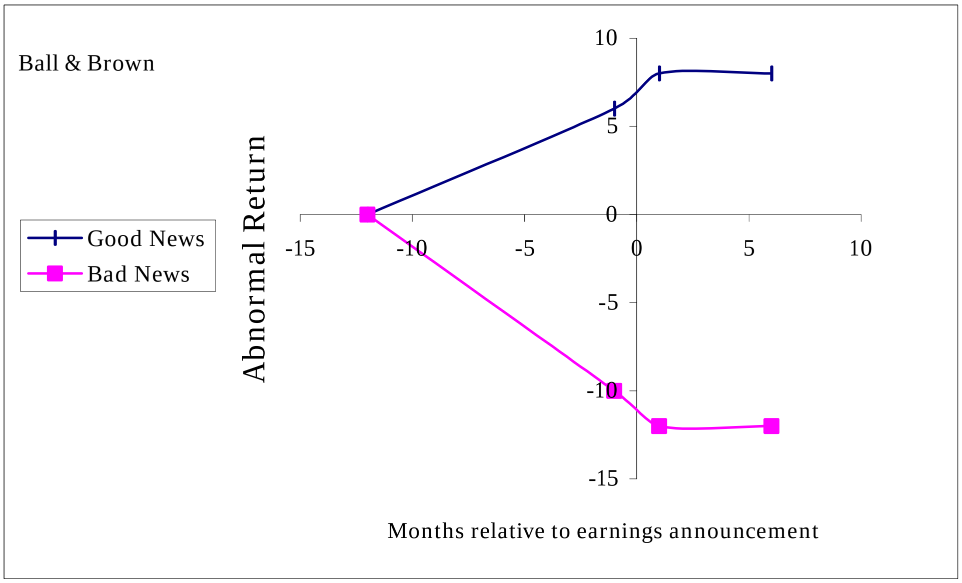
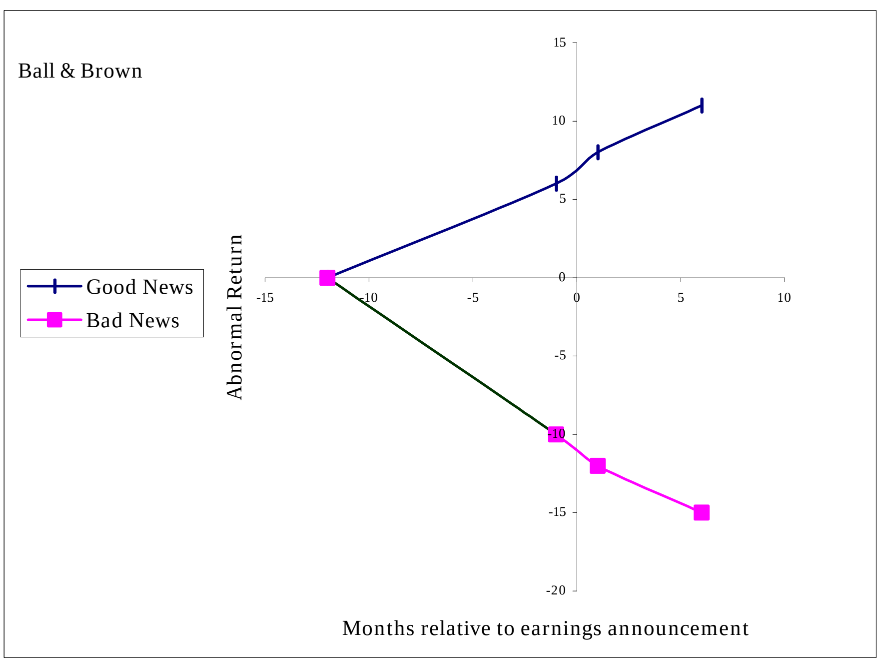
Evidence that stock prices do not fully reflect the implications of current earnings f future earnings

Expected



Actual



Time Series Properties of Quarterly Earnings

Seasonal differences in quarterly earnings are correlated. Correlation

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

Autocorrelations in seasonally differenced quarterly earnings.
Net Income before exrtraordinary 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	Last year	Ch EPS			Expectation	Shock	
Year 1	1	$ 10.00						
							$ 1.00	$ 11.00
	2	$ 10.00	$ 1.00	x	0.34	$ 0.34		
								$ 10.34
	3	$ 10.00	$ 0.34	x	0.34	$ 0.12		
								$ 10.12
	4	$ 10.00	$ 0.12	x	0.34	$ 0.04		
								$ 10.04
Year 2	1	$ 11.00	$ 0.04	x	0.34	$ 0.01		
			$ 1.00	x	(0.24)	$ (0.24)		$ 10.77
	2	$ 10.34	$ (0.23)	x	0.34	$ (0.08)		
			$ -	x	(0.24)	$ -		$ 10.26

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

	Qtr	Expectations Market	Correct	Actual Earnings	Actual Shock
Year 1	1	$ 10.00		$11.00	$1.00
	2	$ 10.00	$ 10.34	$ 10.34	$0.34
	3	$ 10.00	$ 10.12	$ 10.12	$0.12
	4	$ 10.00	$ 10.04	$ 10.04	$0.04
Year 2	1	$ 11.00	$ 10.77	$10.77	($0.23)

Consistent across industries and size.

Abnormal Market Return in t = Size adjusted return over -2, -1, 0
SUE = forecast errors from a seasonal random walk / standard deviat