# Investor Sentiment and Management Earnings Forecast[1]

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Research Paper

## Introduction

Investors' sentiment are the degree of optimism and pessimism of shareholders towards a stock and usually occur due to difficulty in valuing companies, which leads to decisions based on subjective judgments. Previous evidence show that investors and analysts are sensitive to sentiment and can have overly optimistic or pessimistic earnings expectations. Companies usually publish their next year's budget at the end of each fiscal year. One of the most important information in companies' budgets is to forecast the amount of earnings per share. On the other hand, although managers have an information advantage over outsiders about their companies; their performance is not immune to behavioral biases. Therefore, it is expected; managers, like investors and analysts, should be sensitive to sentiment, and managers' forecasts of their companies' annual earnings should be influenced by investors' sentiment.

Compared to analysts, managers have more information about their companies; so, it is possible; when they are forecasting earnings, less be influenced by the feelings of investors. Therefore, this study seeks to answer this question that what is the relationship between investors' sentiment and bias in predicting earnings by managers and how is this relationship in conditions of uncertainty.

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**Methodology**

The research dependent variable, following Horowitz (2017), was the bias in earnings forecast calculated by subtracting the first earnings per share forecast of managers from the actual earnings per share of the company. To measure the investor sentiment as an independent variable, we used the Jones (2005) index based on the return rating. In order to test the second hypothesis, the investor's sentiment is divided into two categories: high sentiment (optimistic) period and low sentiment (pessimism) period; In other words, in order to measure high sentiment period, if the level of investor sentiment is in the upper quintile of the selected companies; the number one is assigned to it and otherwise zero. Also, to measure low sentiment period, if the level of investor sentiment is in the lowest quintile of the selected companies; the number one is assigned to it and otherwise zero. In this study, to test the third research hypothesis, following Horowitz (2017), the sample was first divided into two groups of companies with low uncertainty and companies with high uncertainty, and then we tested model of the first hypothesis, once for companies with Low uncertainty and once for companies with high uncertainty in earnings forecast by management and then the results were compared. The statistical population of the study consisted of 165 companies listed in the Tehran Stock Exchange in the period from 2011 to January 30, 2017, that earnings forecast information was available, were examined for 7 years.

**Results and Discussion**

The results of research hypotheses show that investor sentiment has a negative and significant relationship with optimism in the forecast of annual profits by management; In addition, according to the research results, managers' annual earnings forecasts are not more optimistic in periods of investor optimism; but in times of investor pessimism, it is optimistic. There is no significant difference between investor sentiment and managers' predictions in companies with high uncertainty.

**Conclusion**

The results of testing the first hypothesis of the research showed that managers are not affected by their feelings due to having more information compared to investors. In interpreting the results of this study, it should be noted that the average variable of managers' earnings forecasting in the surveyed companies, is close to zero; that absence of bias in the period under consideration can due to the necessity of earnings forecasting and considering the consequences of optimism in earnings forecasting by managers. Based on the results obtained from the second hypothesis, it is observed; during periods of low sentiment, managers' annual earnings

forecasts have been opportunistic and optimistic; but during periods of high investor sentiment, there is no sign of managers' opportunism due to the non-significant relationship between investor sentiment and forecast bias. According to the results of the third hypothesis that is observed; the presence or absence of uncertainty during the period under review and in the society in question does not affect the relationship between investor sentiment and the bias of managers' predictions. It seems that the small amount of bias in forecasting earnings due to its mandatory in the study population, as well as the lack of macroeconomic variables in our model in the period under review, has been effective on the research results. In addition, it is possible; the division of companies into companies with high and low uncertainty according to the method used in this study in the Iranian market environment, has been inappropriate.

**Keyword:** Emotional Tendencies of Investors, Bias in Predicting Managers' Profits, Uncertainty.

**JEL Classification:** M41, G02