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Extreme language on earnings calls has positive result, study finds

Expressive words on earnings calls can influence trading volume and share price



Zsuzsanna Szabo
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Investors appear to interpret companies' strong language on quarterly earnings calls as a positive sign for future earnings and sales, reveals a combined study from the University of Miami, the University of Texas and the Georgia Institute of Technology.

By contrast, moderate language is associated with weak future performance, finds the research, which is written by Khrystyna Bochkay of the University of Miami, Jeffrey Hales of the University of Texas at Austin, and Sudheer Chava of Georgia Institute of Technology and was originally published in *The Accounting Review*.

The authors looked into the transcripts of 60,940 earnings conference calls including introductory remarks and Q&A sections. Ratings of the words used were then set against short-term trading volumes, price movements, a long-term measure of stock returns, company financial performance and analyst activity.

Mind your language

The use of two or three extremely positive or negative words per 1,000 words in an earnings call can result in a 6.9 percent boost to trading volume, according to the research. Using 12-13 moderate words per 1,000 stimulates only 2.3 percent more trading around the earnings call. Examples of positive extreme words include 'terrific', 'excellence' and 'amazing', while words such as 'default', 'worst' and 'terrible' score as extreme negative terms. 'Steady' and 'competitive' are rated as moderate words.

The research also suggests that using extreme positive language on the earnings call can stimulate trading activity and generate strong price reactions.

A hike in a stock price driven by extreme positivism turns out not to be 'just a temporary blip', notes the research: a three-day price gain appears to last over time. A 1.33 percent increase in extreme words conveying optimism leads to about a 6 percent growth in trading volume in a stock and a 0.63 percent boost in price over three days.

Encouraged to speak out strongly

Hales recommends issuers adopt using strong language on earning calls as long as the context is in line with the expected performance. 'As for CEOs, CFOs or other corporate managers involved in earnings conference calls, they might want to resist pressures from their legal departments to dampen their language when circumstances seem to warrant speaking out strongly,' says Hales.

'Indeed, our results suggest that many executives, to their credit, are voicing their convictions in earnings calls, and this appears to help with price discovery.'