Firm-specific uncertainty around earnings announcements and the cross-section of stock returns

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We examine whether the firm-specific component of ex-ante earnings-related uncertainty is a priced characteristic for stocks. We use option-implied expected earnings announcement day jump variance as the measure for uncertainty and extract the firm-specific component by isolating the portion, correlated with the squared market risk sensitivity. Time series asset pricing tests, applied to the portfolios sorted on firm-specific earnings-related uncertainty, yield that this measure has explanatory power for stock returns: We find economically and statistically significant returns in excess of both the Carhart (1997) model and Fama-French (2015) model predictions for a portfolio which loads on firm-specific earnings-related uncertainty. We show that this result is driven by large cap stocks and is independent of operating profitability.

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