Notes

1 See Patricia O'Brien, "Analysts' Forecasts as Earnings Expectations," *Journal of Accounting and Economics* (January 1988): 53–83.

2 See George Foster, "Quarterly Accounting Data: Time Series Properties and Predictive Ability Results," *The Accounting Review* (January 1977): 1–21.

3 See Robert Freeman, James Ohlson, and Stephen Penman, "Book Rate-of-Return and Prediction of Earnings Changes: An Empirical Investigation," *Journal of Accounting Research* (Autumn 1982): 639–653.

4 See Stephen H. Penman, "An Evaluation of Accounting Rate-of-Return," *Journal of Accounting, Auditing, and Finance* (Spring 1991): 233–256; Eugene Fama and Kenneth French, "Size and Book-to-Market Factors in Earnings and Returns," *Journal of Finance* (March 1995): 131–156; and Victor Bernard, "Accounting-Based Valuation Methods: Evidence on the Market-to-Book Anomaly and Implications for Financial Statements Analysis," University of Michigan, working paper (1994). Ignoring the effects of accounting artifacts, ROEs should be driven in a competitive equilibrium to a level approximating the cost of equity capital.

5 A "normal" profit margin is that which, when multiplied by the turnover achievable within an industry and with a viable corporate strategy, yields a return on investment that just covers the cost of capital. However, as mentioned above, accounting artifacts can cause returns on investment to deviate from the cost of capital for long periods, even in a competitive equilibrium.

6 During fiscal year 2017, the average percentage change in the euro-to-SEK exchange rate amounted to 2.1 percent; the US dollar-to-SEK exchange rate increased by 1.4 percent, on average. Assuming, for simplicity, that half of H&M's cost of sales is paid in US dollars and the other half is paid in euros, we can estimate that exchange rate changes led to an increase in cost of sales of 1.7 percent ($0.5 \times 2.1 + 0.5 \times 1.4$).

7 See Foster, op. cit. A somewhat more accurate model is furnished by Brown and Rozeff, but it requires interactive statistical techniques for estimation. See Lawrence D. Brown and Michael Rozeff, "Univariate Time Series Models of Quarterly Accounting Earnings per Share," *Journal of Accounting Research* (Spring 1979): 179–189.

8 To estimate the model, we write in terms of realized earnings (as opposed to expected earnings) and move Q_{t-4} to the left-hand side:

$$Q_t - Q_{t-4} = \delta + \phi(Q_{t-1} - Q_{t-5}) + e_t$$

We now have a regression where $(Q_t - Q_{t-4})$ is the dependent variable, and its lagged value – $(Q_{t-1} - Q_{t-5})$ – is the independent variable. Thus, to estimate the equation, prior earnings data must first be expressed in terms of year-to-year changes; the change for one quarter is then regressed against the change for the most recent quarter. The intercept provides an estimate of δ, and the slope is an estimate of φ. The equation is typically estimated using 24 to 40 quarters of prior earnings data.

9 See O'Brien, op. cit.