

# **Why are Recommendations Optimistic? Evidence From Analysts' Coverage Initiations**

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## **Abstract**

We examine the long-term stock performance of analyst recommendations and the properties of accompanied earnings forecasts for initiations and noninitiations to evaluate the reporting, selection, and processing explanations for analyst optimism. We find that Strong Buy and, to a lesser degree, Buy initiation recommendations underperform their non-initiation counterparts after controlling for analyst, brokerage, and firm characteristics associated with the initiation decision and expected long-term stock returns. Yet, earnings forecasts accompanying Strong Buy and Buy initiation recommendations are less optimistic and more accurate than those accompanying non-initiation recommendations. Our findings suggest that conflicts of interest (that is, the reporting explanation) are the dominant source for favorable recommendations.

**Keywords:** Analysts, Conflicts of interest, Selection bias, Coverage initiations