Evaluation of Stock Buzz : The Free Stock Recommendation

Chandrashekhar R,
thambi_2k@yahoo.com
Department of Business Administration, Mangalore University

Abstract

Brokerage industry is gaining more popularity at present scenario. Stock brokers estimate the future stock price and provide free advisory services to the investors. It is essential to know their performance in past and present. The past performance helps in knowing the accuracy of free stock recommendations. This study examines the performance of shares suggested under the Stock Buzz Column. I find significant difference between the predicted return and actual short term holding period return. Majority of recommended shares earned negative return over the period and all advisors were inaccurate in predicting future price. It is better not to rely purely on the predictions of these stock broking houses for investment decisions

Key Words: Brokerage, Advisory Service, Negative Return, Stock Buzz

Evaluation of the Stock Buzz : The Free Stock Recommendation

Chandrashekhar R,

thambi_2k@yahoo.com

Department of Business Administration, Mangalore University

Abstract

Brokerage industry is gaining more popularity at present scenario. Stock brokers estimate the future stock price and provide free advisory services to the investors. It is essential to know their performance in past and present. The past performance helps in knowing the accuracy of free stock recommendations. This study examines the performance of shares suggested under the Stock Buzz Column. I find significant difference between the predicted return and actual short term holding period return. Majority of recommended shares earned negative return over the period and all advisors were inaccurate in predicting future price. It is better not to rely purely on the predictions of these stock broking houses for investment decisions

Key Words: Brokerage, Advisory Service, Negative Return, Stock Buzz

Introduction:

Indian stock market is one of the oldest in the world and has a strong presence and network of domestic and local intermediaries. Stock markets and the equity broking firms in India grew unprecedentedly after 1990s. The broking industry is fast emerging as a high growth segment in the Indian financial services sector, in terms of business growth. The basic function of a brokerage firm is to execute, buy and sell orders for clients. SEBI makes it mandatory that all the trading in stocks must be routed through a broker only; no individual can trade in the secondary market without the brokers. The brokerage industry is grown a lot in the recent years. These brokerage houses differ enormously in the type of clientele they attempt to attract. The brokerage houses with their number of products to offer to the customers have been successful in attracting a large number of investor/clients. Jackson, A. R. (2005) reveals that high reputation analysts generate higher future trading volume and accurate analysts are rewarded with higher end-of-period reputations. They provide three types of stock broking services. One concerned to only execution, which means that the broker will only carry out the client's instructions to buy or sell a share. The other concerned with advisor dealing,

where the broker advises the investor on which shares to buy and sell, but leaves the final decision to the investor. Rose (1951) opine that decisions regarding activity on the stock market must be made rapidly if they are to be effective and most traders do not have the information necessary for making accurate predictions. Further he opines that rumour exerts a particularly significant influence on those who trade in the market. Discretionary dealing, where the stockbroker ascertains the client's investment objectives and then makes all dealing decisions on the client's behalf. The business of broking consists of searching out buyers when their customers wish to sell and locating sellers when their customers wish to buy so as to execute transactions as per customers' instructions. The brokers do not function as principals or dealers of transactions. One of the most important functions of the broker will be to provide access to emerging markets and analysis of potential investment opportunities. All of this information is less likely to be available to individual retail investors. The brokers continue to recommend securities on the basis of technical analysis and fundamental analysis. Unsophisticated investors rely almost entirely upon the advice of brokers and they do not question these recommendations (Salmanowitz, 1977). Therefore relying on the broker is likely to remain a crucial element of the client-broker relationship. Brokerage industry is gaining more popularity at present scenario and it is essential to know its performance in past and present. The past performance helps in knowing the factors which led this industry to its new height by improved growth.

Review of Literature:

A few previous researchers analyzed stock recommendations appeared in USA and Europe. Most of the previous researchers examined the stock price reactions to the announcement of stock recommendations. Their study result is briefly presented below.

Bjerring. et.al. (1983) evaluated the recommendations of a Canadian brokerage house. Their results reveal that an investor following the recommendations would have achieved significantly positive abnormal returns, even after allowing for transactions cost. Peterson (1987) evaluates the study of stock recommendations and this study examines daily price reactions to initial reviews of securities by the Value Line Investment Survey. The reviews are found to convey information to the market as significant abnormal returns are found over a 3-day period around release of the information. There is no statistically significant subsequent price reaction after this 3-day period, consistent with market efficiency. Liu et. al.

(1990) indicates that the "Heard-on-the-Street" (HOTS) column of The Wall Street Journal on common stock prices column appears to have an impact on stock prices on the publication day. They also find a smaller, but statistically significant, impact on two days preceding the publication. Beneish (1991) investigates alternative explanations for the significant stock price reaction to analysts' information reported in "Heard on the Street" ("HS"). The evidence indicates that "HS" is not usually a secondary dissemination. First, stock prices adjust prior to publication when recommendations are reported on a single firm. Second, analysts have incentives to release information to "HS" before disseminating it to their clients. Overall, the evidence suggests that "HS" gathers information, forms a consensus, and provides it to investors. Stickel (1992) opines that Members of the Institutional Investor All-American Research Team supply more accurate earnings forecasts than other analysts when forecasts are matched by the corporation followed and by the date of brokerage house issuance. Further he opines this contemporaneous advantage is complemented by a timing advantage; All-Americans supply forecasts more often than other analysts. His study reveals that stocks returns immediately following large upward forecast revisions suggest All-Americans impact prices more than other analysts. He also reports that there is virtually no difference in returns following large downward revisions. Finally he finds collective results suggest a positive relation between reputation and performance, and, assuming that All-Americans are better paid, pay and performance. Stickel (1995) opines that brokerage house buy and sell recommendations influence stock prices. Short-term price reaction is a function of the strength of the recommendation, the magnitude of the change in recommendation, the reputation of the analyst, the size of the brokerage house, the size of the recommended firm, and contemporaneous earnings forecast revisions. The strength of the recommendation, firm size, and contemporaneous earnings forecast revisions are associated with price changes that appear to be permanent, in formation effects. The magnitude of the change in recommendation, analyst reputation, and broker size appear to have temporary, price pressure effect. Trahan and Paul (1995) examine the impact on stock prices of purchase recommendations published in the popular financial weekly, Barron's. Their results show that the publication of this second-hand information has a positive and significant impact on stock prices at the time of publication. They also find that the abnormal returns quickly disperse and the recommendations examined here do not provide superior returns over longer holding periods. Womack (1996) opines that analysis of new buy and sell recommendations of stocks by security analysts at major U.S. brokerage firm’s shows significant, systematic discrepancies between pre recommendation prices and eventual values. The initial return at

the time of the recommendations is large, even though few recommendations coincide with new public news or provide previously unavailable facts. However, these initial price reactions are incomplete. For buy recommendations, the mean post event drift is modest (+2.4%) and short-lived, but for sell recommendations, the drift is larger (-9.1%) and extends for six months. Analysts appear to have market timing and stock picking abilities. Kim et. al. (1997) finds an initial coverage report with a buy recommendation by an analyst has a significant effect on firm value, increasing share prices of NYSE/AMEX firms by approximately 4% and NASDAQ firms by 7%. Their result also provides evidence that there is value to the information collection activities of brokerage firms and analysts and that an element of this value accrues to the benefit of their important clients. Francis and Leonard (1997) analyse a sample of 576 analyst reports published between January 1, 1988 and June 30, 1991, they find that stock recommendations and earnings forecast revisions together explain about 5% of the variation in excess returns cumulated over days (-1,+1) relative to the report publication dates. Their results indicate that recommendations are informative. Further they report that as a group, and after controlling for earnings forecast revisions, variables capturing the level of and the revision in stock recommendations explain a significant (at the .02 level) portion of the variation in cumulative abnormal returns. They also find that investors attach significantly (at the .02 level) larger weights to the earnings forecast revisions in reports containing buy recommendations than they do to revisions in reports containing holds or sells. Carleton. et. al. (1998) studies the investment recommendations made by brokerage and non brokerage firms in an effort of examined the differential agency costs across three unique recommendation reduction environments. Using the ACED databases, recommendation adduction environments are categorized in to national, regional and non-brokerage firms. The results prove that differences exist between brokerage and non brokerage firms: 1) brokerage firms significantly inflate recommendations; 2) regional firms significantly in flatter recommendations, compared to national firms; 3) brokerage firms' recommendations, compared to no brokerage firms' recommendations, are less credible and less predictive of future stock performance; 4) national firms have more reputational capital, and therefore their recommendations are more predictive of investment performances and the regional brokerage firms' recommendation. Michaely and Kent (1999) evaluates that underwriter analysts recommend perform more poorly than "buy" recommendations by unaffiliated brokers prior to, at the time of, and subsequent to the recommendation date. They show that the market does not recognize the full extent of this bias. The results suggest a potential conflict of interest inherent in the different functions that

investment bankers perform. Barber et. al., (2001) documents that purchasing (selling short) stocks with the most (least) favourable consensus recommendations, in conjunction with daily portfolio rebalancing and a timely response to recommendation changes, yield annual abnormal gross returns greater than four percent. Further they find that less frequent portfolio rebalancing or a delay in reacting to recommendation changes diminishes these returns; however, they remain significant for the least favourably rated stocks. Barber. et. al., (2003) reveals that after a string of years in which security analysts' top stock picks significantly outperformed their pans, the years 2000 and 2001 were disasters. During those two years, the stocks least favoured by analysts earned an average annualized market-adjusted return of 13.44 percent whereas the stocks most highly recommended underperformed the market by 7.06 percent, are turn difference of more than 20 percentage points. Jegadeesh et. al., (2004) reveals that analysts from sell-side firms generally recommend "glamour"(i.e., positive momentum, high growth, high volume, and relatively expensive) stocks. Naive adherence to these recommendations can be costly, because the level of the consensus recommendation adds value only among stocks with favourable quantitative characteristics (i.e., value stocks and positive momentum stocks). In fact, among stocks with unfavourable quantitative characteristics, higher consensus recommendations are associated with worse subsequent returns. In contrast, we find that the quarterly change in consensus recommendations is a robust return predictor that appears to contain information orthogonal to a large range of other predictive variables. Malloy (2005) provide evidence that geographically proximate analysts are more accurate than other analysts. They also reveal the stock returns immediately surrounding forecast revisions suggest that local analysts impact prices more than other analysts. Further he opines that these effects are strongest for firms located in small cities and remote areas. His results also suggest that geographically proximate analysts possess an information advantage over other analysts, and that this advantage translates into better performance. O'Brien et al. (2005) hypothesize that affiliated analysts have incentives to respond promptly to good news but prefer not to issue bad news about client companies. Using duration models of the time between an equity issue and the first downgrade, they find affiliated analysts are slower to downgrade from Buy and Hold recommendations and significantly faster to upgrade from Hold recommendations, in both within-analyst and within-issuer tests. Their findings indicate that banking ties increase analysts' reluctance to reveal negative news, and that reform efforts must carefully consider the incentives of affiliated and unaffiliated analysts to initiate coverage and convey the results of the research. Antunovich and Asani (2006) examine Nasdaq and over-the-counter "buy"

recommendations. They reveal that the stock picks show substantial short- and long-run price and liquidity gains, although no new information is revealed about them. Green (2006) opines that early access to stock recommendations provides brokerage firm clients with incremental investment value. He also finds that short-term profit opportunities persist for two hours following the pre-market release of new recommendations. His results are robust within sub-periods and a calendar-based strategy produces positive abnormal daily returns. Further he reveals that recommending firms' market makers shift their quotes accordingly, providing indirect evidence that clients make use of the informational advantage that arises from analysts' opinion changes. Boni and Kent (2006) show that analysts create value in their recommendations mainly through their ability to rank stocks within industries. Further they find that an industry based recommendation strategy substantially improves the return to risk ratio and reduces price momentum tilt relative to portfolios that ignore industry information. Brown et. al., (2009) show that the market's reaction is strongly influenced by the analyst's reputation, the divergence of opinion among analysts and the number of analysts following the stock. Chandrashekhar (2012) examines the Brokers Call column of The Hindu Business Line. He finds significant difference between the actual return and the predicted return. He also reveals that the advisors' fail to predict the actual market movement. He suggests that it is better not to rely purely on the predictions of these stock broking houses for investment decisions.

Objective:

Previous studies reveal mixed opinion on the performance of recommended shares. Therefore the main objective of the study is:

- To evaluates the Stock Buzz column of The Economic Times on the free stock recommendation.

Data and sample selection:

The study analyzes 1191 buy recommendation from January 2011 to December 2011. The study restricts the sample to Stock Buzz buy recommendation appeared in The Economic Times. The closing and opening prices of the stocks are collected from the official website of NSE. In the case of intraday, one day's opening and closing prices is taken into account, under short term t+1 day, t+2 day, one week, one month prices are taken and one year prices are taken into account. If any advisor's buy recommendation is not exceeds 30, such advisor's buy recommendation are eliminated for individual analysis.

Methodology:

Target return, opening return, closing return, T+1 day return, T+2 day return, one week return, one month return and short term returns are calculated to evaluate the buy recommendations. Further average return, standard deviation, z-test, positive return and negative return are used in the analysis. To evaluate the accuracy of the recommendations, the target return is compared with the actual buy and hold return for a given period. The hypotheses that there is no significance difference between targets return and buy and hold return for a given period is tested.

Evaluation of Stock Buzz:

The evaluation of buy recommendations appeared under the column Stock Buz is presented below.

Table No. 1

Test Results of all Buy Recommendations

	Target Return	Opening Return	Closing Return	T+1 Return	T+2 Return	One Week Return	One Month Return	Short Term Return
N	1191	1191	1191	1191	1191	1191	1191	1191
Average	0.2633	0.0014	0.0004	0.0412	0.0381	0.0295	0.0098	-0.1564
z- Test		8.0931	8.1753	6.9715	7.2187	8.0126	8.5618	14.1183
+ Return	1144	726	614	603	583	566	492	222
- Return	45	419	570	581	604	619	694	969

*Source: Study Result. **The critical value for 1 percent and 5 percent level of significance is 2.33 and 1.64.

The average target return predicted by the entire broking house is 26.33 percent. The average return on the day of announcement of advice is positive. The average return for the study period is positive except for the short term. They are significantly different from predicted return at 1percent, 5 percent and 10 percent. Further the above table reveals that majority of their suggestion yielded negative return over the period. It is clear from the above result that

majority of the suggestions of all advisors were inaccurate over the study period. And they fail to predict negative returns on the recommended stocks. Majority of the recommended shares yielded negative return over the period and all advisors were fail to predict negative returns on the recommended stocks.

Table No. 2

Advisor's wise Buy Recommendations Evaluation Result

Advisors		N	Target Return	Opening Return	Closing Return	T+1 Return	T+2 Return	One Week Return	One Month Return	Short Term Return
Ambit	Average	46	0.2610	-0.1059	-0.1019	-0.0166	-0.0238	-0.0387	-0.0429	-0.2662
	z- Test			7.0928	6.9828	8.7622	8.9758	9.3129	9.1017	10.8557
Anand	Average	45	0.2744	0.0035	0.0076	0.1239	0.1213	0.0004	0.0105	-0.2762
	z- Test			11.1380	10.8479	1.2892	1.2671	10.8241	9.7352	12.8218
Angel	Average	78	0.2835	0.0551	0.0549	0.1183	0.1143	0.0981	0.0644	-0.1433
	z- Test			3.0212	2.9241	2.2975	2.3803	2.6448	3.4587	6.4901
Bonanza	Average	55	0.1179	-0.0042	-0.0077	-0.0081	-0.0082	-0.0100	-0.0159	-0.0500
	z- Test			12.7185	12.5198	12.5594	10.9922	11.7585	8.1143	4.6896
Fullerton	Average	40	0.2826	-0.1509	-0.1550	-0.0302	-0.0348	-0.0438	-0.0557	-0.2543
	z- Test			6.8524	6.9423	8.4403	8.5456	8.7371	8.6031	11.0642
ICICI	Average	102	0.2026	-0.0649	-0.0643	-0.0160	-0.0175	-0.0192	-0.0651	-0.2512
	z- Test			9.1463	9.1140	10.7155	10.7075	10.5966	11.0144	14.7007
Kotak	Average	35	0.2780	-0.1953	-0.1972	-0.0577	-0.0606	-0.0646	-0.0943	-0.1798
	z- Test			6.6151	6.6480	7.5661	7.6112	7.7437	8.4884	8.8706
Microsec	Average	60	0.2197	-0.0122	-0.0102	-0.0070	-0.0066	-0.0022	-0.0118	-0.1702
	z- Test			7.0301	6.9491	6.7926	6.7597	6.5406	6.5939	9.9724
Motilal	Average	134	0.3807	-0.0344	-0.0362	-0.0354	-0.0367	-0.0420	-0.0814	-0.2027
	z- Test			14.2835	14.3136	14.2651	14.2724	14.4215	15.3675	18.8397
Nirmal	Average	59	0.3531	0.0098	0.0060	0.0034	0.0065	0.0068	-0.0336	-0.1369
	z- Test			14.1290	14.2146	14.2996	14.1240	13.8225	13.8317	14.9503
Padmakshi	Average	34	0.2597	-0.0477	-0.0451	-0.0441	-0.0313	-0.0394	-0.0708	-0.2102
	z- Test			6.9068	6.7979	6.6879	6.2750	6.4072	7.1385	9.0951
ShareKhan	Average	102	0.3363	-0.0430	-0.0392	-0.0339	-0.0303	-0.0447	-0.0547	-0.2035
	z- Test			11.7937	11.6377	11.4085	11.2612	11.4371	11.1475	14.4983
Unicon	Average	50	0.3066	0.5051	0.5048	0.5068	0.4844	0.4717	0.4522	0.1748
	z- Test			-0.4426	-0.4419	-0.4461	-0.4082	-0.3809	-0.3353	0.2998

*Source: Study Result. **The critical value for 1 percent and 5 percent level of significance is 2.33 and 1.64.

On an average all the advisors predicted more than 20 percent return for short term holding periods. The average opening day returns for majority of the recommended share are negative. This trend continues for the short term holding periods. I find significant difference

between the predicted return and the short terms holding period return for all the advisors. The results of the study reveal that majority of the advisors predictions were not accurate over the period. The advisors fail to predict the negative return over the short term.

Conclusion:

The broking industry is fast emerging as a high growth segment in the Indian financial services sector and it provides various services to the investors. Stock brokers estimate the future stock price and provide free advisory services to the investors. One of the most important functions of the broker will be to provide access to markets and analysis of potential investment opportunities. All of this information is less likely to be available to individual retail investors and there for they rely on the advisors. This study examines 1191 buy recommendations appeared in 'Stock Buzz' column of The Economic Times from January 2011 to December 2011. I find statistically significant difference between the predicted return and the short term holding period return. The results of study reveal that majority of their suggestion yielded negative return over the period and all advisors were inaccurate in predicting future price. There for it is better not to invest only on the recommendations of the advisors.

References

1. Antunovich. P, and Asani. S, (2006), "Fifteen Minutes of Fame? The Market Impact of Internet Stock Picks", The Journal of Business, Vol. 79, No. 6, pp. 3209-3251.
2. Barber B, Reuven L, Maureen M and Brett T, (2003), "Reassessing the Returns to Analysts' Stock Recommendations", Financial Analysts Journal, Vol. 59, No. 2, pp. 88-96.
3. Barber B, Reuven L, Maureen M, and Brett T, (2001),"Can Investors Profit from the Prophets? Security Analyst Recommendations and Stock Returns", The Journal of Finance, Vol. 56, No. 2, pp. 531-563.
4. Beneish M. D., (1991),"Stock Prices and the Dissemination of Analysts' Recommendation", The Journal of Business, Vol. 64, No. 3, pp. 393-416.
5. Bjerring J. H, Josef. L, and Theo V, (1983), "Stock Prices and Financial Analysts' Recommendations", the Journal of Finance, Vol. 38, No. 1, pp. 187-204.
6. Boni, L. and Kent L. W. (2006), "Analysts, Industries, and Price Momentum", The Journal of Financial and Quantitative Analysis, Vol. 41, No. 1, pp. 85-109.

7. Brown, R., Howard W. H. C., and Yew, K. H. (2009), “Analysts’ recommendations: from which signal does the market take its lead?”, Review of Quantitative Finance and Accounting, Vol. 33, pp 91–111
8. Carleton W. T., Carl R. C. and Thomas L. S., (1998), “Optimism Biases among Brokerage and Non-Brokerage Firms' Equity Recommendations: Agency Costs in the Investment Industry” Financial Management, Vol. 27, No. 1, pp. 17-30.
9. Chandrashekhar, R. (2012), “Analysis of Brokers Call: The Free Stock Recommendations”, Global Research Analysis, Vol. 1, No. 5, pp. 37-39.
10. Francis J and Leonard S, (1997),”The Relative In formativeness of Analysts' Stock Recommendations and Earnings Forecast Revisions”, Journal of Accounting Research, Vol. 35, No. 2, pp. 193-211.
11. Green, T. C. (2006), “The Value of Client Access to Analyst Recommendations”, The Journal of Financial and Quantitative Analysis, Vol. 41, No. 1, pp. 1-24.
12. Jackson, A. R. (2005), “Trade Generation, Reputation, and Sell-Side Analysts”, The Journal of Finance, Vol. 60, No. 2, pp. 673-717.
13. Jegadeesh N, Joonghyuk K, Susan D. K and Charles M. C. L, (2004), “Analyzing the Analysts: When Do Recommendations Add Value?” The Journal of Finance, Vol. 59, No. 3, pp. 1083-1124.
14. Kim, S. T., Ji-Chai, L., Myron, B. S(1997), “Market Structure, Informed Trading, and Analysts' Recommendations”, The Journal of Financial and Quantitative Analysis, Vol. 32, No. 4, pp.507-524.
15. Liu, P., Stanley, D. S., Azmat, A. S. (1990), “Stock Price Reactions to The Wall Street Journal's Securities Recommendations”, The Journal of Financial and Quantitative Analysis, Vol. 25, No. 3 pp.399-410.
16. Malloy, C.J. (2005), “The Geography of Equity Analysis”, The Journal of Finance, Vol. 60, No. 2, pp. 719-755.
17. Michaely R and Kent L. W., (1999),” Conflict of Interest and the Credibility of Underwriter Analyst Recommendations”, The Review of Financial Studies, Vol. 12, No.4, pp. 653-686.
18. O' Brien P. C., Maureen F. M., and Hsiou-Wei L, (2005),”Analyst Impartiality and Investment Banking Relationships”, Journal of Accounting Research, Vol. 43, No. 4, pp. 623-650.

19. Peterson D. R., (1987),"Security Price Reactions to Initial Reviews of Common Stock by the Value Line Investment Survey", The Journal of Financial and Quantitative Analysis, Vol. 22, No. 4 , pp.483-494.
20. Rose, A.M. (1951), "Rumor in the Stock Market", The Public Opinion Quarterly, Vol. 15, No. 3, pp. 461-486.
21. Salmanowitz. J. M., (1977), "Broker Investment Recommendations and the Efficient Capital Market Hypothesis: A Proposed Cautionary Legend", Stanford Law Review, Vol. 29, No. 5, pp. 1077-1114.
22. Stickel Scott .E, (1992),"Reputation and Performance Among Security Analysts", The Journal of Finance, Vol. 47, No. 5, pp. 1811-1836.
23. Stickel Scott E, (1995),"The Anatomy of the Performance of Buy and Sell Recommendations" Financial Analysts Journal, Vol. 51, No. 5, pp. 25-39.
24. Trahan, E. A. and Paul J. B.(1995), "The Impact of "Barron's" Recommendations on Stock Prices", Quarterly Journal of Business and Economics, Vol. 34, No. 4, pp. 3-15.
25. Womack. K. L, (1996)," Do Brokerage Analysts' Recommendations Have Investment Value?" The Journal of Finance, Vol. 51, No. 1, pp. 137-167.

Appendix No. 1

Code of Advisors used in the Study

Sl.No	Advisors Code	Name of the Advisor
1	Ambit	Ambit Capital
2	ARFS	Anand Rathi Financial Services
3	Angel:	Angel Broking
4	Bonanza	Bonanza Portfolio
5	Fullerton	Fullerton Securities
6	ICICI	ICICI Direct.Com
7	Kotak	Kotak Securities
8	Microsec	Microsec Capital
9	Motilal	Motilal Oswal Financial Services
10	Nirmal	Nirmal Bang Services
11	Padmakshi	Padmakshi Financial Services
12	Share Khan	Share Khan
13	Unicon	Unicon Fin Intermediaries

ERROR: undefined
OFFENDING COMMAND:

STACK: