

**Economics focus****In a sentimental mood**

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**What bulls and bears can learn from hacks**

THE Harvard “psycho-social” dictionary, which classifies words by the moods they express, contains over 750 entries that convey weakness, words like flounder, fret and tremble. It lists another 42 that suggest a falling motion: collapse, for example, or dip, dive, plunge, stumble and topple. It is, in short, a useful source for any journalist straining to describe the recent unrest in the financial markets.



This distemper, commentators seem to agree, stems from a darkening of investor psychology, not a dimming of economic prospects per se. It was not new information that first upset the markets on May 11th, although troubling American inflation figures six days later did not help. Rather, investors suddenly felt a heightened aversion to risks that were always present in their portfolios, if not always so present in their minds.

“The state of confidence...is a matter to which practical men always pay the closest and most anxious attention,” John Maynard Keynes wrote. But it is a matter most scholarly economists have avoided. This is not because they doubt its importance—most human ventures owe something to “animal spirits and spontaneous optimism”. But moodswings are inherently difficult to explain or to measure. The spirits of investors, Keynes wrote, can turn on nothing more than their “digestions and reactions to the weather”. Some disciples have taken him more seriously than he perhaps intended, showing how sunny mornings, sporting triumphs and even the lunar cycle can move share prices. But most economists consider themselves no better than journalists when it comes to making sense of the market’s mood.

**I read the news today, oh boy**

In fact, one economist, Paul Tetlock of the University of Texas at Austin, thinks his fellow scholars have a lot to learn from the weather-makers in the press. Inspired in part by *The Economist’s* recession index, which counts the number of newspaper articles that mention the R-word, Mr Tetlock keeps a close watch on the diction of the *Wall Street Journal’s* daily column, “Abreast of the Market”. Appearing each morning, the column reports what happened the day before on the bourses, particularly the Dow Jones Industrial Average and the S&P 500.

Mr Tetlock’s research\*, due to be published in the *Journal of Finance*, uses a computer to read more than 3,700 editions of the column from January 1st 1984 to September 17th 1999. The computer counts the number of words falling into each of the 77 “psycho-social” categories in the Harvard dictionary. After a rough day in the market, the column is heavy with the kind of negative vocabulary familiar to readers of the financial press in recent weeks. This is as it should be: reporters aim, after all, to reflect events. But Mr Tetlock thinks that “Abreast of the Market” can also get ahead of the market. Everything else equal, a particularly pessimistic column, steeped in words of “weakness” and “negativity”, foreshadows a fall of 0.081 percentage points in the Dow on the next trading day, he finds. That may not sound like much. But the average daily return of the index from 1984 to 1999 was only 0.054%.

This suggests, then, that a newspaper column can have an appreciable impact on share prices. How is this possible? It is not because the column reveals any fresh insights about the workings of the economy or the fortunes of listed companies. Since it reports mainly on market movements, the news it transmits has already

been priced in, almost by definition. And Mr Tetlock is not overly impressed by the bits and pieces of additional analysis the column gleans from brokers and commentators. He quotes the sceptical remarks of the *Journal's* own former editor, Vermont Royster:

One day last month, for example, a slight drop was explained with the remark, "even the shoeshine boys know the market is over-bought." Then the market was up again. This suggests you shouldn't take advice from your shoeshine boy, or anyone who gets his from the same source.

Mr Tetlock thinks the financial press is more insightful about investors than investments. It may convey news about the "state of confidence" before this information is fully reflected in share prices: not everyone knows what the shoeshiners think before the papers tell them. And even as it disseminates the mood, the press might also help to set it. Reading a gloomy column over morning coffee perhaps has much the same effect on investors as overcast weather or troubled digestion.

The power of the financial press, whatever its source, is fleeting. The pall that a column can cast over the stockmarket soon lifts. In fact, Mr Tetlock finds, the damage is reversed within five days. Prices rebound, and cool-headed arbitrageurs earn their just reward for taking shares off skittish investors' hands.

Indeed, Mr Tetlock thinks that a speculator, with a knack for literary criticism, could make money from reading over investors' shoulders. After a particularly negative column, one could borrow the stocks in the Dow, sell them, and buy them back the next day. After an unusually positive article, one could do the opposite trade. Were it not for the trading costs it entails, this strategy could earn returns of 7.3% a year, Mr Tetlock reckons.

What do his results imply about recent turns in the market? Would-be speculators will have to buy their own subscriptions to the *Journal*. But according to the computer, our own leader last week on the world economy ("Bears in the woods", May 27th) contained 46 negative words (including "culprit", "panic", "shock", "slump" and "grizzly"); 24 words conveying weakness; seven suggestive of pain, and five of submission. On the following trading day, the S&P 500 fell 1.6%.

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\* "Giving Content to Investor Sentiment". Available at [www.afajof.org/afa/forthcoming/2471.pdf](http://www.afajof.org/afa/forthcoming/2471.pdf)