Analysts' Momentum Recommendations

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Published
Journal of Business, Finance, and Accounting 40 (2013), 438-469.

Abstract

We document that the likelihood of analyst recommendations following past stock returns decreased abruptly in 2003, coinciding with the Global Settlement and other regulatory changes designed to restrain analysts' conflicts of interest. We also document that the likelihood of recommendations following past stock returns is abnormally high for recommendations issued after negative stock returns (but not for those issued after positive stock returns), among inexperienced and inaccurate analysts, among large brokerage houses, and for companies with high share turnover. Moreover, the recommendations that are more likely to follow past stock returns are accompanied by earnings forecast revisions that are larger in magnitude and less accurate ex post. Overall, our findings suggest that analysts with conflicts of interest and limited ability are more likely to base their recommendations on past stock returns. Finally, we document that the recommendations that are more likely to follow past stock returns (especially those that were issued before 2003 and those that are issued after negative stock returns) contribute to existing price momentum by generating incrementally stronger short-term and long-term stock returns.

Keywords: Stock recommendations, price momentum, analyst ability.