

Return Uncertainty and the Appearance of Biases in Expected Returns*

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May 2006

Abstract

We introduce an information portfolio to combine multiple return forecasts for a single asset into an estimate of its unknown expected return. Our optimal information portfolio minimizes the aggregate forecast error of an asset's estimated expected return when combining the return forecasts. The expected return from this minimization exhibits the *appearance* of overconfidence, biased self-attribution, representativeness and conservatism along with a property which mimics limited attention. Momentum is also induced by the optimal information portfolio weights assigned to return forecasts. Empirically, our optimal information portfolio yields testable implications distinct from psychology, which we verify using analyst earnings forecasts and their revisions.

JEL Classification: G12, G14

Keywords: Behavioral Biases, Momentum, Information Portfolio

*We thank Bhagwan Chowdhry, Bruce Grundy, Steve Hogan, David Hirshleifer, Ravi Jagannathan, Chuan-Yang Hwang, Avaniidhar Subrahmanyam, Wei Mun Wang, Guojun Wu and Jun Yu for their helpful comments and suggestions as well as seminar participants at Cambridge and the National University of Singapore.

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