What's Included in This Executive Summary?

We first describe the main findings of the study in Main Results, in Brief. We decompose the results by industry, job title, and firm and executive characteristics in Subsample Results. In Ancillary Findings, we examine whether executives trade on their expectation errors and whether stock prices converge to their expectations, and we also link apparent earnings management to errors. At the end, in Selected Anonymous Comments, we present (with permission) a short selection of anonymized comments that we received from executives during the study.

Main Results, in Brief

For the study, we asked executives with full knowledge of their quarterly financial reports to predict the one-day stock market reaction to these reports in the second calendar quarter of 2020. We contacted 3,700 US public firms and received responses from 15% of them. Overall, we collected almost 700 responses from individual executives, representing about 550 firms. Our analysis indicates that the sample of participating firms is generally representative of a broader universe of publicly listed US companies.

Our study uncovers a significant disconnect between managers' expectations and actual returns:

- The average *absolute* difference between managers' expectation and realized stock return (*expectation error*) amounts to 6.8% (or 680 basis points). This error is about 6.6% if we adjust for contemporaneous peer or market returns. To put these numbers into perspective, the average absolute stock reaction to quarterly reports was about 7%. Therefore, **executives' expectation errors are almost as large in magnitude as the actual stock market response**.
- **Every third executive didn't predict the direction of the stock reaction correctly.**
- Volatility and uncertainty related to Covid do not seem to account for these findings. Executives self-report an average error of about 6% (or 600 basis points) in pre-pandemic quarters.
- We compare executives' prediction performance relative to mechanical computer prediction models based on earnings and sales surprises, dispersion of Wall Street analyst estimates, and stock returns in prior days. **Executives' expectations are more accurate than simple mechanical models in only 50% cases—no better than a coin toss. However, executives are significantly better at predicting the direction of stock reaction than a mechanical model.** We also find that executives are more inaccurate than mechanical models when realized returns are negative. Overall, we conclude that, in some circumstances, **executive teams could use simple statistical models to better anticipate stock market reactions.**

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Subsample Results

The table below summarizes executives' error by industry and job title.

	Mean Q2 2020 expectation errors	Mean self-reported pre-pandemic expectation errors
Industry:		
Agriculture and Extractive Industries	4.6	3.7
Chemicals	5.3	10.0
Computers	5.7	5.2
Construction	9.3	3.4
Finance and Insurance	5.2	6.1
Real Estate	3.5	2.6
Food and Beverages	6.2	8.2
Manufacturing - Machinery & Electrical	6.8	9.1
Manufacturing - Raw Materials	10.3	6.1
Manufacturing - Other	9.2	5.1
Pharmaceuticals	6.3	5.9
Retail	6.9	5.9
Services	8.7	6.3
Textiles	5.2	4.7
Transportation	6.6	10.3
Communications and Utilities	6.1	4.0
Job title:		
CEO	6.5	7.5
CFO	5.8	5.0
Investor Relations	6.3	4.1
COO	9.3	12.1
Treasurer	6.3	10.6
Accounting	6.5	4.7
Other	7.1	5.6

Firm and executive characteristics also predict the magnitude of executives' errors. On average, errors are larger for:

- Smaller companies
- Companies with larger stock price declines during the first quarter of 2020
- Companies with less analyst coverage or greater analyst forecast dispersion
- Companies reporting larger EPS surprises
- Companies with greater short interest in the stock
- Companies that do not issue EPS guidance
- Executives with shorter tenures at the company

Other characteristics do not appear to significantly predict the magnitude of errors:

- Executive age or gender
- Executive experience in the C-Suite
- Proportion of stock-based compensation for the executive
- Whether the company reports before or after hours

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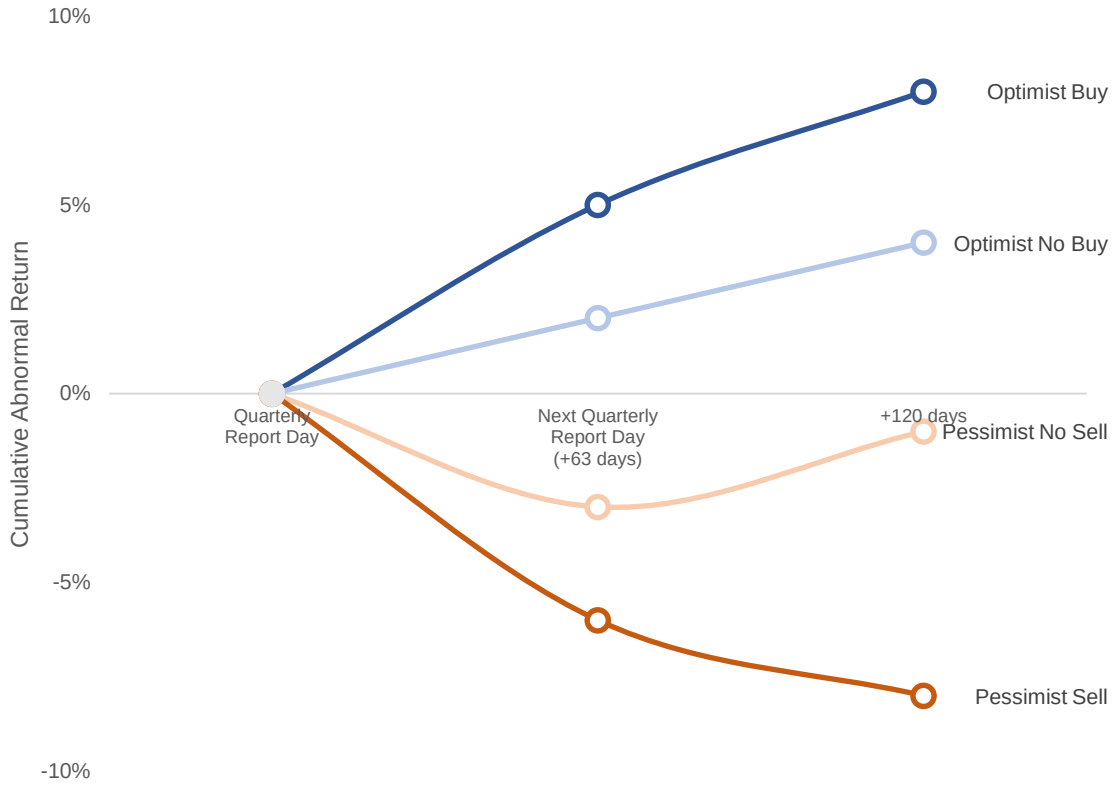
Ancillary Findings

We examine whether the stock price converges to managers' expectations in the long-term. While we do not find evidence of stock price convergence to expectations for the full sample of firms, **we do find statistical evidence of longer-term price convergence for the subset of executives who, in the ten trading days after the report is released, trade in line with their expectation errors**.

For example, "optimistic" executives (i.e., executives whose expectation for the stock return was higher than the market return) who buy company stock within ten trading days following the release date earn positive abnormal returns over the next 120 days and see convergence to their original expectations. We observe similar results for pessimists, who sell their stock. The figure below summarizes our findings:



We also find a correlation between executives' ability to accurately predict the stock market reaction and their company's apparent use of earnings management. The companies of executives who report difficulty in predicting stock price reactions to earnings news appear less likely to use earnings management techniques to increase their reported EPS. This suggests a kind of silver-lining to the difficulty in estimating market responses—executives are less inclined to manage corporate earnings when they are less able to predict the capital market consequences of doing so.

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Selected Anonymous Comments

Overall ability to estimate stock price reaction

"I will say I have been a Senior Officer for over 10 years and throughout that time my estimation on the reaction of the stock post an earning call has been highly inaccurate in both directions. At times I feel it's irrational and some Artificial Intelligence decides the value vs. common sense."

"Curious to see what you come with. My guess is executives have as much luck estimating stock price impact as a monkey guessing sp 500 in one year. Me included."

"Predicting market reaction to quarterly earnings is a no-win endeavor. This is an area of extreme personal frustration and one that I share with a number of colleagues."

"As you may be able to appreciate it is a bit of a lottery and not something I place any credibility on."

"I can tell you in advance that I fall into the category of "your guess is as good as mine"!"

"We have learned that it never trades the way you think it should."

"It often makes me chuckle about insider trading rules. With again the rare exception of times where we have significant announcements or significant differences from market expectation, I am confident that I would not have made money investing with my "superior knowledge" with short term trades."

"I'm fond of saying that if I could ever predict what our stock does in relation to any news, I probably wouldn't have to do this job any longer."

Direction and magnitude accuracy

"Over the long run, we have been directionally accurate regarding the post earnings report stock price on the day after; less so on the magnitude front."

"Following the financial markets, I would say that usually I have a good sense of the direction of the stock price after earnings releases (predictability) but not how the market will value the company or how attractive the stocks will be (accuracy)."

"To add a little more color, I can normally tell a direct of whether the stock should trade up or down on the day of our earnings call. This is primarily because we know whether or not we will meet the consensus estimate of the analysts who follow our stock. If we meet or beat the consensus, we will typically trade higher. And conversely, if we miss consensus, we will trade lower."

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"I would say that our estimate is usually "directionally correct" (i.e. stock will under / outperform). The quantum can be very difficult to predict."

"Historically I have never been good at predicting how the market will react. Normally I can predict if it goes up or down but beyond that a roll of the dice would be more accurate!"

"Generally we are right about the direction of the share price movement, but the magnitude can sometimes surprise us, especially to the down side."

Internal polls

"I'm happy to participate, but we play that game here every quarter and a number of the C-suite tell me what they think the market reaction will be, and I'm amused to inform you that collectively, we're successful at predicting the stock reaction a little more than 50% of the time. A success rate that you'd not be surprised to discover, if you were guessing the result of a toss of a coin."

"Most quarters maybe three of us with knowledge of our numbers have a friendly non-cash wager about what the stock will do."

"We usually have a friendly wager in the office, on where we think the share price will be at the end of day one."

"By way of background, my IR team and the core leadership team each quarter typically "guess" at the stock response the following day."

"It has been a custom for many years here to see how well a few of us do forecasting our stock price on the day of our earnings release. No matter our knowledge level of the to-be-released data, we rarely ever get it right. My informal analysis says there is low correlation to guessing how the stock will trade, irrespective of the level of information know in advance. We joke about it often."

Cross-sectional prediction ability

"It is harder to predict results when results materially deviate from the street consensus."

"We are often surprised by the outcome if we are near market expectations. We also see significant differences depending on market movement before announcement as well as those a relatively short period after. None of which is necessarily describable except anecdotally."

"I will admit that it is always difficult to predict what the stock will do. Many times I think the stock will increase after Earnings and in fact, it goes down. The opposite also occurs. One

reason is because in the US, investors have access to credit card data so they are better able to predict what the earnings of a company will be now so there is not as much of a surprise when a company announces their quarterly results."

"We are an extremely leveraged company and that may have something to do with our stock volatility."

"Typically I expect our earnings to not cause the market to swing one way or another due to our relationship with coverage analysts."

"This earnings call was more of an anomaly given COVID and the fact that we were not providing guidance."

"I had a conservative range of ±5%. The share price a day after earnings release fit within that band. Given my company's high beta, it makes very little sense to select a specific share price."

Executives opting out

"I am not a good candidate for your study because I don't really form opinions about post earnings stock performance. A long time ago I figured out that I have no idea."

"X Corp may not be the best candidate for this study. We have an announced acquisition proposal from Y Inc. to fully acquire X Corp. So the share price reaction was muted and driven by the deal price, not by market factors."

"I'd be happy to help but as our company is under contract to be sold for a mix of cash and stock it will likely trade more based on the acquirer share price than fundamentals. As such it may skew what you are trying to measure."

Field study construction

"I took note of what was different for me this time. I wasn't influenced by my colleagues in making my estimate. Usually, my colleagues will discuss their guesses with me in advance, and I usually change my own opinion in response to theirs. This time, when I saw your email, I picked a number and stuck with it."

"I did not understand that you were not gathering information prior to earnings releases. Given you are not, my concerns are allayed and I would be happy to participate. Note there will be a bias to have been right on the part of CEOs, a generally prideful bunch!"

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