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## Comments on 'An empirical assessment of the residual income valuation model'

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### Abstract

The comment reviews major features of the research design of the DMS study. Several opportunities for future research are discussed, including the exploration of the underlying information variables that influence analyst's forecasts.

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### Introduction

The study by Dechow, Hutton and Sloan (DHS) is well executed and addresses a number of important questions, including the extent to which simple accounting summary measures can explain future abnormal earnings, current price, and future security returns. There is a natural flow to the paper. The questions that arise at one stage naturally lead to the next analysis. Moreover, by conducting a series of tests across a variety of contexts the study is able to address issues it could not otherwise. My comments are more likely to be informative about my lack of understanding of the paper than an evaluation of it. However, with this caveat, my observations consist of four sections: discussion of the major research design features, brief summary of the findings, strong points of the paper, and opportunities for extensions.

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### Section snippets

#### Research design features

The research design consists of several major features: (1) use of the Feltham–Ohlson (Ohlson, 1995; Feltham and Ohlson, 1995) framework, (2) definition of abnormal (or residual) income, (3) variety of

earnings forecasting models examined, (4) variety of forecasting or prediction contexts examined, and (5) use of analysts' forecasts as a proxy for other information.

One of the major features of the research design is the use of the Feltham–Ohlson (henceforth F–O) framework. It provides a way of...

### Brief summary of results

Much of the findings are not entirely surprising given the prior research in each context. However, one of the strengths of the study is its integration across contexts and raising questions at the end of each stage of the analysis that naturally lead to the next stage.

The analysis in Table 1 provides evidence of the persistence of abnormal earnings and evidence that a first-order autoregressive process is a good approximation. Higher-order terms provide little additional explanatory power. In...

### Strong points of the research design

First, the paper is clear in providing perspective comments about its selective reliance on the F–O models. The selective reliance on these models is a conscious research design choice. The paper has goals that extend beyond the scope of the F–O framework, such as the forecasting of future security returns and the examination of the parity between value and price. Whether Feltham or Ohlson would approve of this selective use is another matter, and Ohlson (1998) discusses some concerns. Although...

### Opportunities for extensions

As with most good studies, the DHS study has contained within it the opportunities of extending the analysis. The opportunities for extensions include: revisit the use of F–O framework to motivate the paper, explore further the behavior of analysts' forecasts and other information, and use the F–O approach to examine key characteristics of the financial reporting numbers.

With respect to the reliance of F–O for motivation, parts of the study are better motivated if the accounting variables are...

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