
Euro stoxx 50 forecasts and the business cycle: revisiting rationality

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Abstract

Using about 100,000 EPS forecasts for companies listed in the Euro Stoxx 50, we uncover the loss function of financial analysts. Our results suggest that EPS forecasters on average have an asymmetric loss function and weight positive and negative forecast errors differently. In addition, we report a strong degree of heterogeneity concerning the loss function among individual institutes, forecasted companies, and over time. In times of economic distress, EPS forecasters attribute an overestimation to a loss four times the size of a similarly dimensioned under prediction. This might explain why forecasters prefer to submit pessimistic EPS projections in times of recession. In contrast to that, we report an almost symmetric loss function for the full sample reflecting the forecasters' general ambition to produce an accurate forecast. Moreover, the number of rational forecaster's doubles when assuming flexible loss compared to a standard symmetric loss function.
