Stock Returns, Aggregate Earnings Surprises, and Behavioral Finance

Abstract

We study the stock market's reaction to aggregate earnings news. Previous research shows that, for individual firms, stock prices react positively to earnings news but require several quarters to fully reflect the information in earnings. We find a substantially different pattern in aggregate data. First, returns are unrelated to past earnings, suggesting that prices neither underreact nor overreact to aggregate earnings news. Second, aggregate returns are negatively correlated with concurrent earnings; over the last 30 years, stock prices increased 6.5% in quarters with negative earnings growth and only 1.9% otherwise. This finding suggests that earnings and discount rates move together over time, and provides new evidence that discount-rate shocks explain a significant fraction of aggregate stock returns.