DIEGO GARCIA

Sentiment during recessions

Abstract

This paper studies the effect of sentiment on asset prices during the 20th century (1905-2005). As a proxy for sentiment, we use the fraction of positive and negative words in two columns of financial news from the New York Times. The main contribution of the paper is to show that, controlling for other well-known time-series patterns, the predictability of stock returns using news' content is concentrated in recessions. A one standard deviation shock to our news measure during recessions changes the conditional average return on the DJIA by twelve basis points over one day.