

[Home](#) > [Review of Quantitative Finance and Accounting](#) > Article

# Risk, Mispricing, and Value Investing

| Published: December 2004

| Volume 23, pages 353–376, (2004) [Cite this article](#)[Save article](#)[View saved research >](#)

## [Review of Quantitative Finance and Accounting](#)

[Aims and scope →](#)[Submit manuscript →](#)**Eli Bartov<sup>1</sup> & Myungsun Kim<sup>2</sup>** 2106 Accesses 37 Citations [Explore all metrics →](#)

## Abstract

We evaluate the stock return performance of a modified version of the book-to-market strategy and its implications for market efficiency. If the previously documented superior stock return of the book-to-market strategy represents mispricing, its performance should be improved by excluding fairly valued firms with extreme book-to-market ratios. To attain this, we classify stocks as value or glamour on book-to-market ratios and accounting accruals jointly. This joint classification is likely to exclude stocks with extreme book-to-market ratios due to mismeasured accounting book values reflecting limitations underlying the accounting system. Using both 12-month buy-and-hold returns and earnings announcement returns, our results show that this joint classification generates substantially higher portfolio returns in the post-portfolio-formation year than the

book-to-market classification alone with no evidence of increased risk. In addition, this superior stock return performance is more pronounced among firms held primarily by small (unsophisticated) investors and followed less closely by market participants (stock price <\$10). Finally, and most importantly, financial analysts are overly optimistic (pessimistic) about earnings of glamour (value) stock, and for a subset of firms identified as overvalued by our strategy, the earnings announcement *raw* return, as well as abnormal return, is negative. These last results are particularly important because it is hard to envision a model consistent with rational investors holding risky stocks with predictable negative *raw* returns for a long period of time rather than holding fT-bills and with financial analysts systematically overestimating the earnings of these stocks while underestimating earnings of stocks that outperform the stock market.

---

 This is a preview of subscription content, [log in via an institution](#)  to check access.

---

### Access this article

[Log in via an institution](#) 

### Subscribe and save

 Springer+

from €37.37 /Month

- Starting from 10 chapters or articles per month
- Access and download chapters and articles from more than 300k books and 2,500 journals
- Cancel anytime

[View plans](#) 

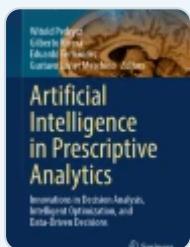
### Buy Now

[Buy article PDF 39,95 €](#)

Price includes VAT (Poland)

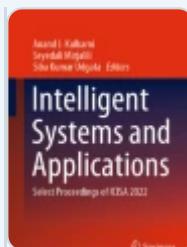
[Institutional subscriptions →](#)

## Similar content being viewed by others



[A New Methodology Based on Multicriteria Ordinal Classification for the Management of Financial...](#)

Chapter | © 2024



[An Ontological Framework for Risk Mitigation in Stock Market](#) [Economic persistence, earnings informativeness, and stock return regularities](#)

Chapter | © 2023



Pend (B): The law of motion and the reporting system

Article | 23 April 2020

## Explore related subjects

Discover the latest articles, books and news in related subjects, suggested using machine learning.

[Behavioral Finance](#) [Capital Markets](#) [Market Psychology](#) [Risk Theory](#)

[Sociology of the Financial Market](#) [Financial Accounting](#)

## References

Ali, A., L. S. Hwang and M. A. Trombley, "Arbitrage Risk and the Book-to-Market Anomaly." *Journal of Financial Economics* (2002) (forthcoming).

Basu, S., "Investment Performance of Common Stocks in Relation to Their Price to Earnings Ratios: A Test of The Efficient Market Hypothesis." *The Journal of Finance* 32, 663-682 (1977).

[Google Scholar](#)

Beaver, W., "The Information Content of Annual Earnings Announcements." *Journal of Accounting Research* 6, 67-92 (1968).

[Google Scholar](#)

Brown, L. D. and M. S. Rozeff. "The Superiority of Analyst Forecasts as Measures of Expectations: Evidence from Earnings." *The Journal of Finance* 33, 1-16 (1978).

[Google Scholar](#)

Brown, L. D., P. A. Griffin, R. L. Hagerman and M. E. Zmijewski. "Security Analyst Superiority Relative to Univariate Time Series Models in Forecasting Quarterly Earnings." *Journal of Accounting and Economics* 9, 61-88 (1987).

[Google Scholar](#)

Chan, K., Y. Hamao and J. Lakonishok. "Fundamentals and Stock Returns in Japan." *The Journal of Finance* 46, 1739-1764 (1991).

[Google Scholar](#)

Doukas, J. A., C. F. Kim and C. Pantzalis. "A Test of the Error-Expectations Explanation of the Value/Glamour Stock Returns Performance: Evidence from Analysts' Forecasts." *The Journal of Finance* 57, 2143-2166 (2002).

[Google Scholar](#)

Fama, E. F. "Efficient Capital Markets: II." *The Journal of Finance* 46, 1575-1617 (1991).

[Google Scholar](#)

Fama, E. F. and K. R. French, "The Cross-Section of Expected Stock Returns." *The Journal of Finance* 47, 427-465 (1992).

Griffin, J. and M. Lemmon. "Book-to-Market Equity, Distress Risk, and Stock Returns." *The Journal of Finance* 57, 2317-2336 (2002).

[Google Scholar](#)

La Porta, R., J. Lakonishok, A. Shleifer and R. Vishny. "Good News for Value Stocks: Further Evidence on Market Efficiency." *The Journal of Finance* 52, 859-874 (1997).

[Google Scholar](#)

Lakonishok, J., A. Shleifer and R. Vishny, "Contrarian Investment, Extrapolation, and Risk." *The Journal of Finance* 49, 1541-1578 (1994).

[Google Scholar](#)

Mulford C. W. and E. E. Comiskey, *The Financial Numbers Game: Detecting Creative Accounting Practices*. New York: John Wiley & Sons, Inc. 2002.

[Google Scholar](#)

*The New York Times*. Cheap Stocks: Undervalued? June 8 (1978).

O'Brien P. C. "Analysts' Forecasts as Earnings Expectations." *Journal of Accounting and Economics* 10, 53-83 (1988).

[Google Scholar](#)

Piotroski, J. D., "Value Investing: The Use of Historical Financial Statement Information to Separate Winners from Losers." *Journal of Accounting Research* 38, 1-41 (2000).

[Google Scholar](#)

Rosenberg, B., K. Reid and L. Ronald, "Persuasive Evidence of Market Inefficiency." *Journal of Portfolio Management* 11, 9-17 (1985).

[Google Scholar](#)

Shumway, T., "The Delisting Return Bias in CRSP Data." *The Journal of Finance* 52, 327-340 (1997).

[Google Scholar](#)

Sloan, R. G. "Do Stock Prices Fully Reflect Information in Accruals and Cash Flows About Future Earnings?" *The Accounting Review* 71, 289-316 (1996).

[Google Scholar](#)

Vassalou, M., "Default Risk in Equity Returns." Working Paper. Columbia University (2001).

*The Wall Street Journal*, Leading the News: AT&TCorp. Resorts To Unusual Motion: Reverse Stock Split-Market Capitalization Stays Constant, but Measure Would Boost Share Price. April 11 (2002).

## Author information

---

### Authors and Affiliations

**Leonard N. Stern School of Business, New York University, 40 W. 4th St., Suite 423, New York, NY, 10012, USA.**

Eli Bartov

**Department of Accounting & Law, School of Management, University of Buffalo, SUNY, Buffalo, NY, 14260, USA.**

Myungsun Kim

# Rights and permissions

## Reprints and permissions

## About this article

### Cite this article

Bartov, E., Kim, M. Risk, Mispicing, and Value Investing. *Review of Quantitative Finance and Accounting* 23, 353–376 (2004). <https://doi.org/10.1023/B:REQU.0000049321.34133.95>

Issue date

December 2004

DOI

<https://doi.org/10.1023/B:REQU.0000049321.34133.95>

[book-to-market](#)

[market efficiency](#)

[mispicing](#)

[accruals](#)

## Search

Search by keyword or author



## Navigation

Find a journal

Publish with us

Track your research

