

Summary and Questions on: “Market Reactions to Tangible and Intangible Information”

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Question

What drives the book-to-market effect?

Is it “distress” (Fama and French 1996)?

Findings

Stock returns are strongly negatively related to “intangible” returns (the past-return component orthogonal to past accounting performance); and unrelated to “tangible” returns

The book-to-market ratio forecasts returns because it proxies for the intangible return

A composite equity issuance measure (related to intangible return) independently forecasts returns

Concepts

Prices can move in response to tangible/intangible information:

$$\log(B_{it}/M_{it}) = bm_{it} = bm_{i0} + \Delta b_i - \Delta m_i$$

Tangible information: news about past accounting performance (Δb_i)

Intangible information: news about future performance unrelated to past performance (Δm_i , not Δb_i)

Procedure

Annual cross-sectional regressions of past 5-year log returns on fundamentals (unanticipated book value, earnings, cash flow, and sales growth, separately and jointly)

Tangible return: the fitted component

Intangible return: the residual

No relation between tangible returns and future returns, but a strong, negative relation between intangible returns and future returns

Composite-Issuance

Measures the amount of equity a firm issues/retires:

Seasoned issues/employee stock options/share-based acquisitions; repurchases/dividends

Future returns are unrelated to internally funded growth in sales/earnings, but are negatively related to externally funded growth

Composite-issuance as an alternative measure of intangible information (private to managers)

Questions

Model misspecifications for tangible returns?

That news in accounting measures does not predict returns is inconsistent with many prior studies

Past sales growth: LSV 1994

Earnings: Bernard-Thomas 1989, 1990;
Piotroski 2000; Fama-French 2006

The composite-issuance as an intangible-news measure is weak?

More related to [real investment](#)? (Loughran-Ritter 1997;
Lyandres-Sun-Zhang 2005)