# EARNINGS EXPECTATIONS: HOW IMPORTANT ARE THE WHISPERS?

By Mark Bagnoli, Messod Daniel Beneish and Susan G. Watts

"Whisper" forecasts are unofficial earnings estimates that circulate among traders and investors. One study indicates that the attention and interest given to these figures is justified—whisper forecasts are increasingly becoming the true market expectation of earnings.

Earnings forecasts are always closely scrutinized by investors. But the forecasts that are garnering the attention these days, especially for technology stocks, are not analyst forecasts, but rather the "whisper" numbers.

"Whisper" forecasts are unofficial estimates of earnings per share that circulate among traders and investors. They are also being reported in the financial press with increasing frequency and are commonly discussed on business news television programs and investor Web sites. Further, professionals describe them as increasingly becoming the true market expectation of earnings, despite their unofficial nature.

How useful is this new source of earnings forecasts to investors?

To answer that, we decided to compare whisper forecasts with analyst forecasts. We also evaluated the usefulness of whispers as a proxy for the market's expectation of earnings.

Our findings indicate that the attention and interest given to these figures may be justified—whisper forecasts are increasingly becoming the true market expectation of earnings.

## WHISPER DATA

To analyze the usefulness of these forecasts, we had to collect whisper data. How do you find whisper numbers?

Our initial sample, consisting of 1,069 whisper forecasts made from January 1995 through May 1997, was garnered from the World Wide Web, The Wall Street Journal and financial newswires. We found some whisper figures on the Dow Jones database through an electronic search of The Wall Street Journal, all Dow Jones newswires and press release wires. We found other whisper forecasts by entering all investor Web sites that we could identify and reading through messages posted on companies' threads. We gathered all earnings forecasts specifically referred to as whispers or identified as being the rumored forecast of earnings. The number of messages posted varied from one or two per day to over 200 per day, depending on the company's size, visibility and investor interest. Further, the posting of whispers was uneven—for some firms, we found whispers for nearly every quarter, whereas for others the postings were more erratic.

There is no way to reliably determine the underlying origin of whisper forecasts. However, the process of collecting them led us to believe that they come from a variety of sources. For example, some of the whisper numbers that we found were attributed to discussions with stockbrokers and/or financial analysts. Others appear to have resulted from discussions with investor relations departments of the companies. (We should note that investor

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relations personnel rarely give out exact earnings numbers—rather, they talk with people who call them, and those people interpret what they hear into some sort of earnings forecast.) Some of the whisper forecasts that we found appear to be the result of private forecasting techniques, and some whispers were not attributed to any source.

On the Web sites, participants make and provide judgments about the quality of other participants' information. However, we did not screen whisper forecasts based on judgments of the poster's credibility by Web participants; instead, we treated all whispers as equally credible.

We compared the whisper earnings forecasts to analyst earnings forecasts for the same firm, using consensus analyst estimates reported by First Call (published by Thomson Financial Services, New York, New York). For that reason, we retained only those whispers for which there was forecast and actual earnings data available in the First Call database. This resulted in a final sample of 943 whispers and 3,546 individual First Call forecasts associated with 127 firms. The bulk of these firms—78.7%—were listed on Nasdaq, while 19.7% were listed on the New York Stock Exchange (NYSE). The whisper firms had total assets averaging \$3.4 billion but a midpoint of \$86.1 million, and total sales averaging \$2.8 billion but a midpoint of \$103.4 million. These statistics reflect the fact that although our sample includes some very large firms (such as Intel, Microsoft, IBM, Ford and Motorola), most are smaller.

Fully 91% of our firms were high-tech, and this industry clustering should be kept in mind when interpreting our findings.

## WHISPER FIRM TRAITS

To better understand the characteristics of firms for which we found whisper forecasts, we compared them to a sample of firms with similar total assets and industry composition. This comparison produced a number of interesting differences.

First, the average market capitalization for whisper firms is significantly larger than the sample. Since the sample firms are similar in terms of total assets and have similar leverage, the larger market value for whisper firms indicates higher price-to-book ratios and thus higher future earnings growth.

In addition, the whisper firms experienced greater sales growth (24% for the whisper firms compared to 12% for the sample firms), and are more profitable (return on assets of 8% for the whisper firms compared to 4% for the sample).

In terms of investment performance, the whisper firms had higher returns in 1995 relative to the sample firms, but they also appear to be both riskier and younger.

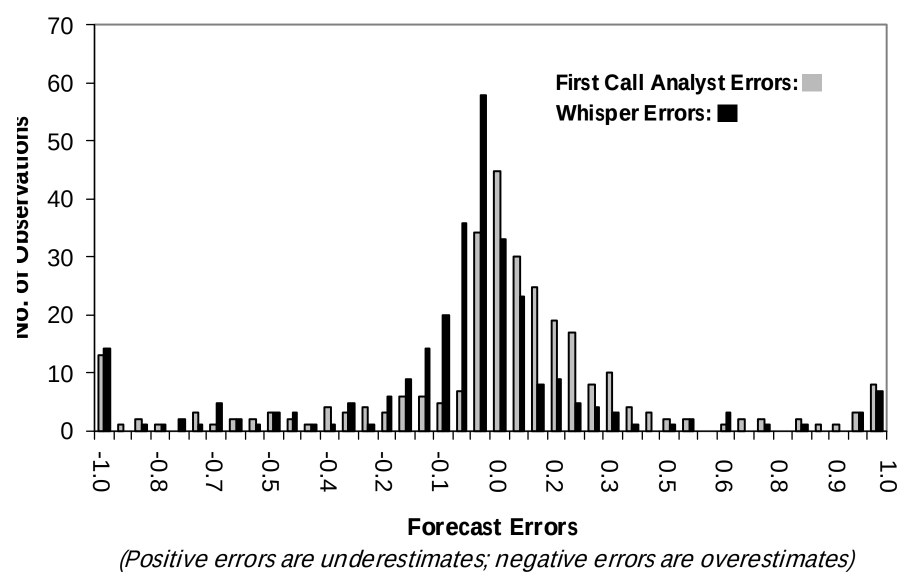
Finally, whisper firms were more actively traded, and their shares are held by a greater average number of institutional investors, but there is no significant difference in the proportion of shares held by institutions.

## WHISPERS vs. THE ANALYSTS

To examine whether whisper forecasts and analyst forecasts differ in their ability to forecast quarterly earnings, we calculated forecast errors for each firm each quarter. A forecast error is the difference between actual earnings per share and the forecasted earnings per share. We compared the average whisper forecasts for each firm to both the quarterly analyst consensus forecasts, which is the average of all First Call analyst forecasts made after the prior quarter's earnings announcement, and a "most recent" forecast, which is the most current available First Call analyst forecast.

The results of these comparisons indicated that the whisper forecasts tended to be more accurate than the First Call forecasts. In addition, the whisper forecasts tended to overestimate earnings (which would produce a negative forecasting error) while First Call forecasts tended to under-

**FIGURE 1. FORECAST ERRORS: WHISPERS VS. FIRST CALL CONSENSUS ANALYSTS**



estimate earnings (which would produce a positive forecasting error). Figure 1 illustrates the results for the consensus forecast comparisons, with the light bars representing the consensus forecast errors, and the dark bars representing whisper forecast errors.

It has been suggested that whisper forecasts have arisen to "undo" the pessimistic bias in analyst forecasts. If so, the relative accuracy of the whisper and First Call forecasts would be sensitive to whether the whisper exceeds the First Call forecast. In our study, fully 78% of the whisper consensus forecasts exceeded their First Call counterparts, a finding that supports the Wall Street conjecture that whispers may arise to "undo" the pessimistic bias in analyst forecasts. However, comparison tests indicated that the whisper forecasts tended to be more accurate than First Call forecasts regardless of whether they are smaller or larger than the analyst forecasts.

Finally, it is possible that the accuracy of whisper and First Call forecasts is driven by their timing. Whisper forecasts tend to appear in print later in the quarter, very close to the actual earnings announcement, although due to their unofficial nature, it is impossible to determine exactly when whispers begin to circulate. First Call forecasts, on the other hand, tend to appear much earlier in the quarter. Interestingly, subsequent revisions of First Call forecasts are not common. This suggests that some of the differences in whisper and First Call forecasts may be due, in part, to whispers' timing advantage. However, when we compared only First Call forecasts that appeared within five days of the earnings announcement to their whisper counterparts, the results we observed were weaker but not eliminated. Thus, differences between whisper and First Call forecasts are only partially explained by the whispers' timing advantage.

## THE USEFULNESS OF WHISPERS

One implication of our analysis is that whisper forecasts contain relevant earnings information that is not contained in the First Call analyst forecasts. This suggests that market prices may be sensitive to the information contained in whispers. To test this, we examined the performance results of several trading strategies based on First Call and whisper forecasts. These trading strategies are not implementable (they are based on backward-looking results), but were designed to provide insight into whether whisper forecasts or First Call forecasts are better proxies for the market's expectation of earnings.

Our first set of trading strategies was implemented this way:

- *Whisper-Based Strategy:* If the consensus whisper forecast was greater than reported earnings, we shorted the stock, and if the forecast was less than reported earnings, we bought the stock.
- *Analyst-Based Strategy:* If the First Call consensus forecast was greater than reported earnings, we shorted the stock, and if the forecast was less than reported earnings, we bought the stock.

The positions were started at the open of trade on the day earnings were released and unwound after one more trading day had passed.

The idea behind the strategy is that if the firm reported earnings that exceeded expectations (as measured by a forecast), the stock price should have risen upon the release of actual earnings, and if reported earnings were below expectations, the stock price should have fallen. If cumulative returns over the two-day holding period are significantly greater for the trading strategy based on the consensus whisper forecast, this is consistent with the consensus whisper forecast being a better proxy for the market's expectation of earnings.

This, in fact, turned out to be the case: The trading strategy returns from the whisper-based strategy were significantly greater than the returns from the analyst-based strategy.

Our second set of trading strategies involved taking positions based on the relation between contemporaneous First Call and whisper forecasts: If the whisper consensus forecast was greater than the First Call consensus, we bought the stock, and if the whisper forecast was less than the First Call consensus forecast, we shorted the stock. Since whispers normally appear in print within a week of the earnings release, we took our positions several days before the earnings announcement and unwound the position at the close of trading on the day before earnings were released.

This strategy produced returns that were significantly greater than zero, indicating that whisper forecasts themselves contain timely earnings information that is subsequently reflected in share prices. If this were not the case, profits would not be made from the trading strategy, since the share price would have adjusted to the information before our trading position was taken.

## CONCLUSION

Whisper forecasts have become an increasingly important and influential phenomenon in today's financial markets.

Our analyses of this new source of earnings information indicated that:

- Whisper forecasts tend to be more accurate than analyst forecasts.
- Whisper forecasts appear to be a timely source of information to market participants—they contain information that is not contained in analyst forecasts, and they are widely enough disseminated so that at least part of this information is incorporated in stock prices prior to the release of actual earnings figures. They thus tend to be a better proxy for the market's expectation of earnings than analyst forecasts.
- Investors may be able to exploit pessimism in analysts' forecasts by

### Web-Based Sources for Whisper and Consensus Analyst Earnings Forecasts

**Whisper Forecasts**

*Whisper estimates can be found in the message boards on many investor Web sites. The following sites specifically focus on whisper forecasts:*

EarningsWhispers.com
www.earningswhispers.com

The Whisper Numbers
www.thewhispernumber.com

WhisperNumber.com
www.whispernumber.com

JAGNotes.com
www.jagnotes.com

StreetIQ.com
www.streetiq.com

**Consensus Analyst Earnings Forecasts**

*Most investing Web sites providing data on stocks will have basic consensus earnings estimate data. The following sites serve as the primary sources for these estimates:*

First Call Corporation
www.firstcall.com

S&P Personal Wealth
www.personalwealth.com

I/B/E/S International
www.ibes.com

Thomson Investors Network
www.thomsoninvest.net

InvestorNet
www.earningsnet.com

Zacks Investment Research
my.zacks.com

comparing the analyst forecasts to the whisper forecasts before an earnings announcement is made.

What's the bottom line for investors? Whisper numbers tend to come from unknown and unnamed sources—they may come from company insiders, perceptive investors, or those who are attempting to manipulate a stock's price. Further, our analysis does not speak to the quality of whisper estimates posted on sites that claim to collect whisper numbers. So, don't simply take whisper numbers at face value; comparing the whisper forecasts to analysts' consensus estimates may be a useful approach.

But don't ignore the whispers when it comes to earnings. The market certainly isn't. ✦