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A company has had a good year, and wants to make sure investors know it. In the press release reporting its annual results, the headline announces "earnings per share up 16.5%," which is a record. What could be more natural for a firm than to headline this impressive earnings number?

Natural it may be. But, according to some new research, it also is a reason for investors to be wary. In the words of a new study in the **American Accounting Association** journal ***The Accounting Review***, "headlining quantitative information incites investor overreaction…At the time of earnings announcements, investors do

actual numbers, while still others (like the company cited above) headline actual numbers.

About 28% of the more than 17,000 earnings releases sampled in the study specified performance numbers in their headlines, a practice the professors characterize as increasing the *salience* of a firm's results. They find that increasing headline salience (for example, when earnings exceed forecasts, headlining by *how much*), gives a hefty lift to a firm's stock price beyond the rise that is normally occasioned by good news. On average, adding one strong performance number to a headline increases a results-inspired boost by an extra one third in the three-day period around the announcement.

Citing psychology research, the professors see this extra boost as due to the effectiveness of headline numbers in attracting investor attention. In addition, "an initial favorable impression can lead investors to underweight contradictory information elsewhere in the report."

But investors beware: after a quick stock-price lift, salience likely portends a considerable reversal over the 60 days following the earnings announcement, a reversal greater than the initial boost that the salience bestowed. In other words, as the professors write, "investors not only undo their initial reaction due to salient headlines but even revise their beliefs in the opposite direction in the subsequent period." In sum, "headlining quantitative information incites investor overreaction to the earnings news at the time of the earnings announcement…This suggests that headline salience misleads investors."

Indeed, headline salience not only foreshadows a stock-price reversal over the course of two months but longer-term disappointments as well. Although they may flaunt strong current results in the headlines of their press releases, firms that do so, the professors find, "have lower earnings persistence consistent with managers' trying to *make hay while the sun shines*...suggesting that headline salience choice is motivated

sell their firm's equity are more likely to choose headline salience to excite investor optimism about the firm. This enables them to take advantage of the high stock price when they sell after the earnings announcement." Conversely, when there is personal financial benefit in a drop in stock price – namely, when an earnings announcement precedes a grant of stock options – managers "are less likely to use salience...seeking to avoid increasing their option strike prices before grant awards."

The study's findings derive from an analysis of corporate annual earnings press releases issued over an 11-year period. Salience was calculated as the number of performance statistics appearing in headlines. In about 72.1% of the releases, there were none; in 11.9%, there was one; and in 8.5% there were two, in 2.9% three, and in the remaining 4.5% more than three.

Of accounting terms appearing in headlines, the greatest number were earnings-related, followed by those related to revenues. Companies' earnings persistence was calculated by whether gains achieved from one year to the next were equaled or exceeded in a third year. Analyses controlled for an array of factors that can affect stock prices or firms' performances.

In addition to the salience findings detailed above, others are as follows:

■ Both 3-day stock returns and 60-day reversals increased with greater headline salience, both being higher as the number of headline statistics increased (for example, from zero to one or from one to two).

■ While headline salience is effective when earnings exceed analyst forecasts, that is not the case when they do not. In other words, greater salience does not spur investor interest when earnings barely meet or fall short of predictions.

■ Headlined earnings numbers have more effect when expressed as percentages

evidence on the tone of qualitative text and managers' verbal communications, raise the question of whether accounting and financial regulators need to consider the broader character of firm communications to protect investors."

The study, entitled "Headline Salience, Managerial Opportunism, and Over- and Underreaction to Earnings," is in the November issue of ***The Accounting Review***, a peer-reviewed journal published six times yearly by the **American Accounting Association**, a worldwide organization devoted to excellence in accounting education, research, and practice. Other journals published by the AAA and its specialty sections include *Auditing: A Journal of Practice and Theory, Accounting Horizons, Issues in Accounting Education, Behavioral Research in Accounting, Journal of Management Accounting Research, Journal of Information Systems, Journal of Financial Reporting, The Journal of the American Taxation Association,* and *Journal of Forensic Accounting Research.*

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