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Post-Earnings Announcement Drift in Spain and Behavioural Finance Models

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investor protection and code-law-based legal system, may explain why our results differ from those obtained in the USA.

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Notes

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momentum. Zhang (2006) uses the 'level of uncertainty' as a proxy for ambiguity and predicts a positive relation with momentum.

The above notwithstanding, Nagel (2001) argues that the important role in predicting the long-term reversion of momentum returns that Lee and Swaminathan (2000) attribute to trading volume is widely subsumed by the BTM ratio.

Zhang (2006) and Doukas and McKnight (2005) made opposite predictions in the relation between analyst dispersion and momentum. The decomposition of analyst dispersion as a function of disagreement and uncertainty made by Liang (2003) can explain why these two studies detected contradicting evidence regarding the analyst dispersion.

The Hofstede (2001) Individualism Index, used by Chui et al. (2010) to proxy for differences in psychological biases, shows important differences across European countries.

Some previous studies on the Spanish market analyse how the earnings announcement affects prices in the days surrounding the announcement date (Arcas and Rees, 1999; Sanabria, 2005). Similar to the previous literature, these studies find that stock prices do react on the days surrounding the earnings announcement date, which suggests that the

PAD is the most important variable in the earnings announcement reaction function. For example, Graham and Bartolo (2005) find that the earnings announcement reaction function is especially sensitive to earnings surprises in the days surrounding the announcement date. Institutional investors are also found to be more active in trading around earnings announcements. This piece of evidence, however, is not consistent with the findings of Sanabria (2005) who finds that the earnings announcement reaction function is not sensitive to earnings surprises. This is, in fact, an empirical finding that is not consistent with the findings of Sanabria (2005). The CPI's



perception of corruption) to 0 (highly corrupt perception).

As proxies of market integrity, Chui et al. ([2010](#)) analyse, among other things, the 'prevalence of insider trading' and 'investor protection' variables, which were considered previously by La Porta et al. ([2006](#)), as well as transaction costs. Although they do not observe a significant relation between the first two variables and price momentum, they do find a significant positive relation between price momentum and transaction costs, which is consistent with the idea that limits to arbitrage need to omit the actuation of arbitrage to offset the price deviations caused by irrational traders. However, this characteristic cannot explain our results for the Spanish market, because Spanish trading costs are similar to those observed in Occidental countries (Chan et al., [2005](#)).

Rangan and Sloan ([1998](#)) and Narayanamoorthy ([2003](#)) use unexpected earnings based on a model of time-series data scaled by their market capitalisation. We have checked our results using other alternatives as the denominator of equation ([1](#)): total assets, market capitalisation, the absolute value of earnings reported in the same quarter in the previous year and the standard deviation of unexpected earnings, instead of the book value. The results remain comparable.

Foster et al. ([1984](#)) find that the random walk model performs as well as other more complex

Hennessey et al. ([1996](#)) show that the book value of equity is a better predictor of the stock's returns than the book value of equity.

We have also checked our results using other alternatives as the denominator of equation ([1](#)): total assets, market capitalisation, the absolute value of earnings reported in the same quarter in the previous year and the standard deviation of unexpected earnings, instead of the book value. The results remain comparable.

Our findings are consistent with those of Foster et al. (1984) and Hennessey et al. (1996), who find that the book value of equity is a better predictor of the stock's returns than the book value of equity. However, the results are not consistent with those of Chan et al. (2005), who find that the book value of equity is a better predictor of the stock's returns than the book value of equity.

Our findings are consistent with those of Rangan and Sloan (1998) and Narayanamoorthy (2003), who find that the book value of equity is a better predictor of the stock's returns than the book value of equity. However, the results are not consistent with those of Chan et al. (2005), who find that the book value of equity is a better predictor of the stock's returns than the book value of equity.



Given the unequal monthly distribution of the SUE surprises, forming the portfolios according to the previous month's surprise will result in very low diversified portfolios in some formation dates.

Two alternative procedures exist for calculating a portfolio return over an investment period: the additive and the rebalancing. The former does not exactly measure the portfolio whole return throughout the analysed period, but its average monthly return. The second one implicitly involves an investment strategy that changes the composition of the portfolio month by month in order to keep the portfolio equally weighted throughout the holding period. In any case, for various reasons, it is the buy-and-hold procedure that has been mainly used in the financial literature. Of these reasons, the price spread bias seems to have less impact on the buy-and-hold procedure and the rebalancing procedure looks less attractive in terms of transaction costs and, perhaps, less fitted for a medium/long investment horizon (Blume and Stambaugh, [1983](#); Barber and Lyon, [1997](#); Lyon et al., [1999](#); Liu and Strong, [2008](#)).

In order to check the robustness to the possible effect of the bid-ask bounce and lead-lag effects, we replicated the analysis with a month skip between the ranking period and the holding period. The results are quite similar and are available to any interested parties.

That is, for a 12-month holding period:

Moreover, the results are robust to a large number of CAPM and the Fama-French momentum.

This consistent with market is the content demonstrate that the cont year time horizons

Daniel and 5 BT momentum portfolios (3 price momentum and 3 analyst coverage portfolios). Doukas and McKnight



(2005) use 30 and 50 price momentum-size portfolios (3 and 5 price momentum portfolios and 10 size portfolios), 9 and 25 price momentum-analyst coverage portfolios (3 and 5 price momentum portfolios and 3 and 5 analyst coverage portfolios, respectively), and 9 and 25 earnings revision-analyst dispersion portfolios (3 and 5 earnings revision portfolios and 3 and 5 analyst dispersion portfolios, respectively). Zhang (2006) uses 30 earnings revision-uncertainty proxy portfolios (3 earnings revision and 10 uncertainty proxy portfolios) and 25 price momentum-uncertainty proxy portfolios (5 price momentum and 5 uncertainty proxy portfolios). Considering the number of portfolios used in previous studies and given the size of the cross section of the Spanish market, we have decided to use 9 portfolios to guarantee a reasonable level of diversification.

We conduct a regression for the cross section of each calendar month. We also include the log(BTM) as an explanatory variable in equation (8) and find that the results are comparable.

We check the robustness of this analysis to two aspects that could be affecting the results. First, the firm size of the BTM partitions markedly decreases with the BTM level: the low BTM partition has markedly bigger firm size than the high BTM partition.

Therefore, the significant negative relation between PAD and size could be driving the positive relation observed between PAD and BTM. To test for this possibility, rather than rank the firms by size, we rank them by residual BTM. We use the same equation as before, but we use the residual BTM as the explanatory variable. The results are similar to the previous ones. These results are



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