

Association between accounting and market-based variables; a canonical correlation approach with U.S. data.

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Abstract

The nature of the association between the firm's accounting and market-based variables is investigated using canonical correlation analysis. The data consists of NYSE and AMEX firms for 1976-1993. A clear relationship between the firm's accounting and stock-market variables is observed. However, the accounting variables making up the relationship vary along time. The decomposed analysis of the association suggests that accrual-based financial ratios are crucial for security analysis. Cash-based financial ratios show increasing relevance over time. The effect of a reduction of the original set of the accounting variables into six key financial ratios is observed. The inclusion of the variance of the stock return into the market-based variable set is found to crucially increase the strength of the association.

Key words: financial statement analysis, stock market, canonical correlation.

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