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Stock recommendations and investment portfolio formation: A study in the Brazilian market

*Recomendaciones de acciones y la formación de portafolio:
un estudio en la bolsa de Brasil*

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Abstract

The stock analysts have a relevant role in the capital market, since, directly or indirectly, they contribute to the paper pricing and to the composition of the investment portfolio. The purpose of this study is to verify if it is possible to obtain extraordinary returns, above those offered by a market portfolio, with the monitoring of the stock recommendations issued by Brazilian capital market analysts, one of the most important in Latin America. Based on a wide range of consensual recommendations concerning the period from 2000 to 2010, and with the monitoring of the historical series of paper returns covered by the analyses, the performance of two portfolios were compared, one formed by stocks that received favorable and the other one formed by stocks that received unfavorable analyst recommendations. The results showed bias in recommendations, since there is, systematically, a greater number of favorable against unfavorable recommendations. The results mainly showed that the analysts were unable to identify the stocks that actually offered greater returns within the period considered.

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Keywords: Stock Analysis; Investment portfolio; Capital market

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Resumen

Los analistas de acciones desempeñan un papel importante en los mercados de capitales, de modo que, directa o indirectamente, contribuyen a la fijación de precios de las acciones y a la composición de portafolios. El propósito de este estudio fue verificar si es posible obtener rendimientos extraordinarios, por encima de los ofrecidos por una cartera de mercado, con el acompañamiento de las recomendaciones de acciones realizadas por los analistas en el mercado de capitales brasileño. Basado en una gama de recomendaciones de consenso para el período comprendido entre los años 2000 y 2010, más el seguimiento de series de tiempo de los rendimientos de los títulos que abarca el análisis, fueron comparados la actuación de dos carteras, una formada por acciones que recibieron recomendaciones favorables y otra formada por las acciones que recibieron recomendaciones desfavorables de los analistas. Los resultados mostraron la existencia de la parcialidad en las recomendaciones, ya que hay, sistemáticamente, un mayor número de recomendaciones favorables en comparación con las recomendaciones desfavorables. Y se mostraron, principalmente, que los analistas no fueron capaces de identificar las acciones que ofrecieron una mayor rentabilidad en el período estudiado.

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Palabras clave: Análisis de acciones; Portafolios; Mercado de capitales

Introduction

The opinions of capital market analysts were object of study of several researches, such as Bjerring, Lakonishok, and Vermaelen (1983), Elton, Gruber, and Grossman (1986), Womack (1996), Lin and McNichols (1998), Barber, Lehavy, McNichols, and Trueman (2001), Jegadeesh, Kim, Krische, and Lee (2004), Lim and Kong (2004), Chan, Brown, and Ho (2006), Moshirian, Ng, and Wu (2009), Hall and Tacon (2010), Sidhu and Tan (2011) and Hobbs and Singh (2015). Some used the recommendations, target prices, and profit previews per stocks to identify the impact of those predictions and recommendations in the stock prices, while others verified the analysts' ability to select overestimated and underestimated stocks, through share investment recommendations.

The objective of this study is to test the effectiveness of the analysts' stock recommendations made in the period of eleven years from 2000 to 2010.

The capital market analysts have, according to Loh and Mian (2006), an important role as middlemen in the financial market. They are responsible for analyzing and following companies' performances, so that they can recommend investments to other participants of the market. The reports they issue take into account sector and economy analyses. Moreover, the analysts indicate target prices for the stocks, which is a widely disseminated reference in capital markets.

Jegadeesh et al. (2004) state that market researchers and participants are naturally interested in understanding how the activities of the analysts affect the efficiency of the capital market. According to Stickel (1995), the brokerage firms' buy and sell recommendations are of interest to individual investors, investment fund managers, brokers and academic researchers. Chan et al. (2006) also highlighted the significant expenditures deployed by the brokerage firms aiming at empowering their analysts so that they produce investment recommendations.

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