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The earnings announcement premium around the globe ☆

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ABSTRACT

U.S. stocks have been shown to earn higher returns during earnings announcement months than during non-announcement months. We document that this earnings announcement premium exists across the globe. Moreover, it is not isolated to a few countries. Of the 20 countries with enough data to conduct a within-country analysis, nine exhibit a significantly positive premium. A cross-country analysis finds that the premium is strongest in countries with the greatest increase in idiosyncratic volatility around the time of their firms' earnings announcements, suggesting that uncertainty over the earnings information to be disclosed is a primary driver of the global announcement premium.

1. Introduction

It has been documented that U.S. stocks earn higher returns during months when earnings are announced than during non-announcement months. The magnitude of this earnings announcement premium has been estimated by Frazzini and Lamont (2007) to be over 7% per year.[1] While a number of potential explanations for the premium have been put forward, uncertainty remains over the reasons for its existence. There are two goals of this study. The first is to investigate the extent to which the earnings announcement premium extends globally, thereby providing out-of-sample evidence of its existence. The second is to exploit observed cross-country variations in the magnitude of the premium in order to gain insights into the factors driving this return.

Our sample consists of roughly 200,000 announcements of annual earnings from 46 foreign countries over a 20-year period. Using these announcements we estimate that the average monthly raw return to a strategy of investing in a portfolio of stocks expected to announce earnings during the month and shorting an equal dollar amount of a portfolio of expected non-announcers is 59.7 basis points, or 7.16% annualized. As shown in Fig. 1, a $1 investment in the long portfolio offset by a similar position in the short portfolio in 1991 would have grown to $4.14 by 2010. By comparison, investing $1 in a global portfolio, equally weighted by country, would have grown to $3.64 over that time period. Moreover, the long-short

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[1] Savor and Wilson (2011) and Bushman, McDermott, and Williams (2012) also document higher returns during earnings announcement months. Others have found a similar premium for shorter windows around earnings announcements. See, for example, Chari, Jagannathan, and Ofer (1988), Ball and Kothari (1991), Cohen, Dey, Lys, and Sunder (2007), and Berkman and Truong (2009). Aboody, Lehavy, and Trueman (2010) find a large earnings announcement premium for the stocks with the greatest prior 12-month return.

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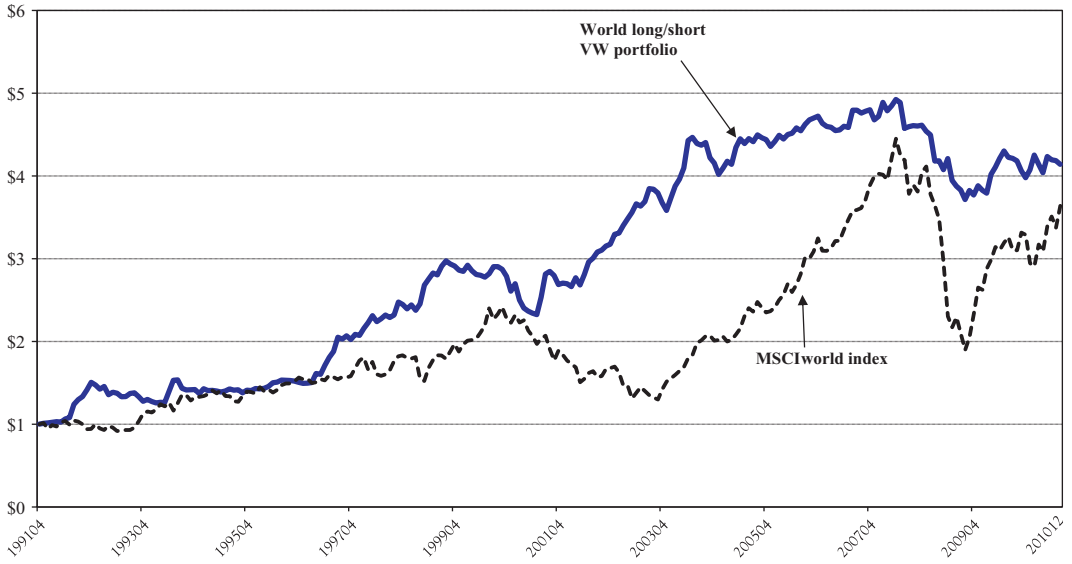

Fig. 1. Cumulative return on an investment of $1 in a long-short expected earnings announcement strategy. Our sample consists of approximately 200,000 annual earnings announcements issued by approximately 28,000 firms in 46 countries over the period from 1990 through 2009. This figure depicts the cumulative raw returns (denominated in U.S. dollars) to (1) a long-short strategy of buying all expected announcers in our global firm sample (excluding the U.S.) and shorting all expected non-announcers in a given month, where returns are value-weighted (VW) at the firm-level; and (2) a long position in the Morgan Stanley Capital International (MSCI) value-weighted global index (excluding the U.S.). Beginning with a $1 investment, returns are cumulated on a monthly basis from April 1991 through December 2010.

portfolio delivered a Sharpe ratio that is over 40% greater than that of the global portfolio.

At 59.7 basis points per month, the economic significance of the return to the long-short portfolio compares well to that of the premier asset-pricing anomalies studied in the literature: size, book-to-market, and momentum. In a global context, Fama and French (2012) find that factors associated with these three anomalies generate monthly returns of 10, 45, and 62 basis points, respectively, for the period from November 1990 to March 2011—largely coincident with the sample period we study. For the years 1981 through 2003, Hou, Karolyi, and Kho (2011) show that global size, book-to-market, and momentum factors are associated with monthly returns of 55, 51, and 63 basis points, respectively. It should be noted, however, that the amount of capital that could be deployed to exploit the announcement premium might be less than for these other anomalies since the announcer portfolio each month is limited to those firms expected to release earnings during the month.

To control for these three asset-pricing anomalies, we re-estimate the return premium using monthly cross-sectional regressions (employing a Fama-MacBeth approach), regressing individual firm returns on firm size, book-to-market ratio, and momentum, and adding an indicator variable for the firm's earnings announcement month. We also include country fixed effects. The coefficient on the indicator variable can be interpreted as the monthly earnings announcement premium. Over the 1991–2010 period, we find that it averages over 11% annually.

The positive earnings announcement premium is not isolated to just a few countries. Of the 20 countries with the greatest number of observations, it is significantly positive in nine. Across these nine countries there is substantial variation in the magnitude of the announcement premium. It ranges from a low of 63.4 basis points for France to a high of 235.5 basis points for the U.K.

We exploit these observed cross-country differences in order to gain insights into potential reasons for the premium's existence. As a prelude to our analysis, we document the patterns of daily abnormal returns, volume, and idiosyncratic volatility around the earnings announcements in our sample. Among our findings are that (a) the bulk of the premium is realized prior to (rather than after) the announcement day, (b) the higher pre-announcement returns are accompanied by reduced volume, and (c) the level of idiosyncratic volatility spikes in the three days centered on the earnings announcement date. These patterns suggest that uncertainty over the information to be released through earnings, and the accompanying abnormally high idiosyncratic volatility, cause investors to demand higher pre-announcement returns and lead to the observed earnings announcement premium. Consistent with this conjecture, we find that countries where firms have the greatest abnormal idiosyncratic volatility around earnings announcements generally have the largest announcement premium. To ensure that endogeneity issues between contemporaneous abnormal idiosyncratic volatility and returns are not responsible for this result, we repeat our analysis using each country's CIFAR financial disclosure score (Center for International Financial Analysis & Research, 1995) as an instrument for abnormal idiosyncratic volatility. The CIFAR score measures the extensiveness of a country's required financial statement disclosures and is a proxy for the amount of earnings information released, which, in turn, drives the spike in idiosyncratic volatility around earnings announcements. In line with our