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Being on the Field When the Game Is Still Under Way. The Financial Press and Stock Markets in Times of Crisis

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Abstract

This paper looks at the relationship between negative news and stock markets in times of global crisis, such as the 2008/2009 period. We analysed one year of front page banner headlines of three financial newspapers, the *Wall Street Journal*, *Financial Times*, and *Il Sole24ore* to examine the influence of bad news both on stock market volatility and dynamic correlation. Our results show that the press and markets influenced each other in generating market volatility and in particular, that the *Wall Street Journal* had a crucial effect both on the volatility and correlation between the US and foreign markets. We also found significant differences between newspapers in their interpretation of the crisis, with the *Financial Times* being significantly pessimistic even in phases of low market volatility. Our results confirm the reflexive nature of stock markets. When the situation is uncertain and unpredictable, market behaviour may even reflect qualitative, big picture, and subjective information such as streamers in a newspaper, whose economic and informative value is questionable.

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Introduction

Global financial crises have always followed similar patterns throughout history (e.g., [1]), including the crucial role of financial press (e.g., [2]; [3]; [4]; [5]). From the bursting of the Tulip buble in 1637 in the Netherlands to the dot.com bubble in 2001 in America, the financial press has significantly influenced the stock market, often amplifying the cognitive bias and herd behaviour of investors (e.g., [6]; [7]).

This behaviour may depend on the strong sensitivity of investors towards bad news. Recent studies have shown that market responses to good and bad news is asymmetric. Indeed, investors are more sensitive to negative news, especially when the market is dominated by uncertainty and unpredictability, and this is an important source of market volatility (e.g., [8]; [9]; [10]; [11]; [12]; [13]; [14]). [15] found that stock prices overreacted to bad news even in good times and underreacted to good news in bad times. Similarly [16] found that bad news has a bigger impact both in phases of market expansion and contraction. Moreover, the press may induce a "framing effect", according to which investors react disproportionally to negative news especially when information source is authoritative (e.g., [17]; [18]; [19]). In this case, communication research indicates that the perceived authoritativeness of news sources implies higher trust in the news from these sources ([20]). This effect has been empirically confirmed by a survey on 321 traders and 63 financial journalists from leading banks and financial news providers in the European foreign exchange market ([21]) and a recent case-study on three Dutch banks during the recent financial crisis ([14]).

While the importance of these aspects has been largely underestimated in economics (e.g., [22], [23]), they have been recently investigated in empirical finance (e.g., [24]; [25]; [26]), with interesting parallels with recent sociological investigation on financial markets (e.g., [27]). Unlike the efficient market hypothesis, these studies show that investors are largely influenced by the media, rumours and gossip even in 'normal' market periods, where prices should contain all necessary information (e.g., [24]; [28]). If this is so, we would expect that, in times of financial crisis such as the 2008–2009 period, not only would the investors' overreaction to bad news have drastically influenced market behaviour, it could even lead investors to overestimate the relevance of not strictly economic, general information. Indeed, in these situations, market prices and other relevant quantitative data on markets are even more variedly interpreted by investors than in normal periods ([27]). Even qualitative, big picture, subjective information, such as streamers in a newspaper, can become relevant in these cases.

To look at this, we investigated the relationship between negative news in financial newspapers and volatility and correlation between stock markets during the recent global financial crisis. We analysed one year of front page banner headlines of three financial newspapers, such as the Wall Street Journal, Financial Times, and Il Sole24ore from 1^{st} September 2008 to 1^{st} September 2009, when the recent financial crisis exploded globally. We created an index of bad news per newspaper on a daily base and studied the relation between this index and the closing values of three stock market indexes, such as the DowJones, FTSE and MIB. We considered these stock markets as they were more domestically affected by these newspapers, while comparing their dynamics was essential to look at equivalences and differences across markets and between different press cultures.