

ACCOUNTING FUNDAMENTALS AND VARIATIONS OF STOCK PRICE: FORWARD LOOKING INFORMATION INDUCEMENT

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ABSTRACT

This study investigates a permanent issue about low association between accounting fundamentals and variations of stock prices. It induces not only historical accounting fundamentals, but also forward looking information. Investors consider forward looking information that enables them to predict potential future cash flow, increase predictive power, lessen mispricing error, increase information content and drives future price equilibrium. The accounting fundamentals are earnings yield, book value, profitability, growth opportunities and discount rate or they could be called as five-related-cash flow factors. The forward looking information are expected earnings and expected growth opportunities. This study suggests that model inducing forward looking information could improve association degree between accounting fundamentals and the movements of stock prices. In other words, they have higher value relevance than not by inducing. Finally, this study concludes that inducing forward looking information could predict stock price accurately and reduce stock price deviations from their fundamental value. It also implies that trading strategies should realize to firm's future rational expectations.

Keywords: *earnings yield, book value, profitability, growth opportunities, discount rate, accounting fundamentals, forward looking, value relevance*

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