

Forecasting the Equity Premium: Mind the News!

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Abstract

We introduce a novel strategy for predicting monthly equity premia based on extracted news from more than 700,000 newspaper articles, published in the New York Times and Washington Post between 1980 and 2018. We propose a flexible data-adaptive switching approach for mapping a large set of different news-topics into forecasts of aggregate stock returns. The information embedded in our extracted news is not captured by established predictors. Compared to the prevailing historical mean between 1999 and 2018, we find large out-of-sample gains in point forecasting accuracy and sizeable economic utility gains. The empirical results further indicate that geopolitical news are at times more valuable than economic news to predict the equity premium.