

Heterogeneous Overreaction in Expectation Formation: Evidence and Theory*

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Abstract. Using firm-level earnings forecast and managerial guidance data, we construct guidance surprises for analysts, i.e., differences between managerial guidance and analysts' initial forecasts. We document new evidence on expectation formation: (i) that analysts overreact to guidance surprises; (ii) that the overreaction is stronger to negative guidance surprises but weaker to larger surprises; and (iii) that forecast revisions are neither symmetric in guidance surprises nor monotonic. We organize the facts with a model where analysts are uncertain about the quality of managerial guidance. A structural estimation shows that a reasonable degree of ambiguity aversion is necessary to account for the documented heterogeneous overreaction.

Keywords. overreaction, expectation formation, managerial guidance, forecast revision, asymmetry, non-monotone, ambiguity aversion

JEL Classification. C53, D83, D84, E31

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