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The relation between aggregate earnings and stock returns for factor-based portfolios

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ABSTRACT

Accounting literature has a long tradition of studying the impact of earnings information on stock price. Recently, this strand of literature has been given a new twist by exploring the dynamics of earnings – returns at the aggregate level. The knowledge about this relationship is particularly useful for investors who hold diversified portfolios. In this study, we test for the relationship between aggregate earnings and returns in ten countries. We specifically test if the aggregate earnings - returns relationship is dissimilar when stocks are aggregated according to different characteristics such as size, value, profitability, investment and leverage. The results of our fixed effects panel regressions suggest that the relation between aggregate earnings and stock returns is relatively weak for small cap portfolios as well as for stocks with high value, growth and operating profitability. These findings are valuable for investors and fund managers who use factor based investing strategies to manage their portfolios.

KEYWORDS aggregate earnings; factor investing; stock prices

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