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An Empirical Analysis of the Market Response to Earnings Warning Announcements

A re: Thesis in partial fulfilment of the requirements for the degree of Master of Business Studies in Finance at Massey University

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Abstract

A review of the recent literature surrounding market efficiency identifies two families of pervasive regularities: the underreaction of stock prices to new information events, such as earnings announcements or warnings, and the overreaction of stock prices to a series of negative or positive news. This study provides an empirical analysis of the market's stock price response to earnings warning announcements. Traditional event study methodology is employed to examine the stock price response of a sample of 372 companies issuing earnings warning announcements over a two-year period (1998 to 1999). The study finds evidence of a systematic stock price underreaction to the news content of an earnings warning announcement resulting in negative post-event 'drift' over the short to medium term for the majority of companies in the sample. The exception to this general finding is the group of stocks that have experienced the worst performance in the year leading up to the earnings warning announcement. This group of stocks displays post-event returns significantly higher than the rest of the sample, possibly as a correction of previous overreaction to a series of negative news events.
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