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Overreaction, Underreaction, and the Low-P/E Effect

David N. Dreman & Michael A. Berry


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Abstract

Although earnings surprises have been studied extensively, they have not been examined in a comprehensive manner. This study examines earnings surprises that favor low P/E stocks and finds that they display a significant positive relationship with the returns of the S&P 500. These results are consistent with the hypothesis that low P/E stocks are undervalued. A correct understanding of the relationship between earnings surprises and the returns of low P/E stocks is essential for a correct understanding of the market. The results of this study suggest that earnings surprises are a significant factor in the determination of the returns of low P/E stocks. The results of this study suggest that earnings surprises are a significant factor in the determination of the returns of low P/E stocks.

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