

## Overconfident CFOs

Each quarter since June 2001 Duke University has conducted a survey of CFOs and financial officers of U.S. companies. The survey seeks to document the CFOs' assessment of the business outlook.

Amongst other things, respondents are asked for their forecast of the return on the S&P Composite Index over the next year. They were also asked to state how confident they were of this forecast by providing an estimate of the 10<sup>th</sup> percentile (the worst case) and the 90<sup>th</sup> percentile (the best case). Thus, in 10% of the cases the actual return should turn out to be worse than the 10<sup>th</sup> percentile and in a further 10% of the cases the return should be better than the 90<sup>th</sup> percentile. In the remaining 80% of the case the return should lie within the stated confidence levels.

Between June 2001 and March 2011 the Duke survey collected 13,300 market forecasts. In only 33% of the instances did the realized one-year return fall within the stated confidence bounds. In other words, 67% of the time the market provided a return that the CFOs believed could occur only 20% of the time. On average the CFOs stated that there was an 80% probability that the return would lie within 14.5% of their forecast. In fact, the spread between the 10<sup>th</sup> and 90<sup>th</sup> percentiles of the *actual* distribution of market returns was 42.2%. Only a tiny proportion of CFOs thought that the market return could depart so far from their forecasts.

The ten years since 2001 included the turbulent markets caused by the financial crisis. CFOs might reasonably plead that they could scarcely have been expected to foresee the extent of the bombshell that hit the market during these years. Nevertheless, even during the more tranquil periods, CFOs substantially underestimated how far returns could depart from their forecast.

*Source:* I. Ben-David, J.R. Graham, and C. Harvey, "Managerial Miscalibration," August 2012. Available at SSRN: <http://ssrn.com/abstract=1640552> or <http://dx.doi.org/10.2139/ssrn.1640552>. Very similar results have been documented for Japanese managers in K. Inoue, H. Kato, and T. Yamasaki, "Managerial Overconfidence: Evidence from Japanese CFOs," Working paper, Tokyo Institute of Technology, April 2012. Available at SSRN: <http://ssrn.com/abstract=2043681> or <http://dx.doi.org/10.2139/ssrn.2043681>.