DISCOVERING THE ROLE OF EQUITY ANALYSTS IN THE SO-CALLED EFFICIENT MARKET

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It is widely accepted in academia that the equity capital market is nearly efficient. Moreover, the average investor should also consider the market to be fairly efficient in terms of information. However, if security prices incorporate all of the information that is available and are assumed to be reasonably priced, then what role do equity analysts play? Our research involves the investigation of the benefits that an equity analyst is expected to generate based upon his/her value-added performance. As it turns out, we cannot know all things at all times; and consequently, due to timing constraints, limited resources, and other impediments, the capital markets contain some inefficiency. Because equity analysts are considered to be industry experts within their respective fields and have more time and resources devoted to evaluating particular stocks, they are able to extract that additional piece of information that others may miss. Thus, at the margin, equity analysts add value with their research. As an empirical experiment, we looked at the price movements of a random sample of large-cap and small-cap stocks on the day that analysts announce their recommendations. Because large-cap stocks tend to have more information readily available, it is hypothesized that their prices would not be as volatile as their small-cap counterparts. As the recommendations are made, the small-cap prices will quickly move to assimilate any new observations discovered by the equity analysts.