Chapter 16

Stock Market Price and Company Performance Between Two Major Downturns:
The Financial Crisis and the COVID-19 Pandemic

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ABSTRACT

The chapter investigates the degree to which stock market prices were influenced by company financial performance during the period March 2007–September 2020, which included both the beginning of the global financial crisis and the ongoing COVID-19 pandemic crisis. Using quarterly financial data retrieved from the first 34 companies listed on the New York Stock Exchange according to their transaction volumes, empirical results show that, in the period between the two crises, stock market metrics including price to earnings, price to sales, price to book value, and price to free cash flow were shaped by financial performance indicators such as gross margin ratio, operating margin ratio, earnings before interest, taxes, depreciation and amortization margin, pretax margin, and net profit margin.

INTRODUCTION

A stock market is a dynamic environment in which share prices are influenced by a variety of factors from macroeconomic, financial and political to psychological, cultural or even natural ones (Basher, Haug & Sadorsky, 2012; Batrancea & Nichita, 2015; Batrancea, Nichita & Batrancea, 2012; Batrancea, Batrancea & Moscviciov, 2009a, 2009b; Batrancea et al., 2018; Benlagha, 2020; Garcia-Vega, Zeng & Keane, 2020; Graham, 2003; Hirsch & Kass, 2012; Hirshleifer, Hsu & Li, 2020; Hong & Li, 2020; Hsing, 2011; Lin, 2012; Malkiel, 2007; Rudzkis & Valkavičienė, 2014; Ornelas & de Carvalho, 2020;

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Padungsaksawasdi, Treepongkaruna & Brooks, 2019; Patra & Poshakwale, 2007; Siddiqui, Mahmood & Margaritis, 2020; Shiller, 2003; Shleifer, 2000; Villanueva & Feinstein, 2020; Wen et al., 2019).

Despite the multitude of factors, both seasoned investors and aspiring newbies decide to join this market aiming to maximize their investments – ideally on the bull market – either on the short run or on the long run. Like any other dynamic ground, the stock market has its own written and unwritten rules. In this regard, investment gurus such as Warren Buffet (chairman and the largest shareholder of the American company Berkshire Hathaway) famously stated that the first rule of investing was "Never lose money", while the second rule was "Never forget rule no.1". According to Warren Buffet, any purchasing decision on the stock market should be preceded by a thorough analysis of the company financial statements and reports in order to understand the business behind the stock. Only after investors grasp the characteristics of the business and its perspective of growth should they buy any shares.

Crunching numbers within financial statements and not letting oneself be influenced by skyrocketing prices, rumors (Kiymaz, 2001; Rose, 1951) or word-of-mouth communication (Argan, Sevil & Yalama, 2014) would be a rational strategy that could prevent investors from falling into the so-called "winner's curse" (i.e., buying an overpriced share). To a certain degree, the well-known principle of "thinking before you speak" could be translated as "analyzing before you buy" for savvy players in the stock market world. In this regard, Warren Buffet wittingly concludes that it is "far better to buy a wonderful company at a fair price than a fair company at a wonderful price".

In this day and age, people interested in investing on the stock market are certainly not running short of advice coming from wealthy professionals, scholars and even Nobel Prize winners. For instance, Lynch (2000: 12) explains his investment strategy in simple words: "I own stocks where results depend on ancient fundamentals: a successful company enters new markets, its earnings rise, and the share price follows along".

By means of various interviews with "super-traders" such as Paul Tudor Jones, Anthony Saliba or Mark Weinstein, Schwager (2012) gives account of how these executives have become legendary in this ever-changing environment. In his follow-up book, Schwager (2020: 323–324) notes that "there is no single formula for succeeding in the markets. […] Trading success is not about finding the right approach but instead finding the right approach for you".

Richard Thaler, the 2017 Nobel Prize in Economics winner and co-founder of the successful Fuller & Thaler Asset Management hedge fund, believes that the best investment strategy comprises three key elements:

1. owning a diversified portfolio, which should include mostly shares;
2. examining the portfolio once a year;
3. ignoring daily news.

Thaler's rationale is sensible and straightforward. Investing in multiple companies at the same time can protect investors from losing everything if one business in their portfolio undergoes financial difficulties or goes bankrupt. Yearly examination of portfolios develops a long-term thinking and trains investors to put financial stability and steady returns ahead of one-time gains. Last but not least, eliminating noise generated by everyday news can prevent investors from selling otherwise profitable stocks under momentary impulses triggered by rumors, herding behavior (Bikhchandani & Sharma, 2000; Christie & Huang, 1995; Demirer, Kutan & Chen, 2010; Lin, Tsai & Lung, 2013; Munkh-Ulzii et al., 2018) or

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