings in t-3		
Earnings in t	-	Earnings in t-4	are negatively correlated	(0.24)
Earnings in t-4	-	Earnings in t-8		

Autocorrelations in seasonally differenced quarterly earnings.

Earnings measure:

Net Income before extraordinary items and discontinued operations

**Market Expectations**

Earnings in t = Earnings in t-4

**True expectations**

Earnings in t = Earnings in t-4 + (Earnings in t-1 - Earnings in t-5) x phi + Shock in t-4 x theta

	Qtr	Market expectation	Correct	Actual Earnings	Actual Shock
Year 1	1			\$ 10.00	
	2			\$ 10.00	
	3			\$ 10.00	
	4			\$ 20.00	
Year 2	1			<b>\$11.00</b>	
	2				
	3				
	4				
Year 3	1				

Consistent across industries and size.

Abnormal Market Return in t = Size adjusted return over -2, -1, 0

Positively related to [Earnings in t-1 - Earnings in t-5] and Shock in t-4

SUE = forecast errors from a seasonal random walk / standard deviation