

CHAPTER I

Introduction

1.1 Background and Problem Review

Analysts' recommendation becomes more interest to academic since it proposes a conflicting conclusion to efficient market hypothesis (EMH). Brokerage firms employ security analysts to provide stock recommendation. This type of information can be a guideline to investors for investing in stock markets. Analysts can analyze market information by using financial approach and knowledge to provide conclusive information for investors which stocks should buy, hold, or sell. The contribution of analysts' recommendation was confirmed by many prior researchers (Stickel (1995), Womack (1996), Barber et al. (2001), Jegadeesh et al. (2002)). However, the contribution from analysts' recommendation may not equivalent for all market. Jegadeesh and Kim (2003) who examine the evidence of analysts' recommendation on G7 countries find that largest effect of analysts' recommendation on stock price has been found in the most developed and biggest equity market like U.S and Japan equity markets.

In emerging markets, investors are different from developed markets. South-east Asian markets data are also appropriate to test analysts' recommendation value since South-East Asian countries are an emerging markets. The markets are also lack of sufficient distributed information to supply investors. Recommendation information can be considered as an "insider" to investors because not all participants can access the recommendation. For this event, investors tend to use this type of information to capture "extra gain" from the markets. In this paper, recommendation data collect from four south-east Asian countries compose of Thailand, Malaysia,

Singapore, and Philippines, because they have enough sufficient data. Moreover they represent Emerging markets that analysts should provide more value than developed market due to lack of information.

Many prior researches use individual analysts' recommendation and collect data from the date that analysts issue the recommended papers to examine extra return. This paper cannot observe event time approach to measure analysts' recommendation value due to the I/B/E/S database cannot provide exact event date that recommendations are issue. I/B/E/S database collect all recommendations from contributed brokers and provide only mean recommendation value not include issue date. However, I/B/E/S database adjust database every month. For the limitation, the data appropriate to use I/B/E/S database to measure analysts' value for two reasons. First, it has lag time effect between recommendations and price drift. Second, to measure analysts' recommendation portfolios value, some stocks price in portfolio will go up immediately after issue date but we cannot capture. On the other hand, some stocks price in portfolio will decrease immediately too. Consequently, it will cancel out the effect each other and make most of all stocks in portfolio can be appropriate to measure value.

However, the advantage from use mean consensus recommendation is reducing bias caused by individual analysts. Lin and McNichols (1998) supported that investment banking relationship can potentially bias analysts' recommendation. The result confirms that individual recommendation from brokerage firm may be bias toward the conflict of interest between accuracy and optimism. This paper use mean consensus recommendation to investigate relationship between analysts' recommendation and stock returns. Consensus can absorb the bias effect by using more analysts' opinion to ensure the recommendation.

As a result, this paper uses I/B/E/S mean consensus recommendation to investigate the relationship between analysts' recommendation and stock returns by using regression analysis. This paper also provides information that analysts' recommendation has influent on stock return. In case of measuring extra value from analysts' recommendation, the paper adopts method of constructing portfolios following analysts' recommendation and evaluates portfolio performance. Moreover, the abnormal trading volume is also examined in the study since it can disclose whether investors use the recommendation on making decision to invest in stocks or not.

1.2 Statement of Problem / Research Questions

First, this paper studies whether average analysts' recommendation on I/B/E/S database can provide value to investor or not. Secondly, different in number of analysts' focus on stocks can create different in value or nor. Finally, investors will react on recommendation or not.

1.3 Objective of the Study

Given the problem stated above, the objective of this proposal study is to examine the value of analysts' recommendation and measure analyst performance in South-East Asian countries which are Malaysia, Philippines, Singapore, Thailand and United States as base case of study. This study also investigates different return between high analysts covered firms and low analysts covered firms and find the effect of analysts' recommendation on trading volume.

1.4 Scope of the Study

This paper studies value of analysts' recommendation that available on I/B/E/S. The period of study is in January 1996 to December 2005.

1.5 Contribution

Analysts' recommendation become famous topic academic study since it proposes a conflicting conclusion to EMH. Many prior researchers can observe the investment value from analysts' contribution. Therefore, if analysts have contribution to stock returns, investors will use method from this paper to bring out the benefit by trading follow I/B/E/S analysts' recommendation. Furthermore, this paper provide new evidence about different between invest in low analysts covered firms and high analysts covered firms.