

Earnings Estimates' Effect on Stock Prices



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One of the most-discussed stock screens on the AII discussion boards is **Estimate Revisions: Up 5%**. The screen seeks out companies with a one-month increase in the consensus earnings estimate for the current year of 5% or more. A post about the screen currently has **86 responses**.

Earnings estimates are forecasts made by analysts about how much a company will earn over a given quarter or year. The consensus estimate is simply the average of all the analysts' forecasts made for a given quarter or year.

Changes in consensus earnings estimates are a driver of stock prices. Positive estimate revisions lead to higher stock prices and negative estimate revisions lead to lower stock prices.

EARNINGS ESTIMATES
\$1.00 • THE OPTIMIST

\$0.75 • HERDING BY ANALYSTS

\$0.50 • THE PESSIMIST

Beyond the direction of the change is the dispersion of the individual forecasts. Analysts frequently engage in herd mentality behavior by keeping their forecasts close to the consensus. A comparatively few brave souls do venture out to the edge with bold projections, but they are not the norm. It can be worthwhile to look at the outlier forecasts and how actual earnings compare to them. A study in this month's **Financial Analysts Journal** says that the price reaction is larger for companies whose beats (actual earnings above the consensus estimate) exceed the most positive forecast or whose misses (actual earnings below the consensus estimate) are below the most pessimistic forecast.

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More on AII.com

- **Earnings Estimates** - AII Journal editor Charles Rotblut discussed in greater detail what

earnings estimates are and why they matter in this May 2015 article.

- **Why Value Beats Growth: A Brief Explanation** - When the dispersion among analysts' forecasts is too large, stocks tend to outperform, as Peter Berezin of BCA Research explains.

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Highlights from the *AII Journal*

- **The Tax Advantages of Qualified Charitable Distributions From IRAs** - Retirees who do not need their entire required minimum withdrawal (RMD) can save on taxes by making charitable distributions directly from their IRA.
- **Active Management Stinks, But It Doesn't Have To** - Dr. Daniel Crosby says that active strategies can be improved if they incorporate some of the better traits used by passive strategies.

AII Sentiment Survey

Optimism about the short-term direction of stock prices fell to an unusually low level, one not seen since last June. There was also an increase in pessimism and a decrease in neutral sentiment. [More about this week's results.](#)

What's Trending on AII

1. **Common Investor Mistakes and Other Investing Insights**
2. **How Interest Rate Changes Affect the Price of Bonds**
3. **Investing to Avoid the Consequences of Being Wrong**

The Week Ahead

Third-quarter earnings season will hit full stride, with 178 members of the S&P 500 on the docket. Included in this group are 12 Dow Jones industrial components: Visa (**V**) on Monday; 3M Co. (**MMM**), Apple (**AAPL**), Caterpillar (**CAT**), DuPont De Nemours (**DD**), Merck & Co., (**MRK**), Procter & Gamble Co. (**PG**) and United Technologies Corp. (**UTX**) on Tuesday; Boeing Co. (**BA**) and The Coca-Cola Co. (**KO**) on Wednesday; and Chevron Corp. (**CVX**) and Exxon Mobil Corp. (**XOM**) on Friday.

The week's first economic report of note will be the October purchasing managers manufacturing index (PMI), which will be released on Monday. Tuesday will feature the August S&P/Case-Shiller home price index (HPI) and the Conference Board's October consumer confidence survey. September international trade and September new home sales will be released on Wednesday. Thursday will feature September durable goods orders and the September pending home sales index. The first estimate of third-quarter GDP, and the University of Michigan's final October consumer sentiment survey will be released on Friday.

Four Federal Reserve officials will make public appearances on Monday: New York president William Dudley, St. Louis president James Bullard, Chicago president Charles Evans and governor Jerome Powell.

The Treasury Department will auction \$26 billion of two-year notes on Tuesday, \$15 billion of two-year floating-rate notes and \$34 billion of five-year notes on Wednesday, and \$28 billion of seven-year notes on Thursday.

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