THE RELATIVE PERFORMANCE OF COMPOSITE FORECASTS OF ANNUAL EARNINGS

Pieter T. Elgers, University of Massachusetts, Amherst, MA 01002. elgers@som.umass.edu May H. Lo, Western New England University, Springfield, MA 01119. mlo@wne.edu Wenjuan Xie, University of New Hampshire, Durham, NH 03824. Wenjuan.Xie@unh.edu Le (Emily) Xu, University of New Hampshire, Durham, NH 03824. Emily.Xu@unh.edu

ABSTRACT

This study constructs composite forecasts of annual earnings and evaluates the performance of composite forecasts under different contexts. The composite earnings forecasts are based upon three forecast sources: time-series (random walk with drift) forecasts, financial analysts' consensus forecasts, and price-based forecasts. The evaluation of performance is based upon the predictive accuracy of composite forecasts versus each of the individual forecast sources used in its construction. The contextual factors examined include (1) firm-years of relatively small vs. large size; (2) firm-years of relatively low vs. high analyst coverage; and (3) firm-years of relatively low vs. high growth. The results of the study show that each of the three forecast resources provides unique information, incremental to that in competing forecasts. In addition, composite forecasts are more accurate than each of the individual forecasts in the pooled sample. When the sample is partitioned based upon the contextual factors, we found that the composite forecasts are significantly more accurate than any of the individual forecasts for smaller firms and for firms with lower analyst coverage. Among larger firms and firms with higher analyst coverage, composite forecasts outperform time-series and price-based forecasts, but not analysts' forecasts.

Keywords: Earnings forecasts, composite forecasts, firm size, analyst coverage.