Forecasting in a Polarized World:

The Role of Political Disagreement in Analyst Forecasts and Information Production

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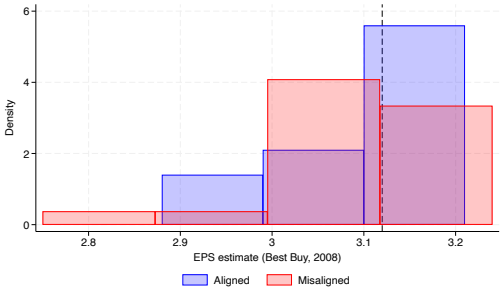
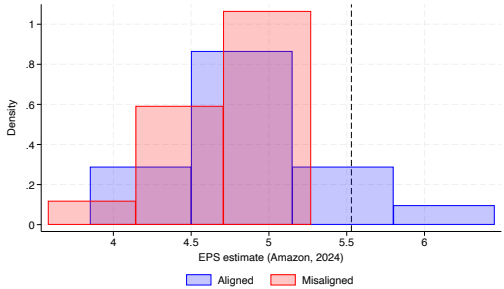
Motivation

- Analysts expectations are important in both asset pricing and corporate finance
  - La Porta (1996), Alti and Tetlock (2014), Bordalo et al (2019)
- Yet analysts often *disagree* toward the same firm, and their dispersions matter
  - Diether, Malloy, and Anna (2002), Hong and Stein (2003), Anderson, Ghysels, Juergens (2005)
- Political beliefs can shape analysts' views
  - Kempf and Tsoutsoura (2021, 2024), Dagostino, Gao, Ma (2023)

Case Studies: Best Buy (2008) & Amazon (2024)



Best Buy (2008)



Amazon (2024)

- *Aligned*: Analysts and CEOs support the *same* political party
- *Misaligned*: Analysts and CEOs support *different* political parties

This Paper

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3. Investigate the **mechanism** using earnings calls
   - Test whether analysts interpret CEOs' statements via the lens of their own political views
4. Explore whether such political biases distort **information transmission** and shape the **analyst labor market**
   - Examine whether the stock market recognizes these politically biased forecasts
   - Compare investment-Q sensitivity
   - Test whether analysts sort into politically aligned brokerages

Main Findings

1. Analysts with different party affiliations cover *similar* types of firms
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1. Analysts with different party affiliations cover *similar* types of firms
   - No systematic differences in firm characteristics across analysts' party affiliations
2. Analysts' political affiliations are *a key driver* of forecast dispersion
   - Politically misaligned analysts issue **9–10% lower** and **12–15% less accurate** forecasts
3. Analysts interpret CEOs' statements through the lens of their *own political views*
   - When CEOs are misaligned with the government, they make more pessimistic statements toward firm and macro prospects during earnings calls
   - Misaligned analysts, *aligned with the government*, discount the CEO's macro pessimism, so more of the firm's troubles must be attributed to firm-specific factors
   - This mechanism **does not require analysts to observe the CEO's party affiliation**

Main Findings (*Continued*)

4. Analysts political biases weaken information transmission
   - The stock market *fails to recognize* politically biased estimates
   - The *investment–Q relation weakens* when firms are followed by more misaligned analysts

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   - The stock market *fails to recognize* politically biased estimates
   - The *investment–Q relation weakens* when firms are followed by more misaligned analysts
5. Political identity also shapes analysts' *career trajectories*
   - Misaligned analysts are 25% more likely to leave; ∼70% join aligned brokerages

Data

Challenges in identifying analysts' party affiliations:

1. I/B/E/S only provides last name and *first name initial* (e.g. D. Lee)
2. I/B/E/S *anonymizes analysts' employers* with numeric codes

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What we do:

1. Merge I/B/E/S data with Linkedin to recover analysts' first names
   - We only keep *financial analysts* from Linkedin profiles
   - Merge two dataset using last name and first name initial
   - Retain all observations with multiple matches for now
2. Merge I/B/E/S + Linkedin data with voters' registration data
   - For *multiple matches*, require all matched individuals to have *the same party affiliation*
3. For CEOs, obtain their full names from Execucomp and BoardEx

Analysts' Characteristics

Party	No. Analysts	No. Forecasts	Age	Female
Democratic	813	80,701	38.172	0.364
Republican	701	75,122	40.616	0.225
Independence	11	1,180	42.189	0.364
American Independent	8	465	39.237	0.250
Libertarian	8	1,209	32.467	0.125
Registered Independent	5	932	40.285	0.800
Green	4	118	36.381	0
Other	1	30	36.500	0
Conservative	1	221	42.376	0
Non-Partisan	616	66,057	38.547	0.255

We remove *non-partisan analysts* covering firms with *non-partisan CEOs* for our main analyses

CEOs' Characteristics

Party	No. CEOs	No. Forecasts	Age	Female
Republican	3,064	109,439	56.332	0.033
Democratic	1,566	53,631	54.650	0.079
Registered Independent	47	1,623	58.989	0.021
American Independent	46	1,525	55.303	0.022
Libertarian	18	885	52.759	0.056
Other	10	187	57.786	0.200
Independence	5	311	55.212	0
Green	3	46	54.761	0
Conservative	3	91	53.077	0
Non-Partisan	1,657	57,158	53.773	0.049

Summary Statistics

Removing non-partisans, we have 18,001 firm-year observations:

Variable	Mean	Median	Std. Dev
Mismatch with CEO	0.517	0.500	0.426
Number of Forecasts	6.619	5.000	6.156
Number of Analysts	1.998	1.000	1.430
Number of Democratic Forecasts	3.294	2.000	4.058
Number of Republican Forecasts	3.169	2.000	3.828

Analysts' Firm Coverage

- Concern: Analysts may cover *systematically different firms* based on their political affiliations, making it difficult to compare forecasts
- Compare *firm characteristics* between those covered by Dem vs Rep analysts
  1. For each year, compute average firm characteristics separately for firms covered by each group
  2. Take the time-series average of annual differences to test for systematic coverage differences

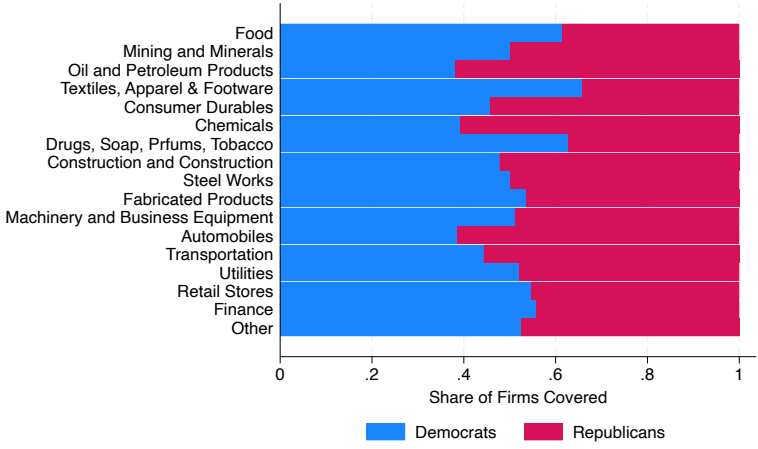
Analysts' Firm Coverage

No systematic differences between the firms covered by Democratic and Republican analysts:

Variable	Democrats	Republicans	Difference	t-stat
Book Asset	15,129	13,573	1,556	0.293
ROA	0.012	0.037	-0.025	-0.352
Gross Profitability	0.382	0.392	-0.010	-0.122
Operating Profitability	0.103	0.109	-0.007	-0.051
Asset Growth	0.184	0.185	-0.000	-0.014
Leverage	0.225	0.237	-0.011	-0.302
Market-to-book	7.236	7.170	0.066	0.005
Tobin's Q	2.245	2.996	-0.751	-0.260
R&D-to-sale	2.022	2.035	-0.013	-0.002
Cash-to-asset	0.183	0.175	0.008	0.357

Industry Comparison: Democrats vs Republicans

Industry coverage is broadly balanced between Democrat and Republican analysts:



Political Diversity and Forecast Dispersion

1. Does political diversity affects forecast dispersion?
   - Measure political concentration using the *Herfindahl-Hirschman Index (HHI) of party shares* based on the number of analysts from each party
   - Regress the standard deviation of EPS forecasts on the HHI of party shares

Political Diversity and Forecast Dispersion

Political concentration reduces the forecast dispersion:

	σ(EPS Forecasts)	
	(1)	(2)
HHI(Party Share)	-0.074**	-0.101***
	(-2.616)	(-3.093)
Observations	6883	6882
R^2	0.454	0.468
Firm FE	Yes	Yes
Year FE	No	Yes

t statistics in parentheses

* $p < 0.10$, ** $p < 0.05$, *** $p < 0.01$

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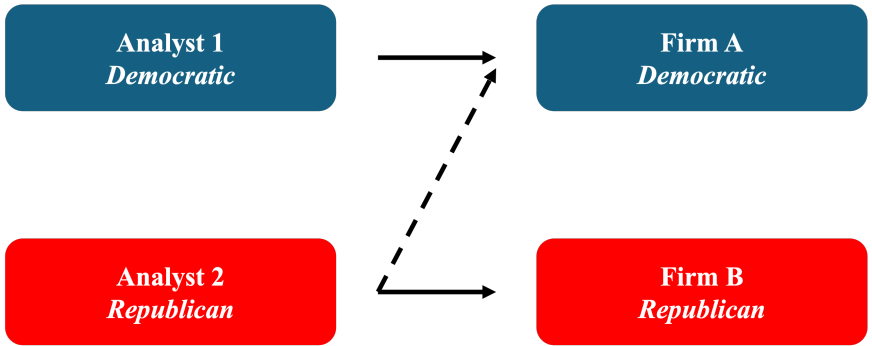
   - Regress the standard deviation of EPS forecasts on the HHI of party shares
2. By how much?
   - Apply *variance decomposition* (law of total variance) using the final forecast from each analyst within a firm-year:

$$Var(\text{EPS Forecasts}) = \underbrace{Var(E[\text{EPS Forecasts}|\text{Party}])}_{\text{Across-Party Share}} + \underbrace{E[Var(\text{EPS Forecasts}|\text{Party})]}_{\text{Within-Party Share}}$$

   - The across-party component accounts for **32%** of the total variance

Empirical Design



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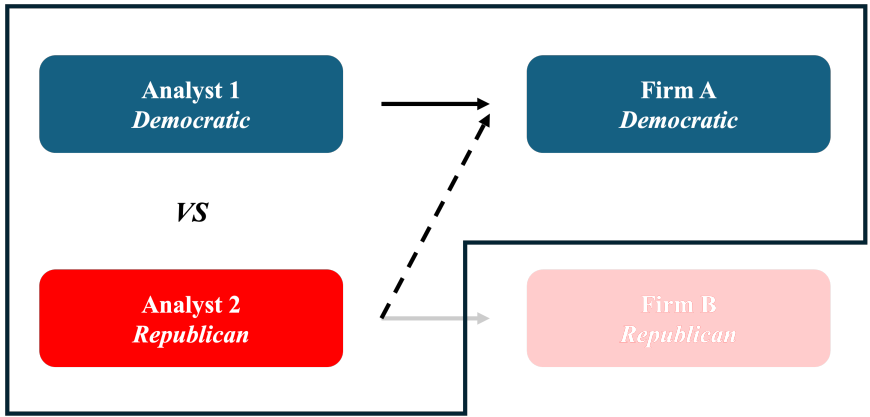


Political Misalignment and EPS Forecasts

- **Compare analysts with different party affiliations covering the same firm**:
  - Identify firms following covered by analysts with different party affiliations
- Compute how far each forecast deviates from the group median within a firm-year

$$\frac{\text{EPS Forecast}_i - \text{Median Forecast}}{|\text{Median Forecast}|}$$

- Compare forecasts between aligned vs misaligned analysts **within the same firm-year**

$$\text{EPS Forecast}_i = \beta \times \text{Mismatch with CEO}_i + \text{Firm-Year FE}$$

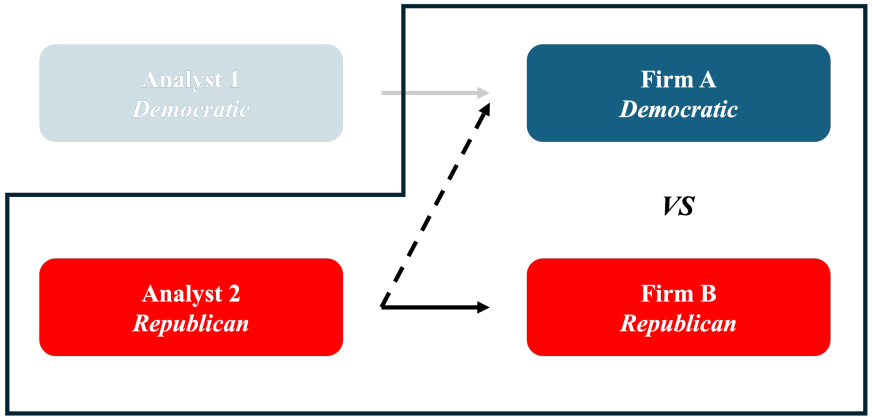
- 2 controls: Mismatch with President & Mismatch between CEO and President

Political Misalignment and EPS Forecasts

Misaligned analysts issue *lower* EPS forecasts than aligned ones:

	EPS Forecasts			
	(1)	(2)	(3)	(4)
Mismatch with CEO	-0.093**	-0.084***	-0.096***	-0.087***
	(-2.570)	(-2.795)	(-2.656)	(-2.821)
Mismatch with President	-0.067	0.940	-0.068	0.999
	(-1.413)	(0.713)	(-1.320)	(0.711)
Mismatch bet. CEO and President	-0.329	-0.264	-0.334	-0.261
	(-0.943)	(-0.942)	(-0.901)	(-0.903)
Observations	87881	87879	82805	82805
R^2	0.209	0.210	0.209	0.210
Analyst FE	Yes	Yes	Yes	Yes
Firm × Year FE	Yes	Yes	Yes	Yes
Brokerage × Year FE	Yes	Yes	Yes	Yes
Party × Year FE	No	Yes	No	Yes
Sample	All	All	Dem & Rep	Dem & Rep

Political Misalignment and EPS Forecasts: Empirical Design



Political Misalignment and EPS Forecasts

- **Compare analysts covering multiple firms within the same year**:
  - Identify analysts following firms whose CEOs have *different* political affiliations
    $\rightarrow$ Ensures each analyst covers both **aligned** and **misaligned** firms
- For each forecast, compute standardized EPS forecast:

$$z_{ijt} = \frac{\text{Forecast}_{ijt} - \text{Mean Forecast}_t}{\text{Std Dev of Forecast}_t}$$

  - We use mean and s.d. across all analysts (including those without political data)
- Compare forecasts between aligned vs misaligned firms **within the same analyst-year**

$$z_{ijt} = \beta \times \text{Mismatch with CEO}_{ijt} + \text{Analyst-Year FE}$$

Political Misalignment and EPS Forecasts

Analysts issue lower forecasts for firms whose CEOs have different political affiliations:

	EPS Forecasts	
	(1)	(2)
Mismatch with CEO	-0.024**	-0.032***
	(-2.414)	(-2.934)
Mismatch with President	0.013	0.003
	(0.155)	(0.033)
Mismatch bet. CEO and President	-0.012	-0.019
	(-0.969)	(-1.412)
Observations	77074	74364
R^2	0.130	0.133
Analyst $\times$ Year FE	Yes	Yes
Sample	All	Dem & Rep

t statistics in parentheses

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Analyst Forecasts Around CEOs' Turnover

- How do analysts adjust their views once a firm changes its CEOs?
  - Estimate a difference-in-difference regression around CEOs' turnover (-6 $\sim$ 6):

$$\text{EPS Forecasts}_{ijkt} = \beta \times \text{Mismatch with New CEO}_{ijt} \times \text{Post}_t + \text{Firm-Year FE} + \text{Analyst-Firm FE}$$

Analyst Forecasts Around CEOs' Turnover

Analysts *quickly & substantially* lower forecasts once misaligned with new incoming CEOs:

	EPS Forecasts	
	(1)	(2)
Mismatch with CEO × Post	-0.268**	-0.279**
	(-2.106)	(-2.075)
Mismatch with President	-0.573	-0.572
	(-0.993)	(-0.992)
Mismatch bet. CEO and President	1.416	1.516
	(0.904)	(0.895)
Observations	9724	9147
R^2	0.283	0.282
Firm × Year FE	Yes	Yes
Analyst × Firm FE	Yes	Yes
Sample	All	Dem & Rep

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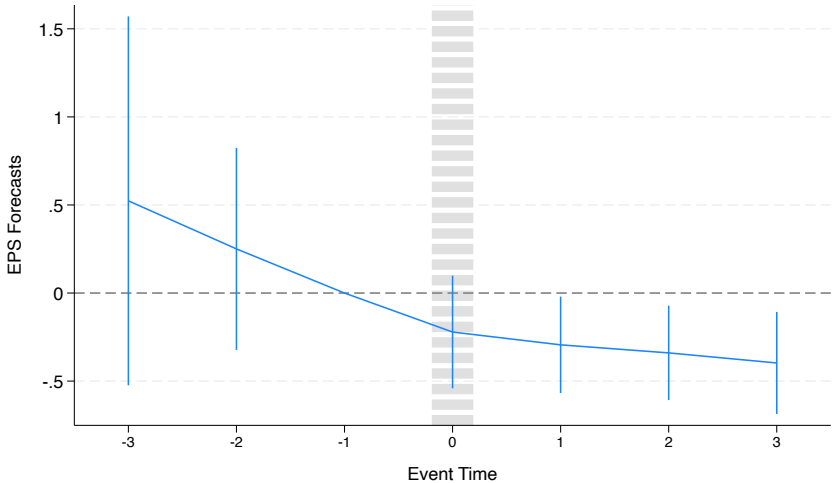

Political Misalignment and Forecasts Accuracy

- Analysts politically misaligned with CEOs issue **lower EPS forecasts** than aligned ones
  - Unclear whether misaligned analysts are *too pessimistic*, or aligned ones are *too optimistic*
    $\rightarrow$ Compare their **forecast errors**

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    $\rightarrow$ Compare their **forecast errors**
- We compute absolute forecast error as follows:

$$|\text{Forecast Error}_{ijkt}| = \frac{|\,\text{Forecast} - \text{Actual EPS}\,|}{\text{Median Forecast}}$$

  - We keep the last forecast per analyst–firm–year, and estimate

$$|\text{Forecast Error}_{ijkt}| = \beta \times \text{Mismatch with CEO}_{ijt} + \text{Firm-Year FE}$$

Political Misalignment and Forecasts Accuracy

Misaligned analysts issue *less accurate* EPS forecasts:

	— Forecast Error —	
	(1)	(2)
Mismatch with CEO	0.153*	0.154*
	(1.824)	(1.878)
Mismatch with President	-0.104	-0.127
	(-0.841)	(-0.865)
Mismatch bet. CEO and President	2.806	1.748
	(0.768)	(0.718)
Observations	21484	19929
R^2	0.766	0.769
Analyst FE	Yes	Yes
Firm × Year FE	Yes	Yes
Brokerage × Year FE	Yes	Yes
Sample	All	Dem & Rep

Mechanism: Earnings Calls

- Taking Stock: Misaligned analysts issue **lower** and **less accurate** EPS forecasts
  - *Why* do politically misaligned analysts interpret the same firm differently?
- Use earnings calls to study *both* sides of the information exchange:
  1. How CEOs talk about firm prospects and the macroeconomy
  2. How analysts interpret these statements
- Use **ChatGPT's API** to classify each sentence in call transcripts:
  - Negative vs Positive *firm-level* sentiment
  - Negative vs Positive *macroeconomic* sentiment
- *Key insight*: The mechanism does not require analysts to **observe** the CEO's political affiliation
  $\rightarrow$ Analysts' own political views shape how they weigh firm-level vs. macro information

CEOs' Political Affiliation and Sentiment

- First, do CEOs' political views affect what they say during earnings calls?
  - Conjecture: CEOs misaligned with the incumbent administration hold *more pessimistic* views about economic conditions
- Estimate:

$$\text{Sentiment}_{jt} = \beta \times \text{Mismatch bet. CEO and President}_{jt} + \text{Firm FE} + \text{Industry-Quarter FE}$$

  - *Sentiment*: Standardized share of sentences expressing negative or positive views about firm fundamentals or the macroeconomy

CEOs' Political Affiliation and Sentiment

Panel A: Macroeconomy

	Negative		Positive	
	(1)	(2)	(3)	(4)
Mismatch bet. CEO and President	0.028**	0.031*	0.012	0.017
	(1.962)	(1.784)	(0.830)	(0.895)
Observations	31466	31243	31466	31243
Firm FE	No	Yes	No	Yes
Industry × Time FE	Yes	Yes	Yes	Yes

Panel B: Firm Fundamentals

	Negative		Positive	
	(1)	(2)	(3)	(4)
Mismatch bet. CEO and President	0.035**	0.043**	0.008	0.015
	(2.100)	(2.391)	(0.405)	(0.794)
Observations	31466	31243	31466	31243
Firm FE	No	Yes	No	Yes
Industry × Time FE	Yes	Yes	Yes	Yes

Analysts' Reactions to CEOs' Sentiment

- Next, how do analysts *interpret* CEOs' statements?
  - Misaligned analysts share political affiliation with the incumbent administration
  - Their *own* political views shape how they weigh firm-level vs. macro information
- Toy example:
  1. President: Republican
  2. CEO: Democrat $\rightarrow$ misaligned with President: *more pessimistic* on firm and macro
  3. Analyst: Republican $\rightarrow$ misaligned with CEO, but *aligned* with President
- How does the Republican analyst interpret the Democratic CEO's pessimism?
  - **Macro**: Analysts disagree with CEOs' macro pessimism $\rightarrow$ Discount it
  - **Firm-level**: Can't blame the macro $\rightarrow$ Firm-specific channel absorbs the residual $\rightarrow$ Weigh it more

Analysts' Reactions to CEOs' Sentiment

Misaligned analysts react *more* to negative firm sentiment, *less* to negative macro sentiment:

	EPS Forecasts	
	(1)	(2)
Mismatch with CEO	-0.094**	-0.096**
	(-2.206)	(-2.080)
Mismatch with CEO × CEOs' Negative Firm Sentiment	-0.092*	-0.099*
	(-1.818)	(-1.795)
Mismatch with CEO × CEOs' Positive Firm Sentiment	-0.049	-0.053
	(-1.221)	(-1.187)
Mismatch with CEO × CEOs' Negative Macro Sentiment	0.049*	0.056*
	(1.736)	(1.775)
Mismatch with CEO × CEOs' Positive Macro Sentiment	-0.001	-0.003
	(-0.093)	(-0.387)
Observations	55317	52257
R^2	0.224	0.224
Analyst FE	Yes	Yes
Firm × Year FE	Yes	Yes
Brokerage × Year FE	Yes	Yes
Party × Year FE	Yes	Yes
Sample	All	Dem & Rep

Analyst Partisan Biases and Stock Market Reactions

- Taking Stock: Misaligned analysts issue **lower** and **less accurate** EPS forecasts
  - Does the market *distinguish* and appropriately discount these biased forecasts?

Analyst Partisan Biases and Stock Market Reactions

- Taking Stock: Misaligned analysts issue **lower** and **less accurate** EPS forecasts
  - Does the market *distinguish* and appropriately discount these biased forecasts?
- Estimate how cumulative abnormal returns (CAR) change when analysts announce forecasts:
  - CARs estimated using Fama–French three-factor expected returns

$$\begin{aligned} CAR_{jt} = {} & \beta_1 \times \Delta\text{EPS Forecast}_{ijt} + \beta_2 \times \text{Mismatch with CEO}_{ijt} \\ & + \beta_3 \times [\Delta\text{EPS Forecast}_{ijt} \times \text{Mismatch with CEO}_{ijt}] + \text{Firm-Year FE} \end{aligned}$$

- If the market distinguishes biased forecasts, $\beta_3 < 0$

Analyst Partisan Biases and Stock Market Reactions

The stock market reacts to their forecasts as strongly as to those of aligned analysts:

	CAR(-1,+1)	CAR(-3,+3)	CAR(-5,+5)
	(1)	(2)	(3)
Δ EPS Forecast	44.235***	47.582***	53.416***
	(3.244)	(3.056)	(3.659)
Mismatch with CEO	-0.203	-2.690	-6.082
	(-0.030)	(-0.379)	(-0.841)
Δ EPS Forecast $\times$ Mismatch with CEO	-7.241	-6.937	-9.636
	(-0.716)	(-0.665)	(-1.001)
Observations	78934	78930	78929
R^2	0.243	0.266	0.296
Analyst FE	Yes	Yes	Yes
Firm $\times$ Year FE	Yes	Yes	Yes
Brokerage $\times$ Year FE	Yes	Yes	Yes

t statistics in parentheses

* $p < 0.10$, ** $p < 0.05$, *** $p < 0.01$

Analyst Partisan Biases and Information Transmission

- The stock market *fails to recognize biased estimates*:
  $\rightarrow$ Stocks covered by more misaligned analysts exhibit **biased valuations**

- Test whether the **investment–Q sensitivity** differs between stocks followed by more misaligned (thus more biased) vs. aligned analysts

  - Compute the *average share* of misaligned forecasts and the *number* of aligned vs. misaligned forecasts for a given firm-year and estimate:

$$\ln(\text{Investment})_{jt+1} = \beta_1 \times \ln(Q)_{jt} + \beta_2 \times [\ln(Q)_{jt} \times \text{Mismatch with CEO}]$$

$$\begin{aligned}\ln(\text{Investment})_{jt+1} = \beta_1 \times \ln(Q)_{jt} + \beta_2 \times [\ln(Q)_{jt} \times \text{No. Misaligned Analysts}] \\ + \beta_3 \times [\ln(Q)_{jt} \times \text{No. Aligned Analysts}]\end{aligned}$$

Analyst Partisan Biases and Information Transmission

The investment-Q relation weakens when a larger share of covering analysts are misaligned:

	$\ln(\text{Investment})_{t+1}$ (%)		
	(1)	(2)	(3)
ln(Q)	6.838***	7.315***	7.233***
	(17.909)	(16.076)	(16.338)
ln(Q) × Share of Mismatch with CEO		-0.701**	
		(-2.086)	
Share of Mismatch with CEO		-0.025	
		(-0.062)	
ln(Q) × No. Aligned			-0.040
			(-1.567)
ln(Q) × No. Misaligned			-0.068***
			(-3.207)
No. Aligned			-0.038
			(-1.024)
No. Misaligned			-0.037
			(-1.245)
Observations	19221	19221	19221
R^2	0.586	0.587	0.588
Firm Fixed Effects	Yes	Yes	Yes
Industry × Year Fixed Effects	Yes	Yes	Yes

Analyst Departures and Political Sorting

- Does political identity also shape analysts' *longer-run career choices*?
  1. Are misaligned analysts more likely to *leave* their employer?
  2. Conditional on departure, do they *sort into* politically aligned brokerages?
  3. Is this sorting stronger for analysts *previously misaligned* with their employer?
- Define majority party within each brokerage-year based on the workforce's affiliations
  - *Mismatch with Colleagues*: analyst's party differs from the brokerage's majority
  - Drop brokerage-years with a 50/50 split
- Estimate:

$$\text{Departure}_{t+1} = \beta \times \text{Mismatch with Colleagues}_{t} + \text{Brokerage-Year FE}$$

Analyst Departures and Political Sorting

Misaligned analysts are *more likely to leave*:

	Departure$_{t+1}$		
	(1)	(2)	(3)
Mismatch with Colleagues$_t$	0.024**		0.023**
	(2.165)		(2.049)
Average Forecast Error$_t$		0.018	0.061***
		(1.475)	(4.256)
Mismatch with Colleagues$_t$ × Average Forecast Error$_t$			-0.056***
			(-3.130)
Observations	8,123	8,123	8,123
R^2	0.298	0.299	0.302
Brokerage × Year FE	Yes	Yes	Yes

Analyst Departures and Political Sorting

Once analysts leave, they are *more likely to sort into politically aligned* brokerages:

	Departure to Aligned$_{t+1}$		
	(1)	(2)	(3)
Departure$_{t+1}$	0.669***		
	(43.442)		
Mismatch with Colleagues$_t$			0.113**
			(2.422)
Constant	0.000	0.689***	0.640***
	(0.066)	(41.802)	(24.049)
Observations	8,123	1,051	1,051
R^2	0.705	0.476	0.484
Analyst FE	Yes	Yes	Yes
Year FE	Yes	Yes	Yes

t statistics in parentheses

* $p < 0.10$, ** $p < 0.05$, *** $p < 0.01$

Conclusion

1. Analysts who are politically misaligned with CEOs issue *lower and less accurate* EPS forecasts
2. Analysts interpret CEOs' statements through the lens of their *own political views*, placing different weight on firm-level vs. macroeconomic information
3. The stock market *fails to recognize these biased estimates*
4. Different investment–Q sensitivities between firms followed by misaligned analysts imply that *political bias distorts information transmission* from stock prices to real investment decisions
5. Political identity also shapes analysts' *career trajectories*, reinforcing ideological segmentation within the analyst labor market