

# How attractive analysts make better stock calls

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It is commonly thought that physically attractive people always get the best deals in life -- better job opportunities, higher earnings, more chances for career success, not to mention connections in high places and an amazing social life. Like it or not, research in sociology and psychology has shown a correlation between an attractive appearance and better treatment both in the workplace and in social settings.

The financial markets of China, perhaps surprisingly, operate under a similar dynamic, with the attractiveness of financial analysts positively associated with the accuracy of their earnings forecasts and the value of their stock recommendations.

In capital markets, sell-side financial analysts employed by broker-dealers and investment banks often play an important role in disseminating information on particular securities or stocks. They give investors information to judge whether certain financial products are worth investing in.

In China, the influence of financial analysts on the stock market is higher than average. This is because the market is dominated by retail investors, who are more likely to be influenced by apparent "expert opinions" than institutional investors.

Analysts seek out information from various sources, including members of company management, with whom they often establish private communications. Such direct communications can turn out to be more useful to earnings forecasts and stock recommendations than companies' public disclosures or the analysts' own primary research, such as corporate site visits or analysis of fundamental operations. Previous studies in China and Western countries have found that analysts issuing optimistic or pessimistic forecasts to cater to the interests of certain executives enjoy an information advantage and exhibit superior forecast performance.

Three colleagues and I recently looked at a sample of 89,056 earnings forecasts made in 2005-2014 by 2,328 Chinese analysts to consider how their physical attractiveness might relate to their success in acquiring accurate information and making better financial forecasts. The analysts came from 102 brokerages, including the largest ones in China.

Some 63 raters from different educational backgrounds, occupations, income levels and social experience scored the analysts, using headshots from the website of the Securities Association of China, on a five-point scale, with 5 reserved for the most attractive. The raters were asked to use the average person in the Chinese population, rather than the sample group of analysts, as the benchmark in grading attractiveness. The raters included members of a Big Four accounting firm and staff from a brokerage and a large private company as well as university faculty and students. Among them, 27 were male and the rest female.

## Gaining access

The study found that the beauty ratings of financial analysts have a significant positive association with the accuracy of their forecasts. That is to say, more attractive analysts make more accurate forecasts.

The evidence gathered clearly suggest that attractive financial analysts are better able to acquire sensitive information from Chinese company management teams. Compared with their less attractive counterparts, they are more likely to gain advance access to information on pending significant corporate events, and they are more likely to issue a stock recommendation in the quarter before the public announcement of a restructuring, signing of a major contract or an earnings warning. Consequently, they are able to produce more informative stock recommendations.

The study results also show that company managers are more likely to disclose information to these attractive analysts during corporate site visits, when the analysts can directly interact with them. Besides their ability to gather more exclusive market information, physically attractive analysts also get better career advancement opportunities, according to our study. An attractive analyst is more likely to be voted as a "star analyst" by institutional investors, which in turn can lead to a better chance of recruitment by a top-notch brokerage.

It may be true that life's favors are often skewed toward those endowed with beauty genes, but looks can only go so far. A further section of the study looked at whether the "beauty effect" has to do with Chinese managers' personal bias and taste or whether they really believe that attractive people possess superior skills and can better serve the interests of their companies.

The study found that the "beauty effect" disappears as soon as managers are allowed to trade shares themselves or when their companies are under a share pledge agreement. In both situations, the managers have a financial stake directly linked to their company's stock price and analyst research can have a material impact on that stake.

As such, when managers have a personal stake in the market, they are less likely to allow their partiality for beauty to sway their decisions on which analysts to favor with information. The actual ability of the analysts to provide solid work thus takes precedence.

While previous research has suggested that Chinese analysts who issue favorable opinions obtain more information from company management, the current study documents how managers' taste for beauty affects interactions with financial analysts. Since this form of discrimination originates from psychological and social bias, regulating it would be very difficult. In turn, this brings a new challenge to regulators and practitioners in the financial industry.

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