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Extreme optimism on earnings calls OK, study finds

Conveying expected performance on earnings calls with extreme language tends to correlate with future positive results, a study shows

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Executives speaking on earnings calls who use extreme language to describe optimistic performance expectations more often than not are accurately anticipating future positive results and aren't just speaking in hyperbole, the results of an academic study show.

"While investors might be naturally suspicious of strong language from corporate managers, particularly when it is of the optimistic variety, our study cautions against rejecting it out of hand," says Jeffrey Hales, professor of accounting at the University of Texas at Austin. "More often than not it reflects managerial conviction."

The study found a 1.33% increase in extreme words conveying optimism results in about a 6% increase in trading volume in the company's stock and a 0.63% boost in price over three days.

What's more, the price increase generally isn't just a blip. The three-day increase tends to be sustained over time. In the 60 trading days following quarterly earnings conference calls, there was "no significant drifts or reversals in prices," the study found.

That performance suggests investors are pricing the information in extreme language correctly, the researchers said.

Language reflects views

To derive their findings, the researchers conducted a linguistic analysis of more than 23,000 words based on transcripts from almost 61,000 earnings conference calls. Online participants assigned rankings to the words to distinguish between those that are extreme and those that are moderate.

Examples of extreme words include "incredible" and "amazing" on the positive side and "terrible" and "worst" on the negative side. "Steady" and "competitive" are examples of moderate words.

Hales said CEOs, CFOs and other executives who participate in earnings calls should feel free to use extreme language if it accurately reflects their views.

"They might want to resist pressures from their legal departments to dampen their language when circumstances seem to warrant speaking out strongly," he said. "Our results suggest that many executives, to their credit, are voicing their convictions in earnings calls, and this appears to help with price discovery."

The research was conducted by Hales, Khrystyna Bochkay, assistant professor in accounting at the University of Miami, and Sudheer Chava, professor of finance at Georgia Institute of Technology. The study, "Hyperbole or Reality? Investor Response to Extreme Language in Earnings Conference Calls," will appear in the March issue of **The Accounting Review, published by the American Accounting Association.**

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