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Abstract

A persistent (but ov arnings announcement retu nse to that surprise are often i er, and Martin, this study provides ontrarian stock returns at the earnings announcement date. Using the most recent Institutional Brokers’ Estimate System (I/B/E/S) consensus earnings per share forecast as the earnings benchmark, the authors find that contrarian returns occur for roughly 40% of the more than 230,000 quarterly earnings announcements that comprise their sample. Contrarian returns are only slightly less prevalent in extreme earnings surprise deciles and are evident each quarter during 1985-2005. The incidence of contrarian returns is statistically related to “noise” in the measured earnings surprise (stale I/B/E/S consensus forecasts, preannouncement stock returns, and the presence of Generally Accepted Accounting Principles [GAAP] exclusions) and “noise” in the share price response to announced earnings (discordant revenue changes, discordant earnings forecast revisions, return volatility, bid-ask spread, and discordant prior quarter earnings surprises). Finally, contrarian stocks exhibit little post-earnings-announcement drift.

Appendices

Appendix Variable Definitions

Variable	Description
Earnings Surprise (*ES*)	"Unadjusted actual" EPS from I/B/E/S minus the last I/B/E/S consensus EPS forecast issued before the quarterly earnings announcement date, scaled by closing share price 3 days before the earnings announcement date
Size-adjusted buy-and-hold abnormal returns (*BHAR*)	Buy-and-hold returns of the firm minus buy-and-hold returns for a value-weighted portfolio of firms in the same NYSE/AMEX/NASDAQ size decile. Returns are accumulated over a 3-day window (Day −1 to +1) to obtain *BHAR*, where trading Day 0 is the Compustat quarterly earnings announcement date
OPPOSITE	1 if the quarterly earnings surprise (*ES*) and its announcement period return (*BHAR*) are of the opposite signs; 0 otherwise. For zero earnings surprises, *OPPOSITE* equals 1 when *BHAR* is positive
IBES Exclusions (*I_EXCL*)	1 if current quarter *EXCL* and *ES* are of the same signs, 0 otherwise; where I/B/E/S Exclusions (*EXCL*) is defined as the unadjusted I/B/E/S actual quarterly EPS less GAAP quarterly EPS, scaled by closing share price 3 days prior to the earnings announcement date. Basic or diluted EPS is determined by the I/B/E/S flag. *EXCL* is positive when IBES actual EPS excludes nonrecurring expenses and negative when nonrecurring gains are excluded.
Timely Earnings Surprise (*I_TES*)	1 if current quarter TES and *ES* are of the opposite signs, 0 otherwise; TES is the I/B/E/S unadjusted actual EPS minus the average of the most recent timely individual I/B/E/S analyst EPS forecasts issued before the quarterly earnings announcement date, scaled by closing share price 3 days before the earnings announcement date. A forecast is timely if it is issued 30 days before the earnings announcement date. If no forecasts are issued within 30 days before the earnings announcement date then the single most recent forecast is used. For zero earnings surprise firm/quarters, *I_TES* equals 1 when TES is positive
Forecast Dispersion (*DISP*)	Standard deviation of analysts' EPS forecasts from I/B/E/S summary file. Forecast dispersion is set to 0 when only one analyst covers the firm
Number of Analysts (*NUMEST*)	Number of estimates comprising the I/B/E/S consensus
Preannouncement Return (*PRE_RET*)	Cumulative size-adjusted abnormal return for the 15 trading days before Day −1

Variable	Description
Revenue Surprise (*I_RS*)	1 if current quarter RS and *ES* are of the opposite signs, 0 otherwise. RS is current quarter sales minus sales from same quarter prior year, scaled by equity market value at the beginning of the quarter. For zero earnings surprise firm/quarters, *I_RS* equals 1 when RS is positive
Short-horizon Revision (*I_SREV*)	1 if current quarter SREV and *ES* are of the opposite signs, 0 otherwise. SREV for quarter *t* is the first I/B/E/S consensus EPS forecast for quarter *t* + 1 issued after the quarter *t* earnings announcement minus the last consensus forecast for quarter *t* + 1 issued before the quarter *t* earnings announcement, scaled by closing share price 3 days before the earnings announcement date. For zero earnings surprise firm/quarters, *I_SREV* equals 1 when SREV is positive
Long-horizon Revision (*I_LREV*)	1 if current quarter LREV and *ES* are of the opposite signs, 0 otherwise. LREV for quarter *t* is defined as first I/B/E/S consensus annual EPS forecast for current and/or next fiscal year issued after quarter *t* earnings announcement minus the last consensus annual forecast issued before the quarter *t* earnings announcement, scaled by closing share price 3 days before the earnings announcement date. We remove SREV from LREV when fiscal periods overlap. The lagged annual EPS forecast is adjusted for the quarter *t* consensus EPS forecast error when the LREV forecast horizon is the current fiscal year. For zero earnings surprise firm/quarters, *I_LREV* equals 1 when LREV is positive
Return Volatility (*BHAR_VOL*)	Standard deviation of daily size-adjusted abnormal returns for the 60 trading days before Day −1
Percentage Bid-Ask Spread (Spread)	Average of the daily bid-ask spread (as a percentage of the daily closing price) over the period of 60 trading days before Day −1
Lagged Surprise (*I_LAGES*)	1 if prior quarter *ES* and current quarter *ES* are of the opposite signs, 0 otherwise. For zero earnings surprise firm/quarters, *I_LAGES* equals 1 when prior quarter *ES* is positive

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