# Analysts impact on the capital markets

Analysts, as a form of information intermediaries, are expected to mitigate information asymmetry and/or reveal mispricing. With access to a wide range of information, including public signals such as stock prices, industry news, and macroeconomic factors, as well as private signals about firm-specific financial and operating situation, analysts’ outputs e.g. coverage decisions, earnings forecasts, and recommendations should contain valuable information for the capital markets and therefore have real economic consequences.

Kelly and Ljungqvist (2012) show that exogenous shocks to analyst coverage terminations through closures and/or brokerage mergers and acquisitions increase firm expected returns by exacerbating adverse selection risk. Analyst coverage affects firm cost of capital and thus induces managers to change investment, and financing decisions (Derrien and Kecskés (2013)). Loh and Stulz (2018) show that analyst coverage decisions and recommendations become much more valuable in bad times. The information content of analyst outputs increase with industry competition and becomes much more important to the functionality of the capital markets (Merkley, Michael and Pacelli (2017)). Das, Guo and Zhang (2006) show that analyst selective coverage decisions can predict future performances of newly listed firms. Lee and So (2017) extend the idea from Das, Guo and Zhang (2006) by applying a characteristic-based decomposition method to a large cross-section of firms find that the coverage signal related to analyst expectations about firm future performances, and show that the signal strongly predicts firm future returns and operating performances.

Asquith, Mikhail and Au (2005), Frankel, Kothari and Weber (2006), and Loh and Stulz (2011) show that analyst earnings revisions incorporate both publicly observed signals and new information to investors. Consequently, prices, trading activity, and liquidity all change around analysts’ forecast revisions. Institutional investors trade more during the recommendation changes to capture the short-lived private information (Kadan, Michaely and Moulton (2017)). Studying intraday data, Bradley, Clarke, Lee and Ornthanalai (2014) find that the market reacts most strongly to analyst recommendation changes. Although analysts forecasts are known to exhibit inherent biases, So (2013) finds that investors in fact overweight them and the predictable biases influence the information content of prices. Hilary and Hsu (2013) find evidence that consistent analyst errors are more informative and more likely to affect prices than unbiased forecasts.

# References

Asquith, P., Mikhail, M. B., Au, A. S. "Information content of equity analyst reports." *Journal of Financial Economics* 75 (2005), 245-282.

Bradley, D., Clarke, J., Lee, S., Ornthanalai, C. "Are analysts’ recommendations informative? Intraday evidence on the impact of time stamp delays." *The Journal of Finance* 69 (2014), 645-673.

Das, S., Guo, R.-j., Zhang, H. "Analysts' Selective Coverage and Subsequent Performance of Newly Public Firms." *The Journal of Finance* 61 (2006), 1159-1185.

Derrien, F., Kecskés, A. "The real effects of financial shocks: Evidence from exogenous changes in analyst coverage." *The Journal of Finance* 68 (2013), 1407-1440.

Frankel, R., Kothari, S. P., Weber, J. "Determinants of the informativeness of analyst research." *Journal of Accounting and Economics* 41 (2006), 29-54.

Hilary, G., Hsu, C. "Analyst Forecast Consistency." *The Journal of Finance* 68 (2013), 271-297.

Kadan, O., Michaely, R., Moulton, P. C. "Trading in the presence of short-lived private information: Evidence from analyst recommendation changes." *Journal of Financial and Quantitative Analysis (Forthcoming)* (2017).

Kelly, B., Ljungqvist, A. "Testing Asymmetric-Information Asset Pricing Models." *The Review of Financial Studies* 25 (2012), 1366-1413.

Lee, C. M. C., So, E. C. "Uncovering expected returns: Information in analyst coverage proxies." *Journal of Financial Economics* 124 (2017), 331-348.

Loh, R. K., Stulz, R. M. "When Are Analyst Recommendation Changes Influential?" *The Review of Financial Studies* (2011), 593-627.

Loh, R. K., Stulz, R. M. "Is Sell-Side Research More Valuable in Bad Times?" *The Journal of Finance* 73 (2018), 959-1013.

Merkley, K., Michael, R., Pacelli, J. "Does the Scope of the Sell-Side Analyst Industry Matter? An Examination of Bias, Accuracy, and Information Content of Analyst Reports." *The Journal of Finance* 72 (2017), 1285-1334.

So, E. C. "A new approach to predicting analyst forecast errors: Do investors overweight analyst forecasts?" *Journal of Financial Economics* 108 (2013), 615-640.