Investors Use of Accounting Estimates during Macroeconomic Uncertainty

Maria Ogneva, Professor, University of Southern California, Marshall

David Milstead, Journalist, Globe and Mail

Anish Chopra, Portfolio Management Corp

John Aiken, Head of Research (Canada) and Senior Analyst at Barclays
Macroeconomic Uncertainty

- Macroeconomic uncertainty spurs the demand for financial information:
  - A greater demand for timely financial information from the investors affects information production by the intermediaries (analysts, journalists)

- Macro uncertainty today differs from prior periods of high uncertainty:
  - Research on the effects of inflation on the acquisition and processing of financial information is very sparse
High economic uncertainty increases concentration of media coverage on earnings announcements (Bonsall, Green, Muller 2020)

- Crowding out the coverage of non-earnings news (including material events in 8-Ks)
- Increased coverage of bellwether stocks or early-season announcers

The expanded media coverage reduces investors’ information acquisition and processing costs
Uncertainty and Supply of Information
Sell-Side Analysts

■ A more complicated task,
  - Difficulty incorporating negative macroeconomic news in the forecasts (Hann, Ogneva, Sapriza 2012), mitigated by access to in-house economists (Hugon, Kumar, Lin 2016)

■ but a greater impact of research
  - Recommendation changes generate a larger stock reaction when the uncertainty is high (Loh and Stulz 2018)
  - Analysts better than managers at impounding macro info into forecasts (Hutton, Li, Shu 2012); more detailed reports in downturns (Loh and Stulz 2018)

Panel A: Downgrades
Panel B: Upgrades

Loh and Stulz “Is Sell-Side Research More Valuable in Bad Times?”, Journal of Finance, 2018
**Inflation Uncertainty**

- **Research focus on the nominal accounting effects:**
  - No recognition for inflation-driven gains & losses (e.g., inventory asset)
  - These gains & losses materialize in future cash flows (when inventory sells)

- **Adjusting financial statements for inflation is costly:**
  - Inefficient or incomplete adjustments made by investors (Konchitchki 2011) and analysts (Basu, Markov, Shivakumar 2010)

- **Which results carry over to the high and volatile inflationary environments, where economic agents pay more attention to inflation effects** (Candia, Coibion, Gorodnichenko 2022)?

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\text{Inflation-adjusted earnings} < \text{Nominal earnings (investors over-estimating inflationary losses)}
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\text{Inflation-adjusted earnings} > \text{Nominal earnings (investors over-estimating inflationary gains)}
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Konchitchki “Inflation and Nominal Financial Reporting: Implications for Performance and Stock Prices?”, 2011