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    Anchoring, the 52-Week High and Stock Price Reactions to Earnings News
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Project Abstract

Daily stock returns around positive earnings surprises are more muted when stock prices just before the current earnings announcements are nearer to their 52-week highs. Returns around subsequent earnings announcements are higher, however, as are the price drifts following the current earnings announcements. This pattern is consistent with underreaction followed by a correction. A symmetric pattern exists for stocks that experience negative earnings surprises whose prices are far below their 52-week highs. Price dynamics based on past stock returns and 52-week lows do not exhibit these patterns. These findings suggest that investors anchor their beliefs on 52-week highs, which impedes the incorporation of earnings news into stock prices. The economic magnitude of this effect is large. A zero investment strategy that ranks stocks by earnings surprise and nearness to the 52-week high is almost twice as profitable (16% per year) as a strategy that ranks stocks by earnings surprise alone.

Activities and Achievement

Anchoring is the tendency for individuals to base their forecasts of an unknown quantity upon a salient statistic (the anchor) that might have nothing to do with the quantity being forecasted. We find that in the real financial markets, investors anchor on the 52-week high price (52WH), which is often featured in financial websites and papers. If the stock price prior to a positive (negative) earnings announcement is already close to (far from) the 52WH, investors would think the positive (negative) news has already been incorporated into the price, and hence be reluctant to bid the price higher (lower). In other words, investors behave as if future price levels are constrained not to deviate too far from the 52WH.

Dissemination

I presented this paper at the CERF Cavalcade in May 2017. It was also featured at the CERF blog in July 2017. This paper was submitted to the accounting review in Aug 2017 and the result is not out yet.

Outputs
Major Difficulties and Any Other Issues
    None at this moment.
Web Links
    https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2391455
Additional Information