"A More Comparable Book-to-market Ratio"

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Abstract

Book values are based on accounting rules that treat certain investments (e.g., R&D) differently than other investments. This results in less comparable book-to-market ratios across firms. Consequently, the previously documented relation between book-to-market ratios and future returns weakens and the relation with profitability disappears during the 1990-2011 period, where R&D expenses are high. This paper employs common adjustments to generate more comparable book-to-market ratios. The findings suggest that the relation between (adjusted) book-to-market, profitability and stock returns remains robust throughout the sample period. Furthermore, the findings imply that (adjusted) profits of high (low) book-to-market firms have high (low) systematic earnings risk.