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The quiet period has something to say

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Abstract

Recent studies suggest that analyst ratings have become less biased following the Global Settlement and National Association of Securities Dealers (NASD) and New York Stock Exchange (NYSE) Rules implemented in 2002. Assuming analyst ratings are more reliable due to the decline in positive bias, we investigate the existence of excess returns for various holding periods based on the strength of ratings issued around the expiration of the Initial Public Offering (IPO) quiet period. We also control for the impact of analyst affiliation and sanctions against investment banks on returns up to 1 year after quiet period expiration. Overall, we find that the strength of analyst coverage can indeed predict future returns, and several factors impact these returns. In addition, we find that only firms which receive positive coverage from a bank sanctioned in the Global Settlement earn positive risk-adjusted returns.

Keywords:

IPO quiet period regulatory reform analyst ratings Global Settlement

JEL Classification:

G12 G14 G24

Notes

[1] See Lin and McNichols (1998), Michaely and Womack (1999), Iskoz (2003), Cliff and Denis (2004), Bradley et al. (2007), Cliff (2007), Bradley et al. (2008) and Kadan et al. (2009).

[2] Henry Blodgett, an equity analyst at Merrill Lynch at the time, was voted the top Internet/eCommerce analyst by Institutional Investor in 2000. See http://www.institutionalinvestor.com/Article.aspx?ArticleID=1028212.

[3] See Bradley et al. (2003, 2004, 2008).

[4] Negative ratings cannot be examined in this study since the sample only contains three negative ratings.

[5] Michaely and Womack (1999) only consider the lead underwriter as affiliated and not managing underwriters for this study.

[6] While the quiet period prohibits American firms from making statements regarding future profitability, some countries permit earnings forecasts in the firm's prospectus. See Firth (1998) and Hartnett (2010).

[7] The sample period is limited to 2005 due to data constraints.

[8] Whenever possible, sample firms are matched based on the first three digits of the sample firm's SIC code. In our final sample, 89% of firms are matched based on a three-digit SIC code.

[9] Following standard practice, we assume that there are 22 trading days per month.

[10] The difference is likely due to conflict of interest reforms which, among other things, prohibited banks from using revenue generated from investment banking to support

sell-side research. See Guan et al. (2010).

[11] Cliff (2007) converts five-point scales into an equivalent three-point scale in a similar manner.

[12] These findings are also consistent with Highfield et al. (2008) who find that the number of positive ratings, not the total number of ratings as suggested by Bradley et al. (2003), is positively related to short-term returns.

[13] The 10 investment banks named in the Global Settlement were Bear, Sterns & Co. Inc., Credit Suisse First Boston LLC, Goldman, Sachs & Co., Lehman Brothers Inc., J.P. Morgan Securities Inc. Merrill Lynch, Pierce, Fenner & Smith, Inc., Morgan Stanley & Co. Inc., Citigroup Global Markets Inc., UBS Warburg LLC and US Bancorp Piper Jaffray Inc. See http://www.sec.gov/news/press/2003-54.htm.

[14] For brevity, the results are summarized in this section, but complete results including omitted tables are available upon request.

[15] Consistent with this assumption and previous studies, 71% of the firms in the sample are listed on the Nasdaq.

[16] Boni (2005) documents the long-run relation between analyst coverage and firm performance following NYSE Rule 472, NASD Rule 2711 and the Global Settlement, but we examine a larger sample period and include all 12 of the firms listed in the Global Settlement.