# Corporate accounting earnings data relevant for determining value of the aggregate stock market

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While teaching a course on financial information analysis, Asst. Prof. Panos Patatoukas observed that capital market participants and policy makers are increasingly turning to accounting earnings data from corporate financial reports for hints regarding the prospects of the aggregate stock market. This observation indicated that, at the aggregate level, accounting earnings data could be relevant for gauging the value of the entire stock market.

Patatoukas, Haas Accounting Group, became so intrigued that he decided to undertake an in-depth investigation of the information that decision makers interested in stock market valuation could extract from accounting earnings data aggregated across publicly traded firms in the U.S.

Patatoukas' study, "Detecting News in Aggregate Accounting Earnings: Implications for Stock Market Valuation" is published in *The Review of Accounting Studies* (March 2013).

Patatoukas' study develops a theoretical framework for understanding the relation between aggregate accounting earnings and stock market valuation. Patatoukas shows that this relation is complicated by the fact that stock market prices are very sensitive to even small revisions in investors' expectations about discount rates. His study provides strong empirical evidence that this is the case.

Using a comprehensive sample of U.S. publicly traded firms from 1981 to 2009, Patatoukas shows that aggregate accounting earnings are tied to news about both expected future cash flows and discount rates. A comprehensive investigation of the link to discount rates reveals that aggregate accounting earnings are tied to news about the real riskless rate, expected inflation, and the expected equity risk premium (i.e., the expected excess return of the stock market over the nominal riskless rate). In fact, over the sample period studied, cash flow news and discount rate news in aggregate accounting earnings move together and have opposite impacts on the value of the aggregate stock market. An increase in expected future cash flows is positive for valuation, while an increase in discount rates is negative for valuation. Importantly, however, prices capture the net impact of cash flow news and discount rate news and so the stock market appears to be insensitive to aggregate accounting earnings.

"My findings illuminate the importance of separating cash flow news from discount rate news when evaluating the information content of aggregate accounting earnings for the stock market valuation," says Patatoukas. "Although the stock market appears to be insensitive to aggregate accounting earnings that does not mean that accounting earnings data are not informative. In fact, aggregate accounting earnings are very relevant for determining the value of aggregate stock market!"

Patatoukas' theory and evidence has the potential to change how capital market participants and policy makers use accounting data from corporate financial reports when making inferences at the aggregate stock market level. "Maybe it is not a pure speculation to expect that future research will uncover even more evidence on the relevance of aggregate accounting data for stock market valuation," says Patatoukas.

**More information:** link.springer.com/article/10.1 … 07/s11142-013-9221-3

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