

WILEY FINANCE

# The Handbook of **News** analytics in finance

Edited by  
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**LEELA MITRA**

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## Preface

The purpose of a preface in our view is rather unashamedly to sell the book—to communicate the message of the book succinctly and either to motivate the reader to explore its content or to leave the reader feeling that just maybe he or she is losing out if the book’s theme does not fire their imagination. So, by ignoring this book you will never know whether you might have seen the light and gleaned the winning strategies of financial analytics! The subheadings in this preface are deliberately linked to coax you to send an email to your quant team instructing them to pick up this handbook and mine it for nuggets of knowledge. You may also post a review in your blog or alert your peers in Linked-in depending on how much enthusiasm we have been able to generate.

The *background* sets the scene. We then highlight the *research problems* that also equate with the *business problems*. We discuss the *role of news* followed by an outline of the different *technologies* that underpin news analytics (NA). We then emphasize that discovering what the experts—that is, our enthusiastic contributors—have to say can be rewarding. We conclude the preface with a suggested reading strategy—a *road map*—with a view to help the reader make the most of effective knowledge mining.

### **Background: the setting**

Our research base, the Centre for the Analysis of Risk and Optimisation Modelling Applications (CARISMA) was established in 2001 within Brunel University. CARISMA conferences bring together practitioners, hard-nosed business people, and academics, the abstract thinkers. Sometimes this formula works and the academics are puzzled, challenged, and fascinated by the prospect of analyzing a difficult business problem that can also be construed as a research problem. There are many different constituents that make up the financial (news analytics) market place: academics, industry-based quant researchers, news sentiment data vendors and, finally, traders and investment strategy managers. All these people are variously attracted by the prospect of determining the quantified sentiment of the market by analysis of the news. There is one common aspect which brings the contributors of this volume together: namely, they are people with a “can do” spirit who believe with unwavering conviction that they will find the silver bullet.

**The research problem = the business problem**

The world of financial analytics is concerned with three leading problems:

- (i) The pricing of assets in a temporal setting.
- (ii) Making optimum investment decisions low frequency or optimum trading decisions high frequency.
- (iii) Controlling risk at different time exposures.

**The role of news**

News provides information about an event and, as such, may be considered to be an event in itself—news moves the market. The dynamics of the flow of information and market uncertainty impacts security price formation, price discovery, market participant behaviour such as price (over) reaction, price volatility, and market stability. Traders and other market participants digest news rapidly; they may revise and rebalance their asset positions. Most traders have access to newswires at their desks. The sources and the volume of news continue to grow.

**The technologies underpinning NA**

It is widely recognized that news plays a key role in financial markets. New technologies that enable automatic or semi-automatic news collection, extraction, aggregation, and categorization are emerging. Machine-learning techniques are used to process the textual narrative of news stories, thus transforming qualitative descriptions into quantified news sentiment scores. A range of computational models (algorithms) have been proposed for this purpose. Typically, positive-word or negative-word counts or vector distance computation, adjective or adverb phrase usage or the Bayesian approach of introducing domain experts' subjective and contextual knowledge are applied to calculate a sentiment score. In the context of trading, news sentiment data have to be fused with the market data of "trades and quotes" to create an analytic data mart for financial models. Herein lies the challenge of automation. Not only do systems that support information flow have to be designed, they have to be connected to models of financial analytics for asset pricing, trading, investment management, and risk control. Thus, financial engineering goes hand in hand with information engineering to create winning strategies.

**The road map**

As editors we set the scene in Chapter 1 of the book. In this chapter we provide a general review of applications of NA in finance. We discuss news data sources, methods of turning qualitative text to quantified metrics and a range of models and applications. In particular, we would like to draw the attention of the reader to the two sections of the appendix where we describe in summary form the structure and content of news data as supplied by Thomson Reuters in its News Scope and RavenPack in its News Scores products. The major themes of this handbook are:

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- Part 1* The methods and models by which news sentiment is measured and quantified.  
*Part 2* News and abnormal returns as found in trading models and investment strategies.  
*Part 3* How news analytics can be used for risk control.  
*Part 4* The insight of industry leaders and relevant commercial information.

Depending on what interests them most, readers may turn their attention to any of these parts, scan the titles and abstracts, and read the articles as they are presented. There is very little interdependence between these four parts of the handbook.

The contributors are either researchers from academia or practitioners from industry—in some instances, both. They have two things in common: they are all experts in NA and they are enthusiastic about applying NA to finance. As editors we believe our salient achievement has been to solicit and convince this team of enthusiasts to contribute their knowledge and their recent research results to this volume. Finally, we would invite readers to contemplate, innovate and be excited by the infectious enthusiasm of the contributors—you may come up with your own rewarding applications of news analytics and hopefully share them with other experts in the field.

*Gautam Mitra and Leela Mitra*  
London

## Acknowledgements

Leela and I would like to thank Leela's mother and my dear wife Dhira for her help in putting this volume together. Dhira has helped us in many aspects of editing this book—communicating with the contributors, the publishers, and the sponsors. She has done so always with a smile and she only frowned whenever one of us (Gautam) kept missing the schedule. Without her help we would have missed the boat. We would not have studied and researched news analytics (NA) had we not been invited to spend a brainstorming weekend in early January 2008 at RavenPack's R&D villa in Marbella, Spain. We got smitten by the research challenges that were presented to us; subsequently, one of us, that is, Leela delved deeper into the subject as part of her PhD research. We also realized that NA, despite being in the early stages of its development, holds great promise as a modeling tool to enhance financial analytics. We therefore decided that the information and research results that we are still gathering should be shared widely with practitioners and the academic community by compiling this handbook. The handbook has also been championed by RavenPack and Thomson Reuters. They have contributed financially (platinum sponsors) and have actively solicited on our behalf contributions from industry leaders. Grateful thanks are therefore due to Armando Gonzales and Richard Brown of RavenPack and Thomson Reuters, respectively. The sponsorships of Media Sentiment and Northfield Information Services are also acknowledged. We would also like to thank all the contributors for enthusiastically sharing their research results. OptiRisk organized workshops and forums on NA in 2009 and in 2010; and a number of colleagues promoted, organized, and hosted these events. We would like to record our appreciation to this terrific team comprising Julie Valentine, Michael and Hetty Sun, Chanakya Mitra, and Natallia Zverovich; these events played a spiritually uplifting key role in the compilation of this handbook.

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## Abbreviations and acronyms

ADR	American Depository Receipt
AI	Artificial Intelligence
AMEX	American Stock Exchange (now NYSE Amex Equities)
AMH	Adaptive Market Hypothesis
APARCH	Asymmetric Power GARCH (Generalized AutoRegressive Conditional Heteroskedasticity)
API	Application Programming Interface
APT	Arbitrage Pricing Theory
ARCH	AutoRegressive Conditional Heteroskedasticity
ARMA	AutoRegressive Moving Average
ASE	American Stock Exchange
ASX	Australian Stock eXchange
CAPM	Capital Asset Pricing Model
CAR	Cumulative Abnormal Return
CPD	Cumulative Probability Distribution
CRS	Company Relevance Score
CRSP	Center for Research in Security Prices
CSV	Comma Separated Value
CUVOALD	Computer Usable Version of the <i>Oxford Advanced Learner's Dictionary</i>
CVaR	Conditional Value at Risk
DJNA	Dow Jones News Analytics
EDA	Exploratory Data Analysis
EDGAR	Electronic Data Gathering, Analysis and Retrieval
EGARCH	Exponential Generalized AutoRegressive Conditional Heteroskedasticity
EMH	Efficient Market Hypothesis
ENS	Event Novelty Score
EPS	Earnings Per Share
ES	Expected Shortfall
ESS	Event Sentiment Score
ETF	Exchange Traded Fund
FD	Full Disclosure

FXR	Foreign eXchange Related
FX	Foreign eXchange
GARCH	Generalized AutoRegressive Conditional Heteroskedasticity
GI	General Inquirer
IA	Intelligence Amplification
ICB	Industry Classification Benchmark
IFRS	International Financial Reporting Standard
IG	Information Gain
IPO	Initial Public Offering
ISIN	International Securities Identification Number
MDH	Mixture of Distribution Hypothesis
ML	Machine Learning
MSCI	Morgan Stanley Capital International
MSH	Morgan Stanley High Tech Index
NA	News Analytics
NASDAQ	National Association of Securities Dealers Automated Quotations
NAV	Net Asset Value
NC	Naive Classifier
NEI	NewsScope Event Index
NLP	Natural Language Processing
NORM	News Optimized Risk Management
NVWAP	News Volume Weighted Average Price
NYSE	New York Stock Exchange
OLS	Ordinary Least Squares
PL/I	Programming Language I
PPI	Producers' Price Index
RIC	Reuters Instrument Code
RNSE	Reuters NewsScope Sentiment Engine
RSS	Rich Site Summary
SEC	Securities and Exchange Commission
SIRCA	Securities Industry Research Centre for Australasia
SVM	Support Vector Machine
SWAG	"Scientific Wild Ass Guess"
TRBC	Thomson Reuters Business Classification
TRNA	Thomson Reuters News Analytics
UTC	Coordinated Universal Time
VaR	Value at Risk
VC	Venture Capital
VWAP	Volume Weighted Average Price
XBRL	Extensible Business Reporting Language
XML	Extensible Markup Language

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