Abstract

It is important to know if earnings variables influence stock returns. This is important not just for investors who want to know what drives stock returns, but also for the overall economy as stock returns and stock markets are also considered to be significant indicators of its performance. Many studies were conducted in the past but with inconclusive results. The aim of the thesis is to examine the relationship between net income and stock returns using two approaches, namely panel data model and multiple linear regression. We utilize a dataset of companies selected from the S&P500 Index. We also analyse possible heterogeneity in cross section and time. Moreover, we incorporate additional factors which have been proven to have significant explanation power for stock returns. Our findings from the panel data estimation suggest that there is no relationship between scaled net income and stock returns. We find there are random effects present between the companies and three structural breaks in time. Furthermore, we explore the significance of the consumer sentiment index and the percentage change in the book value per share variables in the panel estimation. We do not confirm the debt to equity ratio and the GDP growth news factors in the panel estimation as significant. Results concerning the relationship between net income and stock prices coming from the multiple linear regressions are inconclusive.