# Do analysts overreact to information?

## DeBondt & Thaler, "Do security analysts overreact?", American Economic Review, 1990.

### *1. Background*

In their other work DeBondt &Thaler find overreaction. For example, in their classic study "Does the stock market overreact?", Journal of Finance, July 1985, they find that winner stocks become losers, and loser stock stocks become winners. In this present study, they assess whether analysts might be the cause of this.

### *2. The test*

Their approach is simple. They estimate

$$E_t - E_{t-1} = \gamma + \delta.(F_t - E_{t-1}) + e_t$$

where E = earnings, and
F =forecast of earnings

They regress the actual change in earnings from t-1 to t on the predicted change. They find that the coefficient $\delta = 0.65$. This means that the forecasted change in earnings has to be scaled down in order to match with the actual change. This is overreaction.

This evidence is now often called "generalised overreaction", since it is not clear to what information analysts are overreacting. All that is clear is that forecasted changes (both positive and negative) need to be scaled down in order to match with the actual change which occurs.

See also the discussion notes on Abarbanell & Bernard, Journal of Finance, July 1992

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