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Narratives in Finance

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MASTER OF ARTS IN QUANTITATIVE ECONOMICS AND FINANCE

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Abstract

Whenever the U.S. Federal Reserve (Fed) adjusts its target rate, the reaction of the long-term interest rates is unpredictable: an increase in the Fed's target rate can provoke a positive or a negative response. Taking a narrative approach, this thesis analyzes to what extent narrative interpretations of target rate adjustments are able to account for the inconsistent yield curve movements. Probabilistic Latent Semantic Analysis (PLSA) is employed to identify narratives in over 2'300 newspaper articles. Using a framework provided by Ellingsen, Söderström, and Masseng (2003), this thesis tests the hypothesis that long-term rates react positively on policy days associated with one narrative and negatively on policy days associated with a different narrative. However, this thesis finds no support for the hypothesis; the identified narratives are not able to account for the response of the long-term rates. The author attributes this result to the limitations of PLSA when it comes to the identification of narratives. Further research is needed to determine how statistical models can be applied to economic narrative research.

To view the data and code utilized in this thesis, please contact the author to request access to

 github.com/CorinneKnoe/MasterThesis_NarrativesInFinance

Contents

| | | |
|----------|---|-----------|
| 1 | Introduction | 1 |
| 2 | Monetary Policy and Interest Rates | 3 |
| 2.1 | Excess Sensitivity Puzzle | 3 |
| 2.2 | Existing Research and Explanations | 6 |
| 2.3 | New Insights through Narrative Research | 8 |
| 3 | Narratives and Decision Making | 11 |
| 3.1 | On the Nature of Narratives | 12 |
| 3.2 | The Influence of Narratives | 14 |
| 4 | Topic Analysis | 16 |
| 4.1 | Generative Model | 17 |
| 4.2 | Model Fitting with Expectation-Maximization | 20 |
| 4.3 | Adding a Background Language Model | 23 |
| 5 | Data and Methodology | 27 |
| 5.1 | Financial Data | 27 |
| 5.2 | Text Data | 29 |
| 5.3 | Methodology | 31 |
| 5.3.1 | Text Preprocessing | 31 |

| | | |
|----------|---|-----------|
| 5.3.2 | Feature Engineering | 35 |
| 5.3.3 | Application of PLSA | 36 |
| 5.3.4 | Application of PLSA with Background Topic | 39 |
| 6 | Results | 41 |
| 6.1 | Classification of Policy Days | 41 |
| 6.2 | Regression Results | 43 |
| 7 | Discussion | 45 |
| 8 | Conclusion | 47 |
| | References | 50 |
| | Appendices | |
| A | Target Rate and Yield Curves | 56 |
| B | Text Data | 59 |
| C | Topic Model Output | 61 |
| C.1 | PLSA without Background Topic | 61 |
| C.2 | PLSA with Background Topic | 61 |
| D | Classification and Regression Results | 74 |
| D.1 | Classification Output | 74 |
| D.2 | Regression Output | 74 |
| E | Alternative Classification: Median | 79 |
| E.1 | Classification Output according to Median | 79 |
| E.2 | Regression Output according to Median | 79 |

List of Figures

| | | |
|-----|--|----|
| 4.1 | An illustration of four topics (Steyvers & Griffiths, 2007, p. 2). | 18 |
| 4.2 | The generative model and the problem of statistical inference (Steyvers & Griffiths, 2007, p. 3). | 19 |
| 5.1 | Target rate and 3M treasury yield. | 29 |
| 5.2 | Wordcloud illustrating the most common words across all articles. | 30 |
| 5.3 | Dispersion of most common words across time. | 31 |
| 5.4 | Dispersion of the top words in the topics inferred by PLSA across time. | 38 |
| 6.1 | Response of the 10-year interest rate to a change in the 3-month rate on policy days (classification with $\lambda_B = 0$). | 42 |
| 6.2 | Regression coefficients for narrative one and two with $\lambda_B = 0$ | 44 |
| A.1 | Target rate and treasury yields of all maturities. | 58 |
| B.1 | Token and article count across all policy days. | 60 |
| C.1 | Policy day classification according to PLSA with $\lambda_B = 0$ | 62 |
| C.2 | Document classification according to PLSA with $\lambda_B = 0$ - Part I. | 63 |
| C.3 | Document classification according to PLSA with $\lambda_B = 0$ - Part II. | 64 |
| C.4 | Policy day classification according to PLSA with $\lambda_B = 0.1$ | 68 |
| C.5 | Document classification according to PLSA with $\lambda_B = 0.1$ - Part I. | 69 |

| | | |
|-----|---|----|
| C.6 | Document classification according to PLSA with $\lambda_B = 0.1$ - Part II. | 70 |
| C.7 | Policy day classification according to PLSA with $\lambda_B = 0.9$ | 71 |
| C.8 | Document classification according to PLSA with $\lambda_B = 0.9$ - Part I. | 72 |
| C.9 | Document classification according to PLSA with $\lambda_B = 0.9$ - Part II. | 73 |
| D.1 | Response of the 10-year interest rate to a change in the 3-month rate (classification with $\lambda_B = 0.1$). | 75 |
| D.2 | Response of the 10-year interest rate to a change in the 3-month rate (classification with $\lambda_B = 0.9$). | 75 |
| D.3 | Boxplot showing the weight of narrative one (with $\lambda_B = 0$) on policy days classified as endogenous or exogenous by Ellingsen et al. (2003, p. 11). | 76 |
| D.4 | Boxplot showing the weight of narrative one (with $\lambda_B = 0.9$) on policy days classified as endogenous or exogenous by Ellingsen et al. (2003, p. 11). | 76 |
| D.5 | Regression coefficients for narrative one and two with $\lambda_B = 0.1$ | 77 |
| D.6 | Regression coefficients for narrative one and two with $\lambda_B = 0.9$ | 77 |
| E.1 | Policy day classification according to median with $\lambda_B = 0$ | 80 |
| E.2 | Policy day classification according to median with $\lambda_B = 0.9$ | 81 |
| E.3 | Response of the 10-year interest rate to a change in the 3-month rate (classification with $\lambda_B = 0$, applying median as classification threshold). | 82 |
| E.4 | Response of the 10-year interest rate to a change in the 3-month rate (classification with $\lambda_B = 0.9$, applying median as classification threshold). | 82 |
| E.5 | Regression coefficients for narrative one and two with $\lambda_B = 0$, applying median as classification threshold. | 83 |
| E.6 | Regression coefficients for narrative one and two with $\lambda_B = 0.9$, applying median as classification threshold. | 83 |

List of Tables

| | | |
|-----|--|----|
| 4.1 | Formal definition of a topic modeling task. | 17 |
| 5.1 | The top bigrams included in the feature space. | 36 |
| 5.2 | Specification of PLSA model. | 36 |
| 5.3 | The two topics produced by PLSA. | 37 |
| 5.4 | The background topic θ_B introduced in PLSA. | 39 |
| 5.5 | Specification of PLSA model with background topic. | 40 |
| 6.1 | Regression results (classification with $\lambda_B = 0$). | 43 |
| A.1 | FOMC meetings. | 56 |
| A.2 | Target rate adjustments since January 1, 1998. | 57 |
| C.1 | Topic 1 produced by PLSA depending on λ_B | 65 |
| C.2 | Topic 1 and Topic 2 produced by PLSA depending on λ_B | 66 |
| C.3 | Topic 2 produced by PLSA depending on λ_B | 67 |
| D.1 | Regression results (classification with $\lambda_B = 0.1$). | 78 |
| D.2 | Regression results (classification with $\lambda_B = 0.9$). | 78 |
| E.1 | Regression results (classification with $\lambda_B = 0$, median as classification threshold). | 84 |
| E.2 | Regression results (classification with $\lambda_B = 0.9$, median as classification threshold). | 84 |

Chapter 1

Introduction

In his address delivered to the American Economic Association in 2017, Nobel laureate Robert Shiller called for an expansion of the field of economics to include the study of narratives. According to Shiller “the human brain has always been highly tuned toward narratives [...] to justify ongoing actions, even such basic actions as spending and investing.” Other disciplines like psychology, sociology, and anthropology have recognized the importance of narratives. In economics and finance, however, comparatively little effort has been undertaken to understand the impact of narratives. Responding to Shiller’s call for more quantitative narrative research in economics and finance, this thesis analyzes newspaper articles to identify narratives that can account for the puzzling response of the financial markets to the U.S. Federal Reserve’s target rate adjustments.

The understanding of the relationship between monetary policy and market interest rates is incomplete at best. On average, an increase in the central bank’s target rate leads to an increase in the interest rates of all maturities. However, there exist many instances where interest rates of long maturities fell in response to an increase in the target rate. The inconsistent response of the long-term rates, that is the fact that long-term rates may move up or down when the Federal Reserve increases the target rate, is puzzling.

This thesis approaches this puzzle using a quantitative narrative approach and hypothesizes that the narrative interpretation of a policy event by the market participants determines the response of the financial markets and thus the movement of the long-term interest rates. To determine whether an explanation to the movements of the long-term rates can be found in

narratives, over 2'300 newspaper articles reporting on the target rate adjustments in the time period from October 1, 1998 to September 30, 2018 are analyzed. Unlike previous research, the text data is analyzed with the use of natural language processing methods, allowing the analysis of a larger amount of data as well as the removal of any subjectivity bias.

With the application of a topic model, two narratives are identified in the text data. The two narratives are subsequently used to classify the policy days. The hypothesis is simple: if the narratives, that is the interpretations of the target rate adjustments as they are presented in the newspaper articles, drive the movement of the long-term interest rate, one narrative will be associated with a co-movement of the target rate and the long-term rates while the other narrative will be associated with a counter-movement. Previous researchers, most importantly Ellingsen et al. (2003), have already investigated the puzzle using a narrative approach. So far, however, they have relied on a manual approach. In contrast, this thesis explores the possibility of using new quantitative methods to improve the text analysis.

In Chapter 2, an overview of the puzzle of inconsistent yield curve movements is presented. Existing research and explanations are outlined and the research of Ellingsen et al. (2003) in particular is explained. The hypothesis of this thesis is formalized in Chapter 2.3 based on the framework provided by Ellingsen et al. (2003). Drawing on the findings of other disciplines, Chapter 3 gives an overview of the research on narratives to explain how the term *narrative* can be understood and how narratives influence human beings as well as their decision making. Chapter 4 provides a closer look at topic mining and analysis, a field of natural language processing that aims at analyzing the content of text data. Probabilistic Latent Semantic Analysis, the topic model utilized to identify narratives in the text data, is explained in detail. Chapter 5 gives an account of the financial data and the text data as well as the methodology of this thesis. In particular, it explains the processing of the data, the application of the topic model, and finally the narratives produced by the topic model. Chapter 6 presents the results of the financial analysis. In Chapter 7, the results are discussed and evaluated.

Chapter 2

Monetary Policy and Interest Rates

Indisputably, there exists a relationship between monetary policy and market interest rates. Interest rates of all maturities react to changes in monetary policy, creating opportunities and risks for traders, challenges for policy makers, and puzzling effects for academics to study (Ellingsen & Söderström, 2001, p. 1594).

Target rate changes in particular have an impact on the bond market and on interest rates (Cook & Hahn, 1989, p. 332). Yet, the understanding of yield curve movements is incomplete at best. On average, the relationship between monetary policy and interest rates appears to be positive: an increase in the central bank's target rate leads to an increase in the interest rates of all maturities. However, there are many instances where this simple rule has proven false and interest rates of long maturities fell in response to an increase in the central bank's rate (Ellingsen & Söderström, 2001, p. 1594).

Chapter 2.1 gives an account of the puzzle posed by the inconsistent response of long-term rates, Chapter 2.2 touches on previous research and possible explanations, and Chapter 2.3 outlines how an investigation of narratives might be able to shed light on this puzzle.

2.1 Excess Sensitivity Puzzle

Cook and Hahn (1989) analyzed financial data from the late 70s and found that the U.S. Federal Reserve (Fed), by setting the target for the federal funds rate, had a strong influence on interest

rate movements. While the reaction of short-term rates was particularly strong, changes in the target rate also caused small but significant movements in long-term rates.

It is not surprising that short-term rates follow the target rate closely, after all the Fed keeps the overnight rate close to the target and thus directly influences the one-month rate (Ellingsen et al., 2003, p. 1). The movements of the long-term rates are more ambiguous. Cook and Hahn (1989, pp. 343–346) interpret the fact that, on average, 10-year and 30-year bonds co-move with short-term rates as evidence for the expectation theory of the term structure of interest rates. According to the expectation theory, long-term rates are equal to short-term rates over the same period of time plus a term premium. Thus, an increase in the short-term rates is expected to automatically drive up long-term rates (Ellingsen & Söderström, 2001, p. 1594).

To Romer and Romer (2000) on the other hand, the response of long-term rates presents a puzzle. They argue that standard theory predicts a drop in inflation as short-term rates rise which ought to lead to a reduction in long-term rates. The opposite can be observed, however: interest rates for all maturities typically rise following an increase in the target rate. Romer and Romer (2000) explain this anomaly with information-asymmetry between the Fed and the general public. They find evidence that the Fed is in possession of private information which it reveals to other market participants through its monetary policy. In response, market participants adjust their inflation expectations upwards, causing long-term rates to rise.

Dissecting the interest rate response in more detail led Skinner and Zettelmeyer (1995) to paint an even complex picture. While the yield curve shifts upwards on average, they found a number of occasions where an adjustment to the target rate caused the yield curve to tilt: long and short rates responded by moving in opposite directions (as cited in Ellingsen et al., 2003, p. 1). Skinner and Zettelmeyer came to the conclusion that these were not singular occurrences but that such tilts made up a considerable portion of the yield curve responses and could be observed in all four of the big economies they studied, that is in France, Germany, the United Kingdom, and the United States. An example is the yield curve movement in 1994, where interest rates of long maturities fell after the Fed announced an increase in its target rate (Ellingsen & Söderström, 2001, p. 1594). So not only is the positive response of long-term rates difficult to explain, the response is not even consistent in its direction: long-term rates move up or down when the Fed increases the target rate.

Whether positive or negative, to Gürkaynak, Sack, and Swanson (2005b, p. 425) any response of long-term rates is in contradiction to standard macroeconomic models. They argue that models predict short-term rates to return quickly to their steady state. As a result, short-term rates have only a transitory effect on the future path of interest rates. Therefore, one would expect long-term rates not to react to monetary policy changes. They refer to the fact that long-term rates move significantly in response to monetary policy decisions as *excess sensitivity* of long-term interest rates (Gürkaynak, Sack, & Swanson, 2003, p. 2).

Gürkaynak et al. (2005b, pp. 426–427) focus on the response of forward interest rates as a different way of expressing the yield curve. They find that long-term forward rates move in the direction opposite the monetary policy actions. As they note, this stands in sharp contrast to the findings of Cook and Hahn (1989) and Romer and Romer (2000) who observed a movement of long-term rates in the same direction. Gürkaynak et al. (2005b) put this down to their use of forward rates which they consider a better measure for sensitivity. Additionally, they criticize previous research for the usage of raw change in the target rate, neglecting to differentiate between expected and unexpected policy moves. In their opinion, only the unexpected components of a monetary policy action can be assumed to influence the term structure (Gürkaynak et al., 2005b, pp. 430–431).

Since Gürkaynak et al. (2005b) observe a negative response of the long-term forward rates, they suggest that such a response is not an anomaly but has a very natural explanation. Standard macroeconomic models assume that long-run levels of inflations and real interest rates are relatively fixed and known by all market participants (Gürkaynak et al., 2005b, p. 425). Gürkaynak et al. argue that models might be misspecified and long-run inflation expectations are not as perfectly anchored as assumed. They see the most plausible explanation for the observed term structure movements in the fact that monetary policy surprises lead market participants to adjust their expectations of the long-run level of inflation (Gürkaynak et al., 2005b, pp. 434–435).

Even though Gürkaynak et al. (2005b) are able to account for the negative response of long-term forward rates to an increase in the target rate, Ellingsen and Söderström (2004, p. 2) point out that their model is unable to explain the positive response of the long-term rates observed by other researchers. Thus, Gürkaynak et al. (2005b) fail to solve the puzzle as to why the

yield curve shifts on one occasion but tilts at another when provoked by apparently identical monetary policy actions. Ellingsen et al. address this shortcoming in their own theoretical model (2001) and provide empirical support (2003).

2.2 Existing Research and Explanations

Ellingsen and Söderström (2001) use a simple dynamic macroeconomic model where shocks to output and inflation exhibit some persistence and monetary policy actions have a lagged effect on output and inflation. The central bank is assumed to minimize deviations of inflation and output from their long-run averages while market participants form rational expectations concerning the future target and short rates. On the basis of this model, Ellingsen and Söderström (2001, pp. 1599–1602) make several predictions:

- *Proposition 1:* If there is symmetric information, economic shocks are observed by all market participants and affect interest rates directly. Policy actions by the central bank reveal no new information and thus will not affect the term structure of interest rates.
- *Proposition 2:* If the central bank has private information about shocks to supply or demand, market participants will infer this information from the central bank's policy actions. Thus, the yield curve of market interest rates will respond by moving in the same direction as the target rate change.
- *Proposition 3:* If the central bank has private information about changes in its own inflation preferences, market participants will infer these changes by observing the central bank's reaction to an economic shock. Consequently, they will adjust their expectations about future interest rate targets. This causes the yield curve to tilt as long rates move in the direction opposite the target rate change.

Thus, the yield curve moves for two reasons: either the Fed reacts to new, possibly private information about the economy (what Ellingsen and Söderström call *endogenous*, outlined in proposition 2) or the Fed's policy preferences change (what Ellingsen and Söderström call *exogenous*, outlined in proposition 3). They predict that interest rates of all maturities move in the same direction after an endogenous policy action but that short and long rates move in opposite directions after an exogenous change (2001, pp. 1594–1595).

In a second paper, Ellingsen et al. (2003) analyze empirical data to find evidence for their model. In order to determine whether a policy action is endogenous or exogenous, they analyze reports on U.S. monetary policy in the *Credit Market* column of the *Wall Street Journal*. This text basis is supposed to capture the traders' opinions to a policy move and not the central bank's intention behind it, seeing as it is the traders' opinions that drive the bond prices (Ellingsen et al., 2003, p. 2). Ellingsen et al. used the articles on the day of the target rate adjustment as well as on the day before and on the day after. They found publications on the days following a policy action to be the most informative (2003, p. 8).

They estimate the following regression (Ellingsen et al., 2003, p. 13):

$$\Delta i_t^n = \alpha + (\beta_n^{NP} d_t^{NP} + \beta_n^{Ex} d_t^{Ex} + \beta_n^{End} d_t^{End}) \Delta i_t^{3m} + v_t^n, \quad (2.1)$$

where Δi_t^n is the change in the interest rate of maturity n on day t ; d_t^{NP} , d_t^{Ex} , and d_t^{End} are dummies for non-policy, exogenous policy, and endogenous policy days respectively; Δi_t^{3m} is the change in the 3-month treasury bill rate on day t .

The one-day change in the 3-month T-bill rate is taken as a measure of unexpected monetary policy action (regressor in Eq. 2.1). Ellingsen et al. (2003, p. 13) argue that the 3-month rate is sufficiently short to be determined by policy actions but also sufficiently long to avoid noise from expectation errors. If the target rate remains unchanged, that is on non-policy days, the change in the 3-month rate measures the adjustment of expectations about future monetary policy actions provoked by the day's new information. If the target rate changes, that is on policy days, any change in the 3-month rate is interpreted as the unexpected component of the policy action (Ellingsen et al., 2003, p. 12).

The main hypothesis of Ellingsen et al. (2003) states that long-term interest rates respond positively to endogenous policies and negatively to exogenous policies:

$$H_0 : \text{For large } n: \beta_n^{Ex} < 0 < \beta_n^{End} \quad (2.2)$$

Using data from October 1988 to December 2001, Ellingsen et al. (2003, p. 16) find significant positive responses of the the 6-month and 1-year rates to endogenous and exogenous policy actions. For the 10-year and the 30-year rates, on the other hand, the coefficients are

significant and positive for endogenous changes and negative for exogenous changes. Ellingsen et al. conclude that their model finds strong support in U.S. data.

However, Ellingsen et al. (2003, p. 20) admit that their results might be dependent on the classification of a few pivotal events. Since the classification was done manually, it is quite subjective. This could explain why von Krosigk (2017) was unable to replicate their results using text mining techniques. Von Krosigk analyzed data for the time period of January 2002 to June 2017 and found only positive coefficients, especially for exogenous events, with the only significant effect pertaining to the 6-month rate (2017, p. 36). This stands in sharp contrast to Ellingsen et al.'s results and raises doubts concerning the robustness of their findings.

2.3 New Insights through Narrative Research

It is noteworthy that Ellingsen et al. (2003) chose a narrative approach. In their model, they explicitly assume that the yield curve's response depends "on market participants' interpretation of the policy move" (Ellingsen & Söderström, 2001, p. 1603). They classify policy events as they are perceived by financial investors "since it is the investors' beliefs that determine the interest rate response" (Ellingsen & Söderström, 2001, p. 1604). They analyze newspaper articles not to determine the central bank's intentions underlying a policy move but rather the traders' opinions. In their view, it is "irrelevant whether a target change is in fact driven by policy preferences or by economic events. At any given point in time it is traders, and not the Fed, that determine the price of long-term bonds" (Ellingsen et al., 2003, p. 2). Thus, the effect on market interest rates is not driven by policy actions but by the opinions and views market participants form about such actions. In other words, it is not the target rate change that influences the yield curve but the stories surrounding it. Likewise, Cook and Hahn (1989) used newspaper articles to analyze the reaction of the yield curve to target rate movements. To determine the magnitude and direction of a target rate change, they relied on its representation in the Wall Street Journal on the day after the adjustment.

Gürkaynak, Sack, and Swanson (2005a, pp. 86–87) take the same line by saying that "previous studies estimating the effects of changes in the federal funds rate on bond yields [...] have been missing most of the story." Their research revealed that reactions on the financial markets were at least partially driven by the statements accompanying a policy action. Announcements

of the FOMC, the Fed's Federal Open Market Committee which regulates the funds rate target, account for at least three quarters of the variation in the movement of longer term Treasury yields around a FOMC meeting.

Similarly, Goetzmann, Kim, and Shiller (2016) support the view that market participants are highly influenced by narrative statements, especially by the financial press. A survey over a 26-year period revealed that investors generally hold an exaggerated assessment of the risk of a stock market crash and that their assessments were influenced by the news stories, in particular the front page stories, they had read. According to Goetzmann et al. (2016), newspaper articles make market returns, especially negative developments, more salient and thus influence investor behavior. Other researchers, such as Engelberg and Parsons (2011), Kräussl and Mirgorodskaya (2014), and Yuan (2015) support the view that the financial press plays an important role in focusing investor attention and influencing investor behavior.

Consequently, the author of this thesis hypothesizes that it is the interpretation of a policy event by the market participants – that is the narrative surrounding a target rate change – that determines the response of the financial markets and thus the movement of the long-term interest rate. Even though Ellingsen et al. (2003) employ a narrative approach, it remains closely tied to a macroeconomic model and only allows for certain predetermined aspects of a potentially much bigger narrative. Thus, it stands to reason that opening the focus of the analysis to include any type of narrative that could influence a market participant's action will yield more robust results. To this end, the author proposes the following model:

$$\Delta i_t^n = \alpha + (\beta_n^{NP} d_t^{NP} + \beta_n^{N_1} d_t^{N_1} + \beta_n^{N_2} d_t^{N_2}) \Delta i_t^{3m} + v_t^n, \quad (2.3)$$

where Δi_t^n is the change in the interest rate of maturity n on day t ; d_t^{NP} is a dummy for non-policy days, $d_t^{N_1}$ and $d_t^{N_2}$ are dummies for policy days that were classified as being dominated by either narrative one (N_1) or narrative two (N_2); Δi_t^{3m} is the change in the 3-month treasury bill rate on day t .

Ideally, an examination of newspaper articles with regards to narratives will allow the identification of two distinct narratives that are able to account for the inconsistent reaction of the long-term rates. Thus, the null hypothesis stipulates that narrative one is associated with

a negative reaction of the long-term rates while narrative two is associated with a positive reaction:

$$H_0 : \text{For large } n: \beta_n^{N1} < 0 < \beta_n^{N2} \quad (2.4)$$

Chapter 3 gives an overview of the existing research on narratives. The findings of other fields demonstrate that narratives play an important part in individual behavior and decision making and thus warrant more attention in financial and economic research.

Chapter 3

Narratives and Decision Making

In his address delivered to the American Economic Association in 2017, Nobel laureate Robert Shiller called for an expansion of the field of economics to include the study of narratives. According to Shiller (2017, p. 967) “the human brain has always been highly tuned toward narratives [...] to justify ongoing actions, even such basic actions as spending and investing.” As such, narratives have the potential to be the underlying cause of economic outcomes and the serious quantitative study of popular narratives is necessary to understand economic fluctuations (Shiller, 2017, p. 967). This view is supported by Akerlof and Snower (2016) who assert that narratives play a fundamental role in economic decision making.

Other disciplines, such as psychology, sociology, and anthropology have long recognized the importance of narratives and the scientific interest in narratives has increased rapidly since 2010. In economics and finance, however, comparatively little effort has been undertaken to understand the impact of narratives (Shiller, 2017, pp. 969–970). According to Akerlof and Snower (2016, p. 59), standard economics omits the role of narratives in favor of a simplified model of human behavior. The shortcomings of such a model have been highlighted by other disciplines, leading to new fields of research such as behavioral economics. Indeed, insofar as narratives are used as explanations or as points of reference, they are related to concepts such as framing or the representativeness heuristic (Kahnemann & Frederick, 2002; Thaler, 2016; Tversky & Kahneman, 1974). However, as Akerlof and Snower (2016, p. 59) point out, behavioral economics has little to say about the role of narratives in general and additional research is needed before the impact of narratives on economic outcomes will be fully appreciated.

To reach an understanding of the concept of narratives, this chapter draws on the findings of other disciplines to explain how the term narrative can be understood (Chapter 3.1) and how narratives influence human beings as well as their decision making (Chapter 3.2).

3.1 On the Nature of Narratives

For Shiller, narratives are simple stories or easily expressed explanations of events that can be used to stimulate the concerns and emotions of the audience. Consequently, many people will want to bring such stories up in conversation, on the news, or on social media. While narratives may be based on facts, they are constructs enriched with emotions, human interest, and other extraneous detail that form an impression on the human mind (Shiller, 2017, pp. 968–973). Akerlof and Snower (2016, p. 58) keep a simple understanding of narratives as “stories that people tell themselves and others.”

Indeed, story telling seems to be the basis of a narrative understanding of the world. Some researchers go as far as to suggest that human beings, by definition, are “cause-seeking, purpose-forming, story-telling animals” (Atran, 2010, p. 434) or “storytellers by nature” (McAdams, 1993, p. 27). Atran (2010, p. 434) argues that part of being a storyteller is a strong tendency for confabulation, that is a propensity to search for underlying patterns and principles and, when such patterns are absent, to construct them. Active confabulation has been demonstrated in Gazzaniga’s (1985) experiment with split-brain patients.¹

A penchant for storytelling can be beneficial in a world that offers many regularities. Atran suggests that the ability to confabulate as well as to detect and react to recurring patterns has offered a survival benefit to human ancestors, e.g by allowing them to systematically track game,

¹ Taking advantage of the fact that people with a severed corpora callosa can no longer pass information between the two hemispheres of the brain, Gazzaniga presented different visual stimuli to the participants’ brain hemispheres. However, only the left half of the brain has access to the language centers and thus controls speech. When the left hemisphere received the visual stimulus, participants were able to correctly explain what they have seen. When stimulated on the other side, they lacked that ability as the right hemisphere registered the picture but was unable to transfer that information to the language center. An example is a particular subject whose left hemisphere registered a chicken claw, and the right a snow scene. Subsequently asked to choose an image from a selection of pictures, the subject chose a shovel with his left hand and a chicken with the right. The explanation for this choice was that “the chicken claw goes with the chicken and you need the shovel to clean out the chicken shed.” Lacking the necessary information to explain their actions did not stop people from making up plausible stories. This led Gazzaniga to refer to the language centers on the left side of the brain as the interpreter module, whose job it is to give a running commentary on whatever the self is doing, even though the interpreter module has no access to the real causes or motives of the self’s behavior (Gazzaniga, 1985; Gazzaniga, Ivry, & Mangun, 1998).

store food for bad times, or develop agriculture. As a result, human brains are now hard-wired to see patterns, so much so that they are reluctant to believe things just happen by chance. Instead, people insist on telling themselves stories about their lives and all its major events, trying to detect a red thread and a meaningful, coherent narrative (Atran, 2010, pp. 435–436). Evidence in support of Atran’s theory has been provided by Whitson and Galinsky (2008) and Heider and Simmel (1944), amongst others.²

Robinson and Hawpe (1986, pp. 123–124) argue that “narrative thinking – storytelling – is a successful method of organizing perception, thought, memory, and action.” To them, narrative thinking is a heuristic process, requiring skill, judgment, and experience. If successful, the story making will result in a coherent and plausible account of how and why something has happened. Thus, stories are a solution to the social problem of establishing order in human affairs, allowing the (re)interpretation of events and the construction of causal patterns (Robinson & Hawpe, 1986, pp. 111–112). This resonates in Bruner’s (2000) concept of *narrative knowing*, which is employed to understand human conduct. While the paradigmatic mode of thought organizes human experience by means of reasoned analysis, logical proof, and empirical observation, the narrative mode yields a different explanation of events, able to account for the ambiguity of human intention and behavior (Bruner, 2000). Bruner argues that humans evolved to tell stories because the capacity to explain the world in terms of stories is adaptive in a social environment (see also McAdams, 2006; McAdams, 1993, p. 29).

² Whitson and Galinsky (2008) shed light on the phenomenon of illusory pattern perception. At the beginning of their experiments, they induced a feeling of lack of control in their subjects (e.g. through random performance feedback or by letting them vividly recall an experience in which they lacked control). Afterwards, they assessed subjects on the Personal Need for Structure Scale and asked whether they could see patterns in a grainy image or stock market information. Whitson and Galinsky found that feeling a lack of control encourages pattern perception. They ascribe the increase in perceived illusory patterns to a desire for more structure and a need to feel in control. In fact, this desire is so strong that individuals will “produce a pattern from noise to return the world to a predictable state” (Whitson & Galinsky, 2008, p. 117).

Similarly, Heider and Simmel (1944) requested their subjects to interpret a short film depicting moving geometrical figures. All subjects, with very few exceptions, interpreted the movements as actions of animated beings, mainly of persons. Interestingly, a fair amount of subjects reported a coherent story (Heider & Simmel, 1944, p. 246), e.g. interpreting two triangles as men fighting over a girl (a circle) or seeing the shapes as young lovers that are accosted by a villain. It seems that in this short film starring moving geometrical shapes, people automatically and consistently detected patterns and agency and even saw entire stories play out.

3.2 The Influence of Narratives

“Storytelling is sense-making”, both of the external and the internal world (McAdams, 2006, p. 76). Narratives are not only vehicles by which events are understood and rationalized but also a crucial building block of individual identity: “We also expect stories to tell us who we are” (McAdams, 2006, p. 76). Humans naturally tend to construct coherent life stories that reflect not only their experiences but also social expectations and traditions. As such, narratives are psycho-social constructs that go beyond facts in order to (re)construct the past, present, and future (McAdams, 1996, pp. 301–307). Bauer, McAdams, and Pals (2008, p. 81) call this construct a “narrative identity”, that is an internal, dynamic story that an individual constructs to make sense of his or her life.³ Thus, insofar as behavior is attributed to an individual, it is necessarily influenced by narrative elements. As Akerlof and Snower (2016, p. 59) already pointed out, this is a far more nuanced understanding of human decision making than classic economic models usually account for.

Narratives are based on facts and remembered events. However, often facts are at least partially made-up and memories inaccurately recollected. Memory is notoriously unreliable and often people are overconfident when it comes to the accuracy of their memories (McAdams, 2006). In an experiment, Offer, Kaiz, Howard, and Bennett (2000) showed that accuracy of memory was generally no better than expected by chance. Conway and Pleydell-Pearce (2000) propose that memories of past events are influenced by current goals and hopes for the future. As such, in line with their capacity for confabulation, humans tend to remember events in a way that best serves them in the current moment. McAdams (1982, p. 300) talks of “memory selection” and assumes a circular relationship: autobiographical memories are shaped by personal motives and, in turn, personal motives are shaped by memories. In a similar vein, McGregor and Holmes (1999) and Murray and Holmes (1994) discovered that, while narratives are influenced by memories, memories are just as strongly influenced by narratives. Nuanced differences in story lines can change memories, leading to a distorted recollection of evidence and to biased judgments. Additionally, different stories correlate with different real life outcomes, such as different divorce rates in romantic relationships.

³ Life stories are adapted and re-constructed throughout a human life. For an elaboration on the process of life story construction, see the research of McAdams (1985, 1996, 2001, 2006, 2010), Damasio (1999), and Habermas and Bluck (2000).

The stories we tell ourselves and others have the power to influence our identity, our memory, and our behavior (see Pasupathi, Stallworth, & Murdoch, 1998; Murray & Holmes, 1994). Moreover, narratives also contribute to psychological maturity, mental health, and professional and marital satisfaction (McAdams, 2010, p. 248). Research on the link between narratives and subjective well-being found that coherent narratives are connected to higher levels of well-being (King, Scollon, Ramsey, & Williams, 2000). Adler, Skalina, and McAdams (2008) found that themes of agency in narratives are associated with psychological health, subjective well-being, and nuanced meaning-making.

Given the impact narratives have on individuals as well as on their decision making and behavior, Shiller (2017, pp. 997–999) calls for more research on the topic. Specifically, he mentions the increasing feasibility of analyzing text data by use of quantitative methods. Such methods allow the processing of previously prohibitively large amounts of data and the introduction of a new scientific rigor into the field of narrative analysis. Shiller (2017, pp. 997–999) stresses the need for economics to include such methods in its research. This thesis takes a step in this direction by investigating to what extent machine learning methods can be employed to identify economically relevant narratives. Chapter 4 introduces Probabilistic Latent Semantic Analysis, a topic modeling method which will be used to identify different narratives.⁴

⁴ Some of the arguments presented in Chapter 3 were already put forward by the author of this thesis in Knoepfel (2017).

Chapter 4

Topic Analysis

This chapter takes a closer look at topic mining and analysis, a field of natural language processing. Unsupervised text mining techniques are introduced with a focus on probabilistic topic models that discover latent topics in the text data. Zhai and Massung (2016, p. 329) define a topic as “the main idea discussed in the text data, which may also be regarded as a theme or subject of a discussion or conversation.”

The reason for the use of topic analysis in this thesis is simple: news articles that present different narratives on the target rate adjustment will do so by discussing different themes or topics concerning such an adjustment. On an analytical level, we can expect that articles reporting along the lines of different narratives will also employ a different vocabulary, a circumstance which a probabilistic topic model will be able to identify.

A well-known topic model is Latent Dirichlet Allocation (LDA) which was first introduced by Blei, Ng, and Jordan (2003). LDA has been further developed and adapted by Hoffman, Bach, and Blei (2010) to allow for the processing of massive text data collections that arrive continuously. Although LDA is a very popular topic model, this thesis focuses on Probabilistic Latent Semantic Analysis (PLSA) which preceded LDA and provided the foundation for the development of other topic models. Given that a large but fixed set of newspaper articles (see Chapter 5.2) is analyzed, PLSA is an appropriate model that offers sufficient functionality for the analysis.⁵

⁵ Unlike PLSA, LDA is able to assign probabilities to unseen documents. While this is useful when out of sample properties are to be assessed, it offers no advantage in the current analysis.

Probabilistic Latent Semantic Analysis was first introduced by Hofmann (1999). Blei et al. (2003, p. 994) called Hofmann’s model a “significant step forward” in probabilistic topic modeling. The main achievement of PLSA was to supplement the theory of Latent Semantic Analysis with a sound statistical foundation and to introduce a proper generative model of the data (Hofmann, 1999, p. 289). It is based on the idea that documents are mixtures of topics and the generative model specifies a probabilistic procedure by which documents are assumed to be generated (Steyvers & Griffiths, 2007, p. 2). As Blei et al. (2003, p. 994) explain, PLSA “models each word in a document as a sample from a mixture model where the mixture components are multinomial random variables that can be viewed as representations of ‘topics’.”

4.1 Generative Model

As input, a topic modeling task takes a collection of text documents and a specification of the number of topics; as output, it produces the topics as well as the coverage of the topics in every document (Zhai & Massung, 2016, pp. 330–331), as illustrated in Table 4.1.⁶

| Input | |
|---|--|
| • A collection of N text documents | $C = \{d_1, \dots, d_N\}$ |
| • Number of topics | k |
| Output | |
| • Coverage of topics in each document d_i | $\{\pi_{i1}, \dots, \pi_{ik}\}$, with $\sum_{j=1}^k \pi_{ij} = 1$ |
| • k topics | $\{\theta_1, \dots, \theta_k\}$ |

Table 4.1 – Formal definition of a topic modeling task.

In the context of topic modeling, a topic is represented by a probability distribution over words (or terms). That is, a topic is a distribution that assigns each word in the vocabulary set a probability. Words closely associated with the topic are given a higher probability weight so that they are more likely to come up if we were to sample from the distribution. In general, all words in the vocabulary set may have a non-zero probability in any given word distribution. This accounts for the eventuality that a word that is completely unrelated to a topic shows up in a text on the topic (Zhai and Massung 2016, pp. 335–337; Blei et al. 2003, p. 994). Figure 4.1 illustrates four topics, for each of which the 16 words with the highest probability weights are

⁶ Please note that this thesis follows the notation of Zhai and Massung (2016).

Figure 4.1 – An illustration of four topics (Stein & Griffiths, 2007, p. 2).

| word | prob. | word | prob. | word | prob. | word | prob. |
|-----------|-------|---------|-------|------------|-------|-----------|-------|
| DRUGS | .069 | RED | .202 | MIND | .081 | DOCTOR | .074 |
| DRUG | .060 | BLUE | .099 | THOUGHT | .066 | DR. | .063 |
| MEDICINE | .027 | GREEN | .096 | REMEMBER | .064 | PATIENT | .061 |
| EFFECTS | .026 | YELLOW | .073 | MEMORY | .037 | HOSPITAL | .049 |
| BODY | .023 | WHITE | .048 | THINKING | .030 | CARE | .046 |
| MEDICINES | .019 | COLOR | .048 | PROFESSOR | .028 | MEDICAL | .042 |
| PAIN | .016 | BRIGHT | .030 | FELT | .025 | NURSE | .031 |
| PERSON | .016 | COLORS | .029 | REMEMBERED | .022 | PATIENTS | .029 |
| MARIJUANA | .014 | ORANGE | .027 | THOUGHTS | .020 | DOCTORS | .028 |
| LABEL | .012 | BROWN | .027 | FORGOTTEN | .020 | HEALTH | .025 |
| ALCOHOL | .012 | PINK | .017 | MOMENT | .020 | MEDICINE | .017 |
| DANGEROUS | .011 | LOOK | .017 | THINK | .019 | NURSING | .017 |
| ABUSE | .009 | BLACK | .016 | THING | .016 | DENTAL | .015 |
| EFFECT | .009 | PURPLE | .015 | WONDER | .014 | NURSES | .013 |
| KNOWN | .008 | CROSS | .011 | FORGET | .012 | PHYSICIAN | .012 |
| PILLS | .008 | COLORED | .009 | RECALL | .012 | HOSPITALS | .011 |

listed. Based on these words, the topics could be labeled drug use, colors, memory, and health care (Stein & Griffiths, 2007, p. 2). The aim of probabilistic topic models is to discover such word distributions in the text data.

Going back to the formal definition in Table 4.1, each θ_i is a word distribution. Thus,

$$\sum_{w \in V} p(w|\theta_i) = 1,$$

where $p(w|\theta_i)$ is the probability of word w in the word distribution θ_i with w being a unique word in the vocabulary set $V = \{w_1, w_2, \dots, w_M\}$. The vocabulary set is the set of M unique words in a collection C (Zhai & Massung, 2016, p. 338).

The generative model underlying topic models is based on probabilistic sampling rules and specifies how the words in documents are generated on the basis of latent variables. Given the definition of topics as word distributions, the model assumes that every word in a document is drawn from a topic. From which topic a word is to be drawn is determined by a distribution over topics. As such, documents with different content are generated by choosing different distributions over topics (Stein & Griffiths, 2007, pp. 2–3). Figure 4.2 illustrates the process of generating three documents from two topics. While two of the documents are generated exclusively from one topic, one document is an equal mixture of both topics. Note that words can be part of more than one topic, allowing the model to capture the multiple meanings of polysemies (Stein & Griffiths, 2007, pp. 2–3).

The generative process can be inverted to appear as a problem of statistical inference (see

Figure 4.2 – The generative model and the problem of statistical inference (Steiyvers & Griffiths, 2007, p. 3).

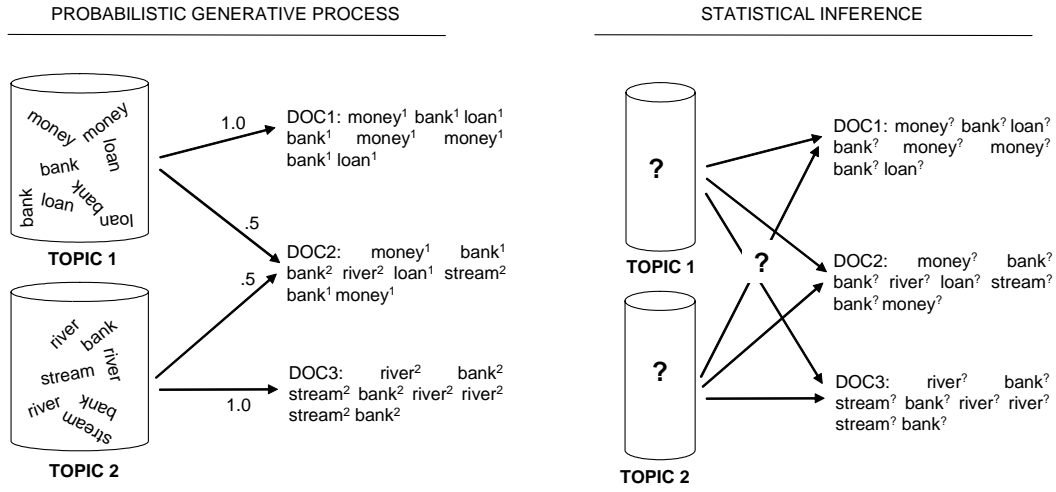


Figure 4.2). When fitting the generative model, the aim is to identify the latent variables, here the latent topics, that are best able to explain the observed data. Thus, the model is able to infer the probability distributions over words and the distribution over topics for each document from the text data (Steiyvers & Griffiths, 2007, p. 3). While the inferred distributions over words are interpreted as topics, the probability distribution over topics can be usefully thought of as the extent to which a topic accounts for the content of a document. That is, the fraction of words in document d_i generated by topic θ_j . Since the probabilities of document d_i covering topic θ_j sum to one across all topics, the inferred topics $\{\theta_1, \dots, \theta_k\}$ account for every word in the document with no words being attributed to undefined topics (Zhai & Massung, 2016, p. 338).

There is one key assumption underlying the generative model: it is assumed that the order of the words in a document as well as the order of the documents in a collection can be neglected. The model picks up on the frequencies of words but completely ignores the position of the words in the text. Should the order of the words contain useful information, it is discarded by probabilistic topic models. This assumption is known as the “bag-of-words” assumption, an assumption of exchangeability of the words in a document (Blei et al. 2003, p. 994; Steiyvers and Griffiths 2007, p. 3). Hofmann (1999, p. 290) himself admits that the “key assumption is that the simplified ‘bag-of-words’ [...] representation of documents will in many cases preserve most of the relevant information.” In Figure 4.2, this principle is captured by illustrating topics as bags containing different distributions over words. The position of the words is arbitrary.

4.2 Model Fitting with Expectation-Maximization

As outlined above, a topic model is a mixture model that consists of several (latent) variables, i.e. word distributions. An estimation of the model's variables is obtained via Maximum Likelihood (ML) estimation. If a mixture model consists of several components, that is more than just one topic, there is no analytical solution to the ML estimation and a numerical optimization algorithm must be employed. The Expectation-Maximization algorithm (EM) is a family of useful algorithms to obtain an ML estimate of mixture models (Zhai & Massung, 2016, p. 359). According to Hofmann (1999, p. 290; 2001, p. 181), EM is the “standard procedure for maximum likelihood estimation in latent variable models.”

In a first step, the ML estimation problem is to be defined. Based on the generative model outlined in Chapter 4.1, the likelihood function is derived. Recall that $p(w|\theta_j)$ is the probability of word w in the word distribution θ_j and that $\pi_{d,j}$ is the coverage of topic θ_j in document d . When faced with the problem of statistical inference, $\pi_{d,j}$ can be thought of as the probability of topic θ_j generating word w . Then, the probability of observing the sequence of words that make up document d and the log thereof are:

$$p(d) = \prod_{w \in V} \left(\sum_{j=1}^k \pi_{d,j} p(w|\theta_j) \right)^{c(w,d)} \quad (4.1)$$

$$\log p(d) = \sum_{w \in V} c(w,d) \log \left(\sum_{j=1}^k \pi_{d,j} p(w|\theta_j) \right) \quad (4.2)$$

with w being a unique word in the vocabulary set $V = \{w_1, w_2, \dots, w_M\}$ and $c(w,d)$ being the count of word w in document d . If we consider the entire collection of N documents $C = \{d_1, \dots, d_N\}$, the log likelihood function is:

$$\log p(C|\pi_{d,j}, \theta_j) = \sum_{d \in C} \sum_{w \in V} c(w,d) \log \left(\sum_{j=1}^k \pi_{d,j} p(w|\theta_j) \right) \quad (4.3)$$

A few words of explanation: $\sum_{j=1}^k \pi_{d,j} p(w|\theta_j)$ denotes the probability of word w occurring once in document d . It is the probability of observing the word regardless of which topic is used. We assume independence in generating each word, hence the probability of the document

equals the product of the probability of each word in the document (see Eq. 4.1). Eq. 4.2 is the log likelihood function for document d , just as Eq. 4.3 is the log likelihood function for the entire collection C (Hofmann, 1999; 2001; Steyvers & Griffiths, 2007; for notation see Zhai & Massung, 2016, pp. 340–377).

With the likelihood function defined, we are faced with the following constrained optimization problem:

$$\arg \max_{\pi_{d,j}, \theta_j} p(C|\pi_{d,j}, \theta_j) \quad (4.4)$$

$$\text{s. t. } \sum_{w \in V} p(w|\theta_j) = 1, \quad j \in [1, k] \quad \sum_{j=1}^k \pi_{dj} = 1, \quad d \in C \quad (4.5)$$

All that is left is to solve the maximization problem. If we knew from which topic any given word in a document is generated, it would be straightforward to calculate the ML estimate. In such a case, the word distributions would simply be the normalized word frequencies (see Chapter 4.3 for elaborations on unigram language models). However, the partitioning of the words among the topics is not known, that is we do not know from which topic a word is generated. Therefore, we have to fall back on an iterative algorithm to solve the maximization problem. The EM algorithm proceeds by guessing from which distribution a word is generated using a tentative estimate of the parameters. Based on the assumed partitioning, the estimate of the parameters is updated. This, in turn, allows an improved inference of the partitioning, leading to an iterative hill-climbing algorithm that improves the estimate of the parameters until it reaches a local optimum (Zhai & Massung, 2016, p. 360). The algorithm proceeds in two steps: in the expectation step (E-step), posteriori probabilities for the latent variables are computed based on current estimates. In the maximization step (M-step), the parameters are updated (Hofmann, 1999, p. 290; 1999, pp. 181–182).

In the E-step, the algorithm uses Bayes rule to infer which topic has been used to generate a word. We introduce a hidden variable $z_{d,w} \in \{1, 2, \dots, k\}$ to capture this information. The value of this hidden variable is inferred based on a tentative set of parameters (Hofmann, 1999,

p. 290; 2001, p. 182; Zhai & Massung, 2016, pp. 362–374):

$$p(z_{d,w} = j) = \frac{\pi_{d,j}^{(n)} p^{(n)}(w|\theta_j)}{\sum_{j=1}^k \pi_{d,j}^{(n)} p^{(n)}(w|\theta_j)} \quad (4.6)$$

Eq. 4.6 shows the E-step of the EM algorithm for PLSA, where $p(z_{d,w} = j)$ is the probability that word w in document d is generated from topic θ_j . Note that this probability depends on the document d , i.e. whether a word has been generated from a specific topic depends on the document. As a result, each document will have a different topic distribution, $\pi_{d,j}$, indicating the varying emphasis on specific topics across documents. This fact will be exploited to classify articles according to different narratives (see Chapter 5.3.3). The probability value of $z_{d,w}$ is calculated for every unique word in each document by computing the product of the probability of word w given the selected topic and the probability of selecting a topic. The product is normalized to ensure the constraints in Eq. 4.5 hold. The superscript (n) indicates the generation of parameters in the iteration (Zhai & Massung, 2016, pp. 374–376).

In the M-step, we calculate an ML estimate of the parameters $\pi_{d,j}$ and $p(w|\theta_j)$ using the estimate obtained in step E. We use the estimated partitioning of the words among the topics to adjust the word count $c(w, d)$, that is we obtain a discounted word count $c(w, d)p(z_{d,w} = j)$ which can be understood as the expected count for the event that word w is generated from θ_j . Remember that the ML estimation could not be solved analytically because we did not know the partitioning of the words. Having obtained a tentative guess of the partitioning, we can easily estimate $\pi_{d,j}$ (the probability of document d covering topic θ_j) and $p(w|\theta_j)$ (the probability of word w for topic θ_j) (Hofmann, 1999, p. 290; 2001, p. 182; Zhai & Massung, 2016, pp. 364–375):

$$\pi_{d,j}^{(n+1)} = \frac{\sum_{w \in V} c(w, d) p(z_{d,w} = j)}{\sum_{j \in k} \sum_{w \in V} c(w, d) p(z_{d,w} = j)} \quad (4.7)$$

$$p^{(n+1)}(w|\theta_j) = \frac{\sum_{d \in C} c(w, d) p(z_{d,w} = j)}{\sum_{w \in V} \sum_{d \in C} c(w, d) p(z_{d,w} = j)} \quad (4.8)$$

As Eq. 4.7 and Eq. 4.8 illustrate, the computation of the parameter estimates amounts to no more than aggregating the expected word counts and normalizing them among all topics or among all words, respectively. The normalization must ensure that the constraints in Eq.

4.5 hold. The new generation of parameters is used to adjust the probabilities of $z_{d,w}$ which is subsequently used to compute a next generation of parameters. The EM algorithm continues to iterate over the E- and M-step until the likelihood converges. Instead of using a convergence condition, a stopping rule can be employed. In this case, the algorithm stops updating the parameters once a sufficient performance, as defined in the stopping criterion, is reached (Hofmann, 2001, pp. 182–183).

As mentioned before, EM is a hill-climbing algorithm that starts with an initial guess of the parameter values and then successively improves it. In the process of improving the estimate, the EM algorithm is guaranteed to converge to a local not a global maximum. To account for this, Zhai and Massung recommend applying the algorithm repeatedly with changing initial values for the unknown parameters and using the run with the highest likelihood value (2016, pp. 363–368).⁷

4.3 Adding a Background Language Model

In the original PLSA (Hofmann, 1999; 2001) as it was introduced in Chapter 4.2, there is no background topic. The model contains k topics, $\{\theta_1, \dots, \theta_k\}$, that are treated as unknown and inferred via a probabilistic process. As a result, very common words will show up prominently in the learned topics. Yet, common words often carry very little relevant information, such as stop words (more on stop words in Chapter 5.3.1). The aim of a background topic is to represent the common words in the text data so that the learned topics can capture the content-bearing words and the statistical semantic word patterns of interest are revealed (Darling, 2011, pp.7–8).

Chemudugunta, Smyth, and Steyvers’s (2007) special words with background model (SWB) is an example of a probabilistic topic model that includes background distributions. It is an extension to LDA and allows words in a document to be modeled as either originating from general topics, or from document-specific “special” word distributions, or from a corpus-wide background distribution. However, a simpler approach where only one background distribution is added to LDA is possible as well, as Darling (2011, pp. 7–8) demonstrates. Analogously to Darling (2011), a single background distribution will be added to PLSA in this thesis.

Consider the behavior of a mixture model to understand the usefulness of a background

⁷ For more details on the properties of EM, see Chapter 9 in Bishop (2006).

topic. Topics are word distributions with the simplest word distribution being the unigram language model. We assume that words in a text are generated independently. Thus, the likelihood of a sequence of words is equal to the product of the probability of each word (Zhai & Massung, 2016, pp. 51–54). Assume that θ is the single topic to be inferred from document d . Then the ML estimation problem is given by

$$p(d|\theta) = \prod_{w \in V} p(w|\theta)^{c(w,d)} \quad (4.9)$$

$$\text{s. t. } \sum_{w \in V} p(w|\theta) = 1 \quad (4.10)$$

the solution to which is

$$p(w_i|\hat{\theta}) = \frac{c(w_i, d)}{|d|} \quad (4.11)$$

where $c(w, d)$ is the word count in document d and $|d|$ is the total number of words in document d (Zhai & Massung, 2016, pp. 341–343).

Eq. 4.11 illustrates that the ML estimator of a unigram language model gives each word a probability equal to its relative frequency in the document. Consequently, only observed words have a non-zero probability while words that do not show up have zero probability. Further, a very high probability is given to words that show up frequently. The more prominent a word, the higher its probability in the word distribution. Usually, functional words and stop words occur most frequently in a text and thus will have high probabilities while content-carrying words will have a much lower probability. Thus, a topic can be completely dominated by uninformative words. Introducing a background language model can help filter out such words (Zhai & Massung, 2016, pp. 51–54).

To change the predominance of common words, the generative process needs to be adjusted so that the learned topics do not have to generate these words. Specifically, another word distribution that generates the common words, called the background topic (θ_B), has to be introduced. A natural choice for the background topic is the unigram language model of the text collection because it assigns high probabilities to frequent words. Including a background model in the mixture model will allow the learned topics to assign high probabilities to content-

carrying words, thus improving the informative value (Darling, 2011, pp. 7–8; Chemudugunta et al., 2007).

Consider the optimization problem of a mixture model in Eq. 4.4 and Eq. 4.5. In order to maximize the overall likelihood, different topics tend to put a high probability on different words. Put differently, when a word w_1 is assigned a high probability in one word distribution, w_1 will tend to have a low probability in another distribution. That is, if $p(w_1|\theta_j)$ is high, then $p(w_1|\theta_i)$ tends to be low, and vice versa. Thus, the behavior of a mixture model ensures that when a background model is introduced, the other distributions are encouraged to put a low probability on common words and more probability mass on words that rank low in the background distribution. Still, due to the nature of the ML estimate of a mixture model, if a word appears very frequently in the text, it will tend to have a high probability in all distributions as this optimizes the overall likelihood (Zhai & Massung, 2016, pp. 353–359).

When a background topic is introduced into a mixture model, a word can either be generated by the background model θ_B or by one of the learned models θ_i . This choice is controlled by a probability distribution over the components of the mixture models: λ_B denotes the probability that the background model was used to generate a word. The likelihood function is given by (Zhai & Massung, 2016, p. 372):

$$\log p(C|\pi_{d,j}, \theta_j) = \sum_{d \in C} \sum_{w \in V} c(w, d) \log \left(\lambda_B p(w|\theta_B) + (1 - \lambda_B) \sum_{j=1}^k \pi_{d,j} p(w|\theta_j) \right) \quad (4.12)$$

The differences to the likelihood function in Chapter 4.2 is set in blue. The ML estimation problem remains unchanged (see Eq. 4.4 and Eq. 4.5). Note that the probability of observing a word from the background distribution is $\lambda_B p(w|\theta_B)$ while the probability of observing a word from the learned topic θ_j is $(1 - \lambda_B) p(w|\theta_j)$. The background model θ_B is assumed to be known. This is a powerful way to introduce domain knowledge about the text into the model (Zhai & Massung, 2016, pp. 352, 372–376).

Consider how the probability of choosing the background model λ_B influences the maximization problem. The higher the probability of choosing the background model, the higher is the probability mass on the words in the background model. The opposite is true for learned topics since $(1 - \lambda_B)p(w|\theta_j)$ will be lower the higher λ_B . Consequently, the higher λ_B , the more

common words are filtered out from the learned topics $\{\theta_1, \dots, \theta_k\}$ (Zhai & Massung, 2016, pp. 352–359).

λ_B indicates the fraction of words generated from the background model. This parameter needs to be specified and can be understood as a prior in the process of Bayesian inference. It encodes a prior belief about the partitioning of the words between the background and the learned topics and thus again allows us to introduce domain knowledge that we may have about the text (Zhai & Massung, 2016, pp. 361, 372–376).

Based on Eq. 4.12 the EM algorithm looks as follows:

$$p(z_{d,w} = j) = \frac{\pi_{d,j}^{(n)} p^{(n)}(w|\theta_j)}{\sum_{j=1}^k \pi_{d,j}^{(n)} p^{(n)}(w|\theta_j)} \quad (4.13)$$

$$p(z_{d,w} = B) = \frac{\lambda_B p(w|\theta_B)}{\lambda_B p(w|\theta_B) + (1 - \lambda_B) \sum_{j=1}^k \pi_{d,j}^{(n)} p^{(n)}(w|\theta_j)} \quad (4.14)$$

Eq. 4.13 and Eq. 4.14 show the E-Step of the EM algorithm for PLSA with a background model, where $p(z_{d,w} = j)$ is the probability that word w in document d is generated by topic θ_j (conditional on not being generated by the background model) and $p(z_{d,w} = B)$ is the probability of w being generated by the background model θ_B . The M-step is:

$$\pi_{d,j}^{(n+1)} = \frac{\sum_{w \in V} c(w, d) (1 - p(z_{d,w} = B)) p(z_{d,w} = j)}{\sum_{j \in k} \sum_{w \in V} c(w, d) (1 - p(z_{d,w} = B)) p(z_{d,w} = j)} \quad (4.15)$$

$$p^{(n+1)}(w|\theta_j) = \frac{\sum_{d \in C} c(w, d) (1 - p(z_{d,w} = B)) p(z_{d,w} = j)}{\sum_{w \in V} \sum_{d \in C} c(w, d) (1 - p(z_{d,w} = B)) p(z_{d,w} = j)} \quad (4.16)$$

As before, in the M-step we use a tentative partitioning of the words, as derived in the E-step, to update the parameters. Now, however, words are partitioned among the k inferred topics, $\{\theta_1, \dots, \theta_k\}$, conditional on not being allocated to the background topic (Zhai & Massung, 2016, pp. 372–376).

Note that the PLSA model with a background topic is the more general case. By setting $\lambda_B = 0$ we arrive at the formulae for the PLSA model without background distribution. If $\lambda_B = 1$, the background topic is an infinitely strong prior that leaves no room for other topics. This is in line with the intuitive understanding of λ_B as the fraction of words that are generated by the background topic.

Chapter 5

Data and Methodology

This chapter gives an overview of the data used in this thesis. The financial data set is outlined in Chapter 5.1, the text data set in Chapter 5.2. Further, Chapter 5.3 explains how the data was processed and applied to the topic modeling task.

5.1 Financial Data

Data on target rate adjustments and FOMC meetings was retrieved from the Fed’s website (Federal Reserve System, 2018, 2013; Federal Open Market Committee, 2018a; 2018b) and summarized in table A.1 and A.2 in Appendix A.

The FOMC holds eight regularly scheduled meetings during the year. Additional unscheduled meetings are called when necessary (Federal Open Market Committee, 2018b). In April 2011, the Fed has taken up the practice of holding quarterly press conferences in order to comment on its policy decisions, including its treatment of the target rate. Usually, the press conferences take place after every other meeting. In June 2018, the Fed announced that starting January 2019 it will hold a press conference after every meeting (Federal Open Market Committee, 2018c). Table A.1 in Appendix A lists all 195 FOMC meetings that have taken place over the last 20 years. If a meeting lasted two days only the last day is listed. Unsurprisingly, certain years necessitated more emergency meetings than others: In 2008, the FOMC held a total of 14 meetings, 6 more than usual. In 2001, the FOMC held 13 meetings, two of which were conference calls shortly after the events of 9/11. While the market anticipates the sched-

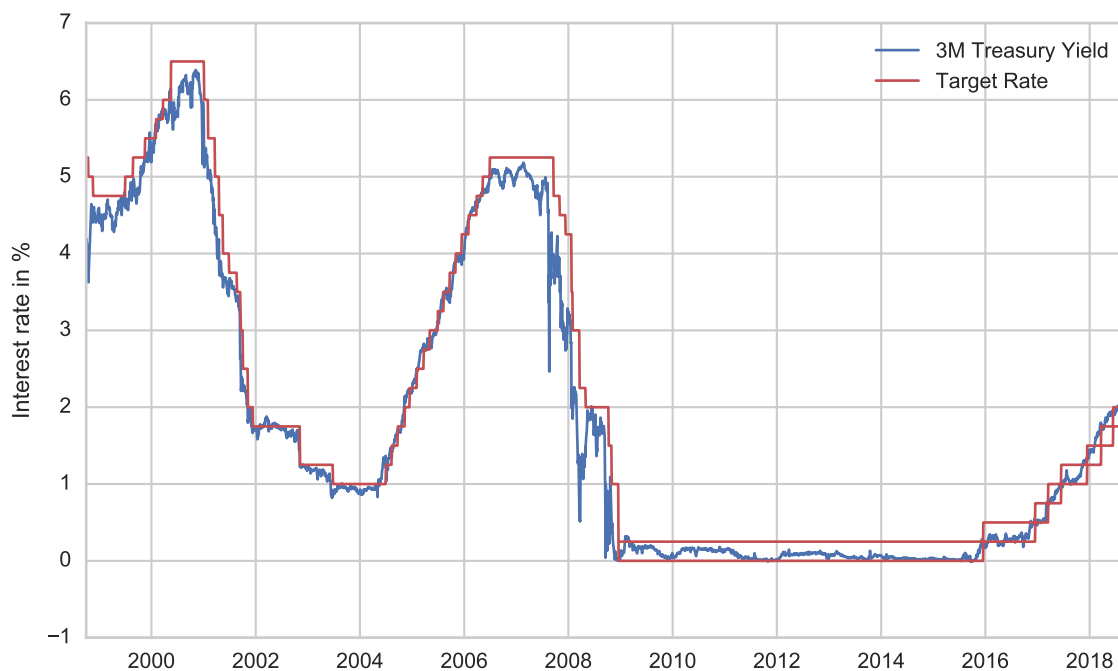
uled meetings and forms expectations about potential policy actions the same is not possible for unscheduled emergency meetings.

Table A.2 in Appendix A gives an overview of the changes in the target rate over the past 20 years. From January 1998 to September 2018, the target rate was adjusted on 57 occasions. Only six of the 57 adjustments happened after unscheduled meetings. Most notably, two surprise adjustments took place during 2008 and three during 2001, one of them shortly after 9/11. Until 2008, the Fed used to decide and implement the new target rate on the same day. The practice was changed after 2008 and the target rate was subsequently adjusted on the day following the FOMC meeting.

The development of the target rate over time is characterized by periods of stark increase and decrease. In May 2000, the target rate was at its highest with 6.5%. From January 2001 to June 2003, the target rate decreased steadily until it reached a low point of 1%. Mid-2006, the target rate was again at 5.25% but was lowered drastically in 2007 and 2008 until it reached its all-time low of 0% in December 2008. At the same time, the FOMC introduced a target range and defined the target rate no longer as a discrete number but with the help of an upper and lower bound. For seven years, until december 2015, the FOMC kept the target rate in the range of 0% to 0.25%. Since then, it has slowly increased the target rate, announcing a range of 2%–2.25% in September 2018.

The daily yield curve of the US Treasury bills, notes, and bonds for the period of October 1, 1998 to September 30, 2018 was retrieved from Thomson Reuters Datastream. Figure 5.1 illustrates the development of the 3-month treasury yield as well as the target rate over the 20-year period. As explained in Chapter 2.2, Ellingsen et al. approximate unexpected monetary policy actions with the change in the 3-month T-bill rate. They argue, that the 3-month rate is sufficiently short to be determined by the target rate, but also sufficiently long to avoid noise from expectation errors (Ellingsen et al., 2003, p. 13). Indeed, Figure 5.1 shows that the 3-month T-bill rate and the target rate seem to move in tandem.

The treasury yields for all other maturities are depicted in Figure A.1 in Appendix A. Please note that for the 1-month rate the data series starts on July 31, 2001 and for the 7-year rate the series starts on May 26, 2009. As expected, while the short term yields (up to 1 year) move

Figure 5.1 – Target rate and 3M treasury yield.

quite closely with the target rate, the longer the maturity the more it emancipates itself from the target rate.

5.2 Text Data

Articles are collected from the Dow Jones Factiva Database⁸ by use of the search terms *Federal Reserve* and *interest rate*. Only articles that appeared in the *United States* on the subject of *interest rates* in a window of three days around each target rate adjustment (the day before, of, and after an adjustment as listed in Table A.2) are taken into account. The articles are mainly taken from the *The Wall Street Journal*, *Financial Times*, *Reuters*, *The Associated Press*, *Market News International*, *Dow Jones Institutional News*, *Agence France*, and *AFX*, as these newspapers seem to publish the most articles on the topic.

From October 1, 1998 to September 30, 2018, 56 target rate adjustments have taken place for which a total of 2'318 articles have been extracted. Since the FED changed its policy from undertaking a target rate change on the same day as a FOMC meeting to only doing so on the following day, articles ± 1 day around the official target rate change have been collected. This

⁸ <https://global.factiva.com>

Figure 5.2 – Wordcloud illustrating the most common words across all articles.



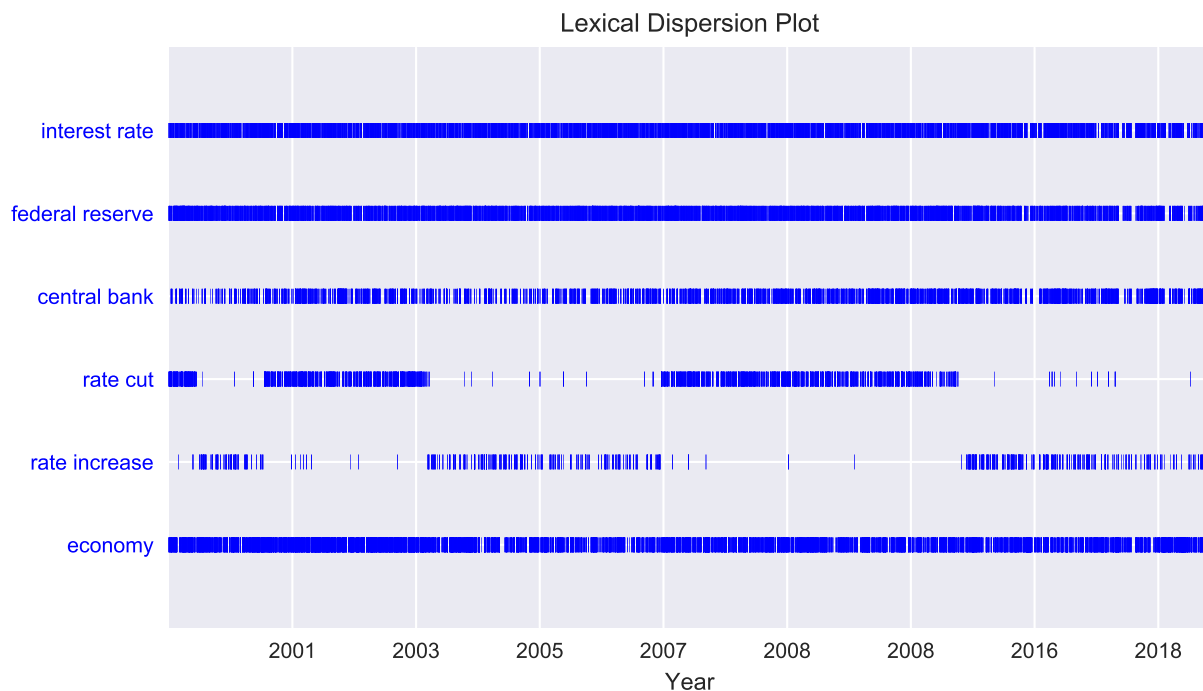
ensures that the articles capture any information, speculation, and interpretations that abound directly after the meeting, on the day of the target rate change as well as on the following day. On rare occasions, the number of articles ran in the several hundreds and only the most relevant have been selected.

The final sample comprises between 14 and 97 publications for every policy day. In total, over 1'600'000 tokens are extracted from these articles. After stop words have been removed, the token count drops to roughly 850'000. For more information on text preprocessing, see Chapter 5.3.1. Figure B.1 in Appendix B illustrates the spread of the text data across policy days and shows that the token count fluctuates quite drastically. More data is available for recent target rate adjustments, less for more historic adjustments.

Looking at the most common words in the entire text data base, as illustrated in Figure 5.2, yields no surprises. As one might expect, the articles make heavy use of context specific vocabulary such as *interest rate*, *federal reserve*, *economy*, but also of terms appropriate for a financial environment such as *basis point*, *percentage point*, or *investor*.

A closer look at the dispersion of the most common words reveals that their usage is consistent over time (see Figure 5.3⁹). The frequently used terms are just as likely to be used in

⁹ A remark on the label of the x-axis: The x-axis tracks the token count of the entire text data and the dispersion plot indicates at which token count the word of interest has been found. However, displaying

Figure 5.3 – Dispersion of most common words across time.

older articles as in newer publications. As one might expect, the articles talk about *rate cut* in times where the Fed is lowering the target rate and about *rate increase* when the Fed is in the process of raising the target rate.

5.3 Methodology

This Chapter explains the preprocessing of the text data (Chapter 5.3.1), the engineering of the feature space (Chapter 5.3.2), and the application of the PLSA model with and without background topic (Chapter 5.3.3 and 5.3.4).

5.3.1 Text Preprocessing

Text data in its raw form contains all the ambiguities inherent in natural language. Thus, before any NLP tasks can be performed, the text data needs to be prepared. Text preprocessing is the process of converting raw text into “a well-defined sequence of linguistically meaningful units.”

the token count at which a word is found has little meaning. Thus, the x-axis displays the progression of years in which the articles were published. Since the tokens are not spread smoothly across the years, the intervals are irregular.

This part of the NLP process is essential, as any analysis that follows is based on the linguistic units (characters, words, and sentences) identified at this stage (Palmer, 2010, p. 9). Topic models in particular are sensitive to preprocessing as they rely on a sparse vocabulary (Schofield & Mimno, 2016, p. 288).

Recall that topic models rely on the “bag-of-words” assumption and neglect the order of words in a text as well as the order of documents in a corpus. Therefore, the main task of the preprocessing stage is the correct identification of words as the linguistically meaningful units. Palmer (2010, p. 10) refers to the process of converting text data into its components as text segmentation. In particular, the process of breaking up a sequence of characters at the word boundaries is called word segmentation. Words identified by word segmentations are known as tokens and the process of identifying them is also known as tokenization (Palmer, 2010, p. 10).

Palmer (2010, pp. 16–19) points out that there exists plenty of tokenization ambiguity. In a language where words are generally space-delimited, a natural approach to tokenization is identifying any sequence of characters preceded and followed by a space as a token. However, this leaves a certain amount of ambiguity when it comes to punctuation and multi-word expressions. For instance, apostrophes are used to mark contractions, the genitive form of nouns, and even the plural form of nouns. Tokenization needs to implement a rule regarding the treatment of such ambiguous cases. Consider the example word *Peter’s*. In this case, *’s* could indicate a possession or a contraction of the verb *is* and it could be tokenized as *Peters* or as two tokens, *Peter* and *’s*, or even as *Peter* and *is*, if that was the supposed meaning (Palmer, 2010, pp. 16–19).

Bird, Klein, and Loper (2009) supply a series of word tokenizers. However, even they admit that when it comes to tokenization “no single solution works well across-the-board, and we must decide what counts as a token depending on the application domain.” The problem of tokenization gets compounded by the problem of stop words. As outlined in Chapter 4.3, functional words occur frequently in texts and thus can clutter up the information we are trying to discover. Such stop words carry little information and obscure the analysis by crowding-out more meaningful words. It can therefore be useful to remove stop words from the text data altogether.

To remove stop words, one can make use of publicly available lists of stop words. However,

Nothman, Qin, and Yurchak (2018) point out the difficulties and incompatibilities of such lists. Investigating the variation and consistency of several lists, they come to the conclusion that stop words are often included based on frequency statistics but also based on manual selection and filtering. Thus, lists vary greatly in the words they include. Apart from uncertainty regarding the selection of the stop words, stop lists may also assume a particular tokenization strategy. Yet, as Nothman et al. (2018) point out, the stop lists provided by some open source libraries do not always go with the tokenizer provided by the same libraries. For example, while a tokenizer might split the word *hasn't* into the tokens *has* and *n't*, the accompanying stop word list might only contain *has* and *not*, omitting the token *n't*. Further, several lists include the words *has* and *have*, but fail to list *had*, letting the omission and inclusion of stop words appear arbitrary (Nothman et al., 2018, pp. 7–11).

By general assumption, topic models benefit from stop word removal (Schofield, Magnusson, & Mimno, 2017a, p. 432). Blei et al. (2003), Chemudugunta et al. (2007), Steyvers and Griffiths (2007), and Hofmann (2001) removed stop words during text preprocessing to prevent them from impacting their analysis. According to popular belief, topic models benefit from manually constructed stop word lists (Schofield et al., 2017a, p. 432). Darling (2011, p. 7), for instance, claims that stop lists must often be domain-specific. Contrarily, Schofield et al. (2017a) show that a domain specific approach to stop word removal is not necessary. While the removal of very frequent terms improves the quality of topic models, the removal of text specific stop words yields little benefit. If the removal of common stop words proves insufficient unwanted terms can be removed after model training, yielding better results than ex-ante removal (Schofield et al., 2017a, p. 432; Schofield, Magnusson, & Mimno, 2017b).

Another common step in the stage of preprocessing is stemming. Stemming removes the suffixes of words in order to reduce related words to an identical stem. The words *happily*, *happier*, and *happy*, for instance, might be reduced to the same token (Schofield & Mimno, 2016, p. 287). Potential advantages of stemming are an improved model fit due to a reduced feature space, improved stability in the topics due to elimination of small morphological differences, and improved interpretability due to word equivalence. However, stemming may also render words unrecognizable (e.g. *stai* as the stem of *stay*), or it may lead to the incorrect conflation of unrelated words (e.g. *absolutely* and *absolution*), and it does not deal well with morphologically

similar words that carry different meanings (Schofield & Mimno, 2016, p. 287). Schofield and Mimno (2016) analyze the effect of stemming in topic modeling and find that it yields little benefit and might actually be harmful. For one, stemming leads to no likelihood gains after controlling for vocabulary size. Further, the coherence of the topics is not improved by stemming. As Schofield et al. (2017b) point out, topic models are already placing morphologically similar words in the same topic, thus making stemming for the purpose of morphological conflation redundant. Lastly, strong stemming increases the model’s sensitivity to random initialization as it decreases clustering consistency, that is stemming does not ensure that related words are spread across fewer topics (Schofield & Mimno, 2016, pp. 293–295).

In conclusion, Schofield et al. (2017b) recommend to preprocess lightly, that is to remove only the most frequent stop words and to omit stemming altogether in order to avoid discarding useful text information.

The text data used in this thesis is collected from the Down Jones Factiva Database and converted to .txt files for further processing. The metatext of all articles has been discarded so that only the main body of text remains. To segment the text into words, the tokenizer provided by Bird et al. (2009) in the nltk library is applied. This tokenizer uses regular expressions to split the text at the word boundaries, generally treating punctuation characters as separate tokens and splitting standard contractions, i.e. *don’t* is tokenized as *do* and *n’t* and *children’s* as *children* and *’s*.

Subsequently, stop words are removed using the stop word list for the English language provided by the nltk library (Bird et al., 2009). The list encompasses 179 words, including common verbs, articles, prepositions, and contractions. Nothman et al. (2018, pp. 8–9) caution against stop lists that fail to complement the accompanying tokenizer and mention that many stop lists also tend to include controversial words, e.g. *system* or *cry*. A closer examination of the nltk list reveals that the token *n’t* is not included in the list even though the nltk tokenizer clearly produces it. Further, the stop word lists contains many contractions without the preceding apostrophe even though the tokenizer joins the apostrophe and the enclitic in one token. For instance, the stop word list carries *ll*, *s*, *d*, and *ve* while the tokenizer produces *’ll*, *’s*, *’d*, and *’ve*. On the upside, the nltk list appears to carry no obviously controversial terms. The missing tokens are manually added to the stop word list before application.

In line with the recommendation from Schofield et al. (2017b), no stemmer is applied. However, all characters are converted to lower case to ensure that word equivalence is not hindered by capitalization. Also, all non-alphabetic characters as well as tokens of length one are removed since numbers, punctuation marks, and single characters are of little use when it comes to topic generation and interpretation.

After tokenization, the text data collection encompasses more than 1'600'000 tokens. After the removal of stop words, the token count drops to roughly 1'100'000 tokens. Subsequently, the non-alphabetic characters, especially the punctuations marks, are removed and the final count amounts to approximately 850'000 tokens. Thus, even though a conservative preprocessing strategy has been chosen, the text data is reduced by almost half during preprocessing (see Figure B.1 in Appendix B).

5.3.2 Feature Engineering

Selecting the features is the most important factor in determining the success of a statistical learning process. While machine learning models are often general, feature engineering is domain-specific and a lot of effort in any machine learning project has to be dedicated to the construction of the feature space. At the same time, feature engineering can appear as “black art” in the sense that it requires intuition, creativity, and an understanding of the domain (Domingos, 2012). Thus, exercising the necessary discretion, a few adjustments to the feature space are made to improve and speed up the learning process.

Considering the most common words in the tokenized text data (see Figure 5.2) illustrates that some tokens show up in tandem, such as *interest rate*, *federal reserve*, or *basis point*. It stands to reason that these terms should be tokenized as one token instead of two separate words as they have a conjoint meaning. Processing the text data as bigrams, the 50 most common bigrams are selected and added to the feature space (see Table 5.1¹⁰).

Including the tokens in table 5.1, the feature space consists of over 23'300 unique tokens, some of which occur only once or twice. However, tokens that occur only rarely increase

¹⁰ The attentive reader will have noticed that the table lists only 47 bigrams. From the top 50 bigrams, the expressions *wsj com*, *fed said*, and *year treasury* have been excluded as they have no clear conjoint meaning. Note that the author set the limit at 50 because these bigrams are mostly idiosyncratic expressions featuring prominently in the text data while lower ranked bigrams appear more random with a less specific conjoint meaning.

| bigram | count | bigram | count | bigram | count |
|------------------|-------|--------------------|-------|---------------|-------|
| federal reserve | 3'353 | economic growth | 804 | last week | 560 |
| interest rate | 3'342 | wall street | 803 | federal open | 547 |
| interest rates | 3'338 | percent percent | 759 | central banks | 540 |
| central bank | 2'263 | fed funds | 759 | rate hike | 540 |
| funds rate | 2'209 | next year | 712 | fed rate | 522 |
| per cent | 2'202 | open market | 691 | long term | 494 |
| new york | 1'176 | rate increases | 679 | raise rates | 492 |
| rate cut | 1'151 | rate percent | 677 | point cut | 486 |
| percentage point | 1'142 | financial markets | 672 | stock market | 485 |
| basis points | 1'139 | chief economist | 650 | cut rates | 485 |
| federal funds | 1'139 | market committee | 633 | discount rate | 472 |
| short term | 1'119 | quarter percentage | 619 | two year | 461 |
| monetary policy | 1'108 | basis point | 589 | half point | 453 |
| dow jones | 1'106 | term interest | 578 | rate hikes | 453 |
| quarter point | 980 | rate increase | 573 | oil prices | 435 |
| rate cuts | 827 | fed officials | 569 | | |

Table 5.1 – The top bigrams included in the feature space.

the sparsity of the feature space and slow down computation without having any impact on topic generation. Thus, tokens that appear only once (about 7'900 tokens), twice (about 3'400 tokens), or thrice (around 1'900 tokens) are removed. This reduces the feature space from 23'300 unique tokens to approximately 10'150 tokens.

5.3.3 Application of PLSA

Using the preprocessed and prepared text data, the PLSA algorithm without a background topic is applied. The model specifications are presented in Table 5.2.

| Input | |
|---|---|
| • A collection of 2'318 text documents | $C = \{d_1, \dots, d_{2318}\}$ |
| • Number of topics | $k = 2$ |
| Output | |
| • Coverage of topics in each document d_i | $\{\pi_{i1}, \pi_{i2}\}$, with $\pi_{i1} + \pi_{i2} = 1$ |
| • 2 topics | $\{\theta_1, \theta_2\}$ |

Table 5.2 – Specification of PLSA model.

As explained in Chapter 2.3, we are looking for two narratives according to which policy days can be classified. Thus, we set $k = 2$ which will yield two topics, $\{\theta_1, \theta_2\}$. As recommended by Zhai and Massung (2016, p. 363), the algorithm is run repeatedly (six times, to be specific)

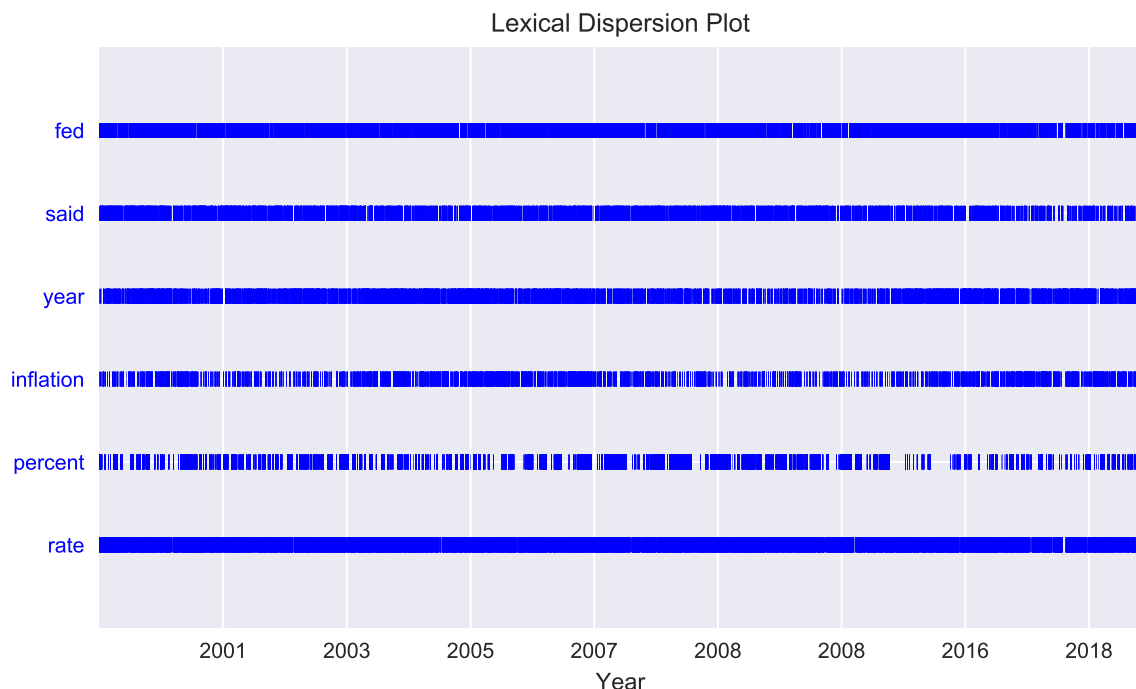
using different random initializations. In the end, only the run with the highest likelihood value is used. The top 20 words of each topic are listed in Table 5.3.

| Topic 1 | | Topic 2 | |
|-----------------|------|-----------------|------|
| word | prob | word | prob |
| said | .011 | fed | .024 |
| year | .011 | said | .013 |
| percent | .009 | inflation | .011 |
| market | .009 | economy | .010 |
| rate | .008 | rate | .009 |
| dollar | .007 | would | .007 |
| fed | .007 | year | .006 |
| cut | .007 | rates | .006 |
| bank | .006 | economic | .006 |
| rates | .006 | percent | .005 |
| investors | .006 | growth | .005 |
| interest rate | .005 | policy | .005 |
| federal reserve | .005 | market | .005 |
| per cent | .004 | federal reserve | .005 |
| markets | .004 | interest rates | .005 |
| bond | .004 | could | .005 |
| expected | .004 | meeting | .004 |
| yield | .004 | time | .004 |
| interest rates | .004 | statement | .004 |
| us | .004 | interest rate | .004 |

Table 5.3 – The two topics produced by PLSA.

Considering the top words, no clear topical concentration becomes salient. Both topics attribute a high weight to words concerning interest rates, the federal reserve, and the economy. This is hardly surprising as the articles have been selected for their focus on interest rates and the federal reserve (see Chapter 5.2). It is to be expected that the articles will make heavy use of a related vocabulary which, by the nature of PLSA, will come to dominate the inferred topics. A look at the the lexical dispersion of the top words as shown by Figure 5.4 illustrates that the top words appear frequently in all articles. As explained in Chapter 4.3, the introduction of a background topic could help shift the weight from frequent terms to more meaningful, content-carrying terms. For the implementation of such a model see Chapter 5.3.4.

The text data collection comprises between 14 and 97 articles for every policy day. The words of each article are partitioned between the two topics, resulting in a topic coverage probability that indicates the extent to which an article is to be attributed to a topic. To

Figure 5.4 – Dispersion of the top words in the topics inferred by PLSA across time.

classify a policy day as belonging either to narrative one (N_1) or narrative two (N_2), the topic coverage probabilities of all articles on a given policy day are averaged and the day is attributed to the topic that dominates the articles. Figure C.1 in Appendix C.1 depicts the resulting classification of the policy days.¹¹

38 policy days have been attributed to topic 2 and only 18 days to topic 1. Also, quite often both topics command a large share of the articles on a given day, one topic dominating the other only by a small margin. Thus, the classification of the policy days is not as clear cut as one might wish. If we consider how the individual articles have been classified, we would expect that, on a given day, all articles are attributed to the same topic. That would be a clear indication that a specific narrative, as identified by our topic model, dominated the press reporting at that time. However, as Figure C.2 and C.3 show, quite often the articles on a specific day are almost evenly split between the topics.

¹¹ Ideally, articles on a given policy day would be fully attributed to the same topic. However, often the articles are made up from words of both topics. Using the average as a threshold value for classification is intuitive but leads to an unbalanced split between N_1 and N_2 . Alternatively, the threshold can be adjusted to allow an even split of the policy days between the two narratives. The results of the analysis with a balanced split are presented in Appendix E. However, the results based on a median threshold hardly differ from the results with an average threshold.

5.3.4 Application of PLSA with Background Topic

To improve the topics inferred by PLSA, a background topic that captures the most common words in the text data is introduced. The background topic is a unigram language model generated from the entire text data collection. Thus, every word has been given a probability weight that corresponds to its relative frequency in the collection (see Eq. 4.11). Table 5.4 lists the 20 top words of the background topic.

| Background Topic | | | |
|------------------|------|-----------------|------|
| word | prob | word | prob |
| fed | .016 | federal reserve | .005 |
| said | .013 | cut | .005 |
| year | .008 | interest rate | .004 |
| rate | .007 | interest rates | .004 |
| percent | .007 | bank | .004 |
| economy | .007 | economic | .004 |
| inflation | .006 | expected | .004 |
| market | .006 | markets | .003 |
| rates | .006 | dollar | .003 |
| would | .005 | could | .003 |

Table 5.4 – The background topic θ_B introduced in PLSA.

The most common word in the background topic is *fed*, followed by *said*, *year*, and *rate*. These words also feature prominently in the inferred topics of PLSA without a background distribution. Introducing the background topic should allow the learned topics to be populated with meaningful words instead. To that end, the number of words generated by the background topic needs to be specified (as indicated by the parameter λ_B). Since this quantity is unknown, the model is run several times with different specifications for λ_B . The model specifications are as presented in Table 5.5.

The top 20 words of every topic are listed in Tables C.1–C.3 in Appendix C.2. The higher λ_B , the more the count of common words in the topics decreases in favor of more interesting words. Topic 1 appears to focus on *investing*: With an increasing λ_B terms like *investors*, *yield*, *rose*, *fell*, *trading*, *index*, and *stocks* climb to the top of the word distribution. Topic 2, on the other hand, seems to focus on the *Fed's economic analysis*: With an increasing λ_B terms like *economic*, *growth*, *greenspan*, *bernanke*, *statement*, *chairman*, and *economists* come to dominate the topic. Thus, the topics clearly pick up on different subjects (or narratives) in the articles

| Input | |
|---|---|
| • A collection of 2'318 text documents | $C = \{d_1, \dots, d_{2318}\}$ |
| • Number of topics | $k = 2$ |
| • The background topic | θ_B |
| • Fraction of words generated by θ_B | $\lambda_B \in [0.1, 0.2, 0.3, 0.4, 0.5, 0.6, 0.7, 0.8, 0.9]$ |
| Output | |
| • Coverage of topics in each document d_i | $\{\pi_{i1}, \pi_{i2}\}$, with $\pi_{i1} + \pi_{i2} = 1$ |
| • 2 topics | $\{\theta_1, \theta_2\}$ |

Table 5.5 – Specification of PLSA model with background topic.

and, with an increased use of the background topic, the topical focus of the word distributions becomes salient.

Figures C.4 and C.7 in Appendix C.2 depict the resulting classification of the policy days for $\lambda_B = 0.1$ and for $\lambda_B = 0.9$. With $\lambda_B = 0.1$, 37 policy days have been attributed to topic 2 and only 19 days to topic 1. With $\lambda_B = 0.9$, 36 policy days have been attributed to topic 2 and 20 days to topic 1. The introduction of a background model as well as the level of λ_B has very little impact on the classification of the policy days. When it comes to the classification of single documents, an increase in λ_B leads to a decrease in ambiguity, as Figures C.5, C.6, C.8, and C.9 show. This is not surprising: When only 10% of the tokens of a document have to be split between topic 1 and 2, an allocation of all tokens to the same topic is more likely.

When it comes to the evaluation of topic model quality, there are several possible approaches. First, a test can be set up in which a human judge must assess topic quality, in particular the coherence of the inferred topics. Second, traditional metrics, such as the log-likelihood of held-out data, can be employed to measure how well a topic model generalizes. However, such metrics are often negatively correlated with topic quality as assessed by human judges. A third approach is downstream task improvement: A model is assessed based on the statistically significant improvement it facilitates in another task (Zhai & Massung, 2016, pp. 383–384).

It has already been mentioned that an increase in λ_B makes the topics more interpretable. The results of the financial analysis are presented in Chapter 6 and discussed in Chapter 7.

Chapter 6

Results

In Chapter 6.1, the results of the policy day classification are presented. The classification of the policy days is subsequently used in the financial regression, the results of which are presented in Chapter 6.2.

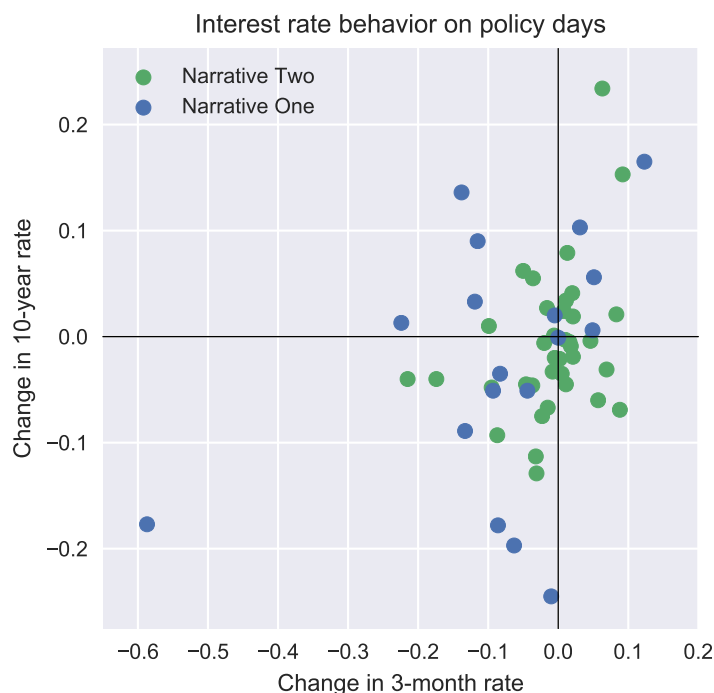
6.1 Classification of Policy Days

Following Ellingsen et al. (2003), a day on which the target rate has been adjusted by the Fed is considered a policy day. If the FOMC held a meeting but failed to change the target rate, the day is considered a non-policy day. In this thesis, a 20-year period from October 1998 to October 2018 is analyzed. During this time frame, there are 56 policy days and 5'161 non-policy days.

Analogously to Ellingsen et al. (2003, pp. 14–15), we take a look at the behavior of the interest rates. Figure 6.1 plots the change in the 3-month rate against the change in the 10-year rate on policy days. Ellingsen et al. (2003, p. 14) found a clear positive relationship between the change of the 10-year and the 3-month rate with some outliers. Similarly, Figure 6.1 shows a predominantly positive relationship, barring some odd observations, and a concentration around the origin. This indicates that the long-term rates tend to move in the same direction as the short term rates and the target rate change.

Note that the policy days are split up according to their classification by either narrative one or narrative two (as classified by PLSA without background topic, that is for $\lambda_B = 0$). A

Figure 6.1 – Response of the 10-year interest rate to a change in the 3-month rate on policy days (classification with $\lambda_B = 0$).



successful classification of policy days is expected to separate the days characterized by a co-movement of the yield curves from the days on which the rates move in opposite directions. As such, one narrative should dominate the days with a clear positive relationship, with the data points of one color populating quadrants 1 and 3, while the other narrative should characterize the days with a negative relationship, with all data points of the other color populating quadrant 2 and 4. However, Figure 6.1 shows a rather ambiguous picture. Both narratives classify policy days with co-movement of the rates as well as days with counter-movement. It should be noted that Ellingsen et al. (2003, pp. 14–15), too, only found an ambiguous relationship.

Figures D.1 and D.2 in Appendix D show the split of the policy days when λ_B is increased to 0.1 and 0.9, respectively. Even though the output of the topic model changes notably in terms of topic quality with an increase in λ_B , the introduction of a background topic has little impact on the classification of the policy days. As such, Figures D.1 and D.2 present an almost identical picture to Figure 6.1.

There is a small overlap in the time frame of Ellingsen et al. (2003) and of this thesis. In Figures D.3 and D.4 in Appendix D.1 a comparison of the classification of Ellingsen et al. and the classification of this thesis is presented. However, the comparable sample is quite small

due to the small overlap in the time frame as well as the fact that Ellingsen et al. chose no to classify a quarter of their data. Thus, only 12 of Ellingsen et al.'s endogenous policy days and 6 of their exogenous policy days have been classified in the course of this thesis. Figures D.3 and D.4 show that the classification according to narratives does not split the policy days in a fashion similar to Ellingsen et al. Both, the days classified as endogenous as well as the days classified as exogenous are attributed to narrative two in this thesis.

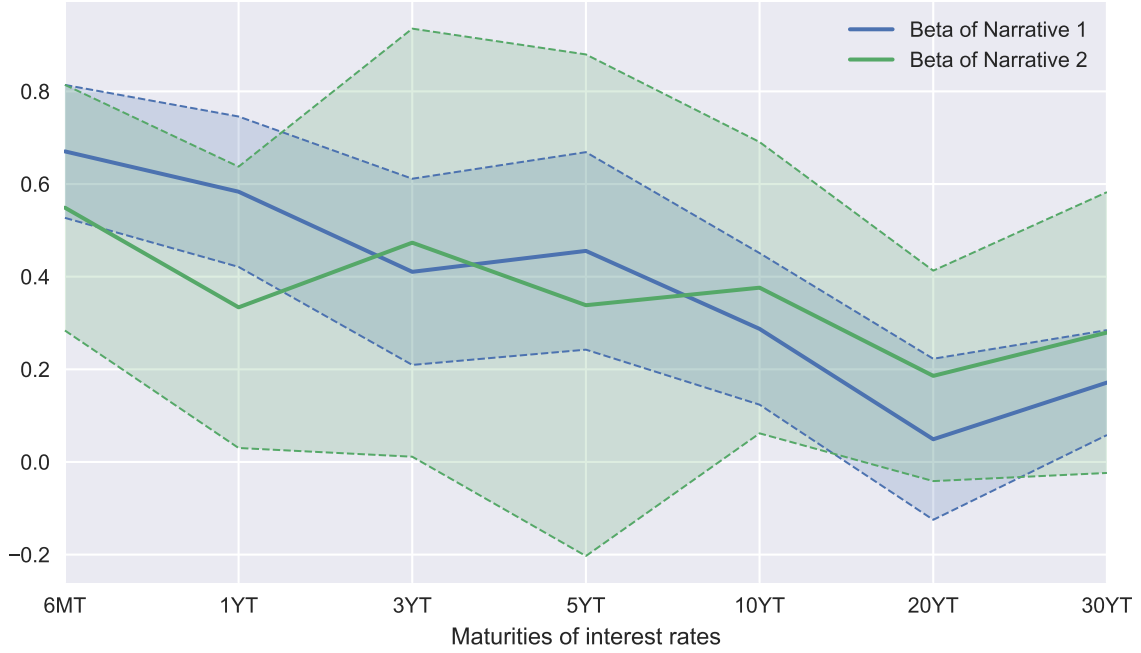
6.2 Regression Results

In a next step, we run the regression formulated in Eq. 2.3 for the classification with $\lambda_B = 0$. Table 6.1 reports the ordinary-least-square estimates for maturities from 6 month to 30 years. β_n^{NP} measures the reaction of the n -maturity interest rate to daily change in the 3-month rate on non-policy days, β_n^{N1} measures the reaction on policy days classified as being influenced by narrative one and β_n^{N2} on policy days classified as belonging to narrative two. α_n is the constant term. **/* indicate significance on the 1% and 5% level, respectively. Heteroskedasticity robust White's (1980) standard errors are listed in brackets. The last row reports the test statistics from the test of equality between the estimated coefficients.

| | 6m | 1y | 3y | 5y | 10y | 20y | 30y |
|-------------------------------|------------------|------------------|------------------|------------------|------------------|------------------|------------------|
| α_n | -0.00 (0.00) | -0.00 (0.00) | -0.00 (0.00) | -0.00 (0.00) | -0.00 (0.00) | -0.00 (0.00) | -0.00 (0.00) |
| β_n^{NP} | 0.36** (0.05) | 0.30** (0.04) | 0.28** (0.04) | 0.25** (0.03) | 0.18** (0.03) | 0.13** (0.02) | 0.12** (0.02) |
| β_n^{N1} | 0.67** (0.07) | 0.58** (0.08) | 0.41** (0.10) | 0.46** (0.11) | 0.29** (0.08) | 0.05 (0.09) | 0.17** (0.06) |
| β_n^{N2} | 0.55** (0.14) | 0.33* (0.15) | 0.47* (0.24) | 0.34 (0.28) | 0.38* (0.16) | 0.19 (0.12) | 0.28 (0.15) |
| R^2 | 0.30 | 0.20 | 0.08 | 0.05 | 0.03 | 0.02 | 0.02 |
| $\beta_n^{N1} = \beta_n^{N2}$ | 0.12 | 0.25 | -0.06 | 0.12 | -0.09 | -0.14 | -0.11 |

Table 6.1 – Regression results (classification with $\lambda_B = 0$).

As expected, the intercept is zero. However, the null hypothesis (see Eq. 2.4) finds little support in the data. The slope coefficients for the non-policy days are large and strongly significant for most maturities. Yet, in line with the null hypothesis, we would expect to find that β_n^{N1} is positive for short maturities but negative for long maturities. Even though the

Figure 6.2 – Regression coefficients for narrative one and two with $\lambda_B = 0$.

slope coefficient β_n^{N1} is decreasing with longer maturities and remains significant, it does not turn negative.

The slope coefficient β_n^{N2} also decreases in maturity but less so than β_n^{N1} . Figure 6.2 illustrates the change in the coefficients given the duration of the maturities. Indeed, while the difference in the betas is positive for short maturities, it turns negative for long maturities. However, the differences between the coefficients are never significant. As the equality test shows, the two responses, β_n^{N1} and β_n^{N2} , cannot be statistically separated for any maturity. In line with this finding, Figure 6.2 illustrates that the 95% confidence intervals of the two coefficients mostly overlap.

Tables D.1 and D.2 in Appendix D.2 show the regression result for policy day classifications with $\lambda_B = 0.1$ and $\lambda_B = 0.9$, respectively. However, the introduction of a background topic changes little in terms of policy day classification and, consequently, the regression results are very similar across all λ_B . Thus, the relationship of the slope coefficients remains stable across λ_B , a fact that is once again illustrated by Figures D.5 and D.6 in Appendix D.2. Additionally, the introduction of a background topic has no effect whatsoever on the explained variation (R^2).

Discussion

The PLSA topic model produced two topics as illustrated by Tables 5.3 and C.1–C.3. With an increasing weight on the background topic, different thematic foci become salient. The first topic picks up on words concerning *investing*, the second topic on words regarding the *Fed's economic outlook*. Technically speaking, the topics inferred by PLSA are word distributions. In the context of this thesis, they are interpreted as narratives. Specifically, it is assumed that the use of different vocabularies indicates the presence of different stories in the analyzed articles. In this case, the articles reporting on the target rate adjustments do so by talking about issues and concerns surrounding investments or by mentioning the Fed and its economic analysis.

Using the two narratives to classify the policy days does not separate the days characterized by a co-movement of the yield curves from the days on which the rates move in opposite directions. An increase in the weight on the background topic only marginally affects the classification. This is a first indication that, while the PLSA model identifies two distinct narratives and is able to attribute the articles accordingly, the narratives do not pick up on the information that explains the inconsistent reaction of the yield curves.

Indeed, the regression results do not support the the null hypothesis (see Eq. 2.4). While the slope coefficients for the non-policy days are large and strongly significant for most maturities, they do not turn negative for long maturities. Additionally, the differences between the two slope coefficients are not significant for any maturity. As with the policy day classification, changing the weight on the background topic has almost no effect on the results.

Clearly, the two narratives the author was able to identify with the use of PLSA do not

explain the inconsistent response of the long-term interest rates. There are several potential reasons for this. First, it is possible that narratives in general are not the defining factor that drives inconsistent yield curve movements. Moreover, it is possible that narratives in newspaper articles do not pick up on the relevant information to explain the response of the long-term rates. However, the author of this thesis finds that unlikely, seeing as other researchers already applied a narrative approach with some success (see Ellingsen et al. (2003), Cook and Hahn (1989), Goetzmann et al. (2016), Gürkaynak et al. (2005a)). Second, PLSA might not be able to pick up on narrative nuances that would allow to account for the yield curve movements. While being a very effective tool in topic mining, PLSA is only able to produce word distributions and relies on the bag-of-words assumption. Interpreting the use of vocabulary as synonymous with the use of narratives might be an oversimplification and even lead to the elimination of important narrative elements such as agency, causal chains, etc. On top of that, given the current specifications, PLSA is only able to detect two topics. Consequently, the two narratives remain closely related with both topics being almost exclusively made up of economic terms. In reality, there might be a greater mix of narratives in the text data or even sub-narratives that only become salient once the dominant and obvious topics are accounted for.

In conclusion, using PLSA to identify two narratives does not yield a successful classification of policy days and the identified narratives are not able to account for the unexplained puzzle in the movements of the yield curve. However, this is most likely an indication that PLSA in its current form, despite its promising premise, is not the right tool to undertake a quantitative analysis of economic narratives. The author suggests that further research is undertaken to gain a better understanding of how text processing methods can be applied to the analysis of economic narratives and how the scientific rigor of statistical methods can be introduced into narrative analysis.

Conclusion

The relationship between monetary policy and market interest rates poses a puzzle: long-term rates move up or down in response to an increase of the Fed’s target rate. This thesis analyzes to what extent narratives can explain the inconsistent reaction of the long-term interest rates. It is hypothesized that the different reactions of the long-term rates are driven by the market participants’ interpretation of the target rate adjustments rather than the policy move itself. These interpretations can be understood as narratives and are assumed to be reflected in the newspaper articles reporting on the target rate adjustment.

Nobel laureates Robert Shiller and George Akerlof have stressed the importance of narratives when it comes to understanding economic decision making and economic fluctuations. Other disciplines, such as psychology and sociology, have shown an increasing interest in narratives in recent years and research has found that narratives have a significant impact on individuals and their behavior. However, comparatively little research has been undertaken in the fields of economics and finance. In response to this lack of research, Shiller called for an expansion of the field of economics to include the study of narratives. Specifically, he emphasized the need to utilize the increasing opportunities offered by statistical learning models in text data analysis. Following Shiller’s call, this thesis applies a quantitative narrative approach to investigate the puzzle of the inconsistent response of the long-term interest rates.

In order to identify different narratives surrounding the target rate adjustments, over 2’300 articles from American newspapers are analyzed. The articles reported on the 56 target rate adjustments that took place between October 1998 to September 2018. With the use of Prob-

abilistic Latent Semantic Analysis (PLSA), a topic mining model, two topics were identified. Technically, the topics produced by PLSA are word distributions, i.e. they attach a probability weight to the words in the text data and are, in turn, characterized by the words that are given a large weight. In terms of narratives, word distributions indicate the use of a specific vocabulary and under the assumption that different narratives demand the use of different vocabularies the word distributions are interpreted as narratives. Of the two topics inferred with PLSA, one focuses on *investing*, with terms like *investors*, *yield*, *trading*, *index*, and *stocks* featuring prominently, and the other on the *Fed's economic analysis*, with terms like *economic*, *growth*, *greenspan*, *bernanke*, and *chairman*.

The words of all articles are attributed to either narrative one or narrative two. Subsequently, the policy days are classified as being influenced by either narrative. To that end, it is determined whether a policy day is mostly dominated by articles reporting on narrative one or by articles attributed to narrative two. Having achieved a split of the policy days between the two narratives, it is straightforward to determine whether the narratives are correlated with yield curve movements: one narrative should be associated with a co-movement of the interest rates while the other narrative should dominate the policy days on which the rates move in opposite directions.

Having achieved a classification of policy days by narratives, the daily change in the interest rates with maturities 6 month, 1 year, 3 years, 5 years, 10 years, 20 years, and 30 years are regressed on the change of the 3-month rate. In line with the research of Ellingsen et al. (2003), the one-day change in the 3-month T-bill rate is taken as a measure of unexpected monetary policy action. According to the hypothesis proposed in this thesis, it is expected that both slope coefficients are positive for short maturities but that one of the slope coefficients is negative for long maturities. The financial analysis lends no support to the hypothesis. The slope coefficients of both narratives are positive for all maturities. Additionally, the differences between the coefficients are never significant. As the equality test shows, the responses of the two different narratives cannot be statistically separated for any maturity.

Clearly, the two narratives identified with the use of PLSA do not explain the inconsistent response of the long-term interest rates. There are several potential reasons for this. Possibly, narratives in general have no influence on yield curve movements and can thus not explain

its inconsistent response. However, other researchers in the field already applied a narrative approach to the problem with some success. Thus, the author is not inclined to discount the influence of narratives altogether. Rather, it is possible that PLSA was not able to pick up on the relevant narratives. PLSA is based on a probabilistic approach and relies on the bag-of-words assumption, that is it neglects to recognize the order of words in the text data. As a result, important narrative information might have been lost in the analysis. Thus, the author can only conclude that PLSA in its current form is not the right tool to undertake a quantitative analysis of economic narratives. The author suggests that further efforts are undertaken to understand the impact of narratives in economics. In particular, research is needed to understand which text processing methods are effective in the analysis of economic narratives.

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Appendix A

Target Rate and Yield Curves

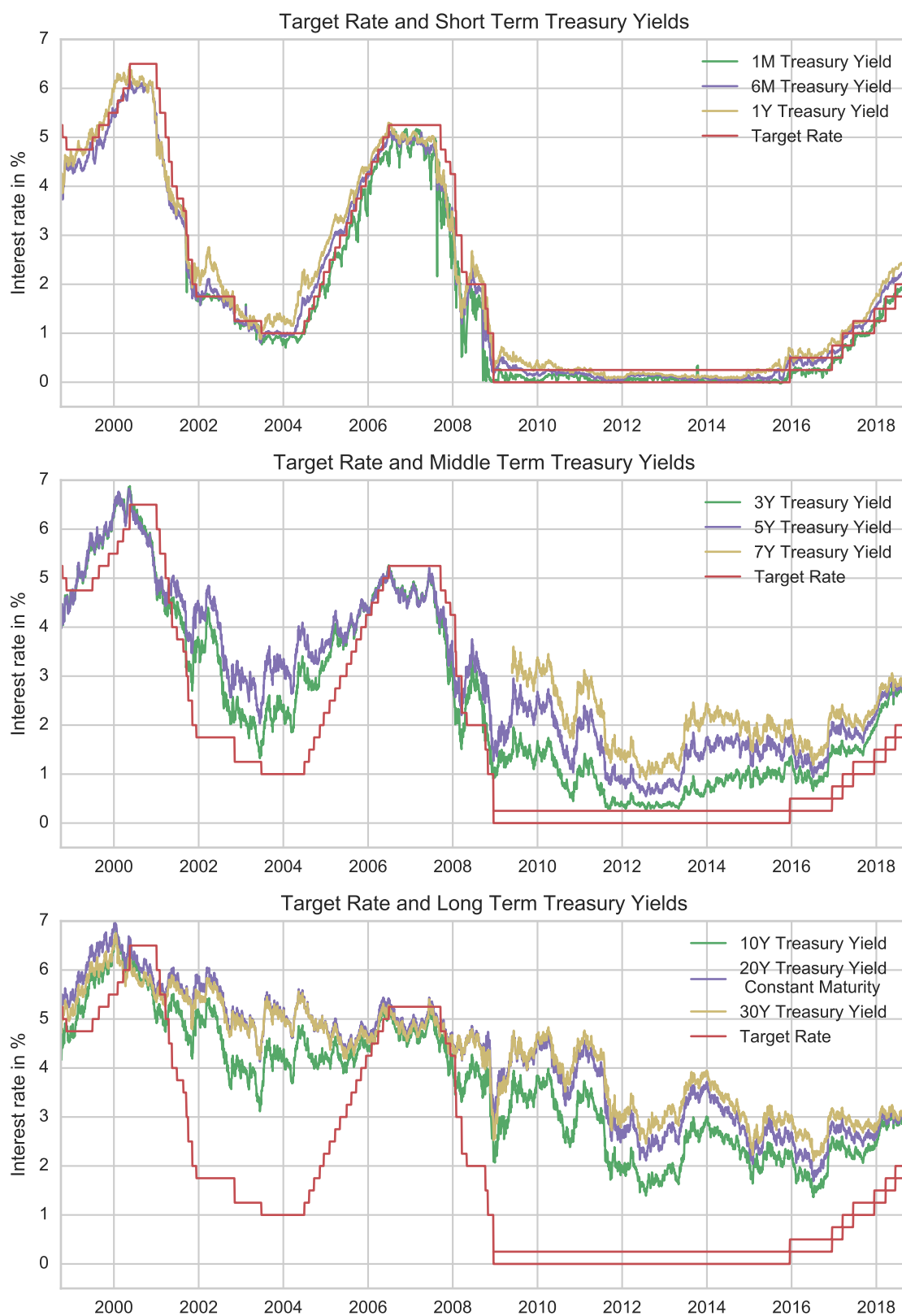
| Dates of all FOMC meetings since January 1, 1998 | | | | | | |
|--|-------------|-------------|-------------|------------|-------------|-------------|
| 26.09.2018 | 18.03.2015 | 13.12.2011 | *07.02.2009 | 12.12.2006 | 12.08.2003 | 31.01.2001 |
| 01.08.2018 | 28.01.2015 | *28.11.2011 | 28.01.2009 | 25.10.2006 | 25.06.2003 | *03.01.2001 |
| 13.06.2018 | 17.12.2014 | 02.11.2011 | *16.01.2009 | 20.09.2006 | 06.05.2003 | 19.12.2000 |
| 02.05.2018 | 29.10.2014 | 21.09.2011 | 16.12.2008 | 08.08.2006 | *16.04.2003 | 15.11.2000 |
| 21.03.2018 | 17.09.2014 | 09.08.2011 | 29.10.2008 | 29.06.2006 | *08.04.2003 | 03.10.2000 |
| 31.01.2018 | 30.07.2014 | *01.08.2011 | *07.10.2008 | 10.05.2006 | *01.04.2003 | 22.08.2000 |
| 13.12.2017 | 18.06.2014 | 22.06.2011 | *29.09.2008 | 28.03.2006 | *25.03.2003 | 28.06.2000 |
| 01.11.2017 | 30.04.2014 | 27.04.2011 | 16.09.2008 | 31.01.2006 | 18.03.2003 | 16.05.2000 |
| 20.09.2017 | 19.03.2014 | 15.03.2011 | 05.08.2008 | 13.12.2005 | 29.01.2003 | 21.03.2000 |
| 26.07.2017 | *04.03.2014 | 26.01.2011 | *24.07.2008 | 01.11.2005 | 10.12.2002 | 02.02.2000 |
| 14.06.2017 | 29.01.2014 | 14.12.2010 | 25.06.2008 | 20.09.2005 | 06.11.2002 | 21.12.1999 |
| 03.05.2017 | 18.12.2013 | 03.11.2010 | 30.04.2008 | 09.08.2005 | 24.09.2002 | 16.11.1999 |
| 15.03.2017 | 30.10.2013 | *15.10.2010 | 18.03.2008 | 30.06.2005 | 13.08.2002 | 05.10.1999 |
| 01.02.2017 | *16.10.2013 | 21.09.2010 | *10.03.2008 | 03.05.2005 | 26.06.2002 | 24.08.1999 |
| 14.12.2016 | 18.09.2013 | 10.08.2010 | 30.01.2008 | 22.03.2005 | 07.05.2002 | 30.06.1999 |
| 02.11.2016 | 31.07.2013 | 23.06.2010 | *21.01.2008 | 02.02.2005 | 19.03.2002 | 18.05.1999 |
| 21.09.2016 | 19.06.2013 | *09.05.2010 | *09.01.2008 | 14.12.2004 | 30.01.2002 | 30.03.1999 |
| 27.07.2016 | 01.05.2013 | 28.04.2010 | 11.12.2007 | 10.11.2004 | 11.12.2001 | 03.02.1999 |
| 15.06.2016 | 20.03.2013 | 16.03.2010 | *06.12.2007 | 21.09.2004 | 06.11.2001 | 22.12.1998 |
| 27.04.2016 | 30.01.2013 | 27.01.2010 | 31.10.2007 | 10.08.2004 | 02.10.2001 | 17.11.1998 |
| 16.03.2016 | 12.12.2012 | 16.12.2009 | 18.09.2007 | 30.06.2004 | *17.09.2001 | *15.10.1998 |
| 27.01.2016 | 24.10.2012 | 04.11.2009 | *16.08.2007 | 04.05.2004 | *13.09.2001 | 29.09.1998 |
| 16.12.2015 | 13.09.2012 | 23.09.2009 | *10.08.2007 | 16.03.2004 | 21.08.2001 | *21.09.1998 |
| 28.10.2015 | 01.08.2012 | 12.08.2009 | 07.08.2007 | 28.01.2004 | 27.06.2001 | 18.08.1998 |
| 17.09.2015 | 20.06.2012 | 24.06.2009 | 28.06.2007 | 09.12.2003 | 15.05.2001 | 01.07.1998 |
| 29.07.2015 | 25.04.2012 | *03.06.2009 | 09.05.2007 | 28.10.2003 | *18.04.2001 | 19.05.1998 |
| 17.06.2015 | 13.03.2012 | 29.04.2009 | 21.03.2007 | 16.09.2003 | *11.04.2001 | 31.03.1998 |
| 29.04.2015 | 25.01.2012 | 18.03.2009 | 31.01.2007 | | 20.03.2001 | 04.02.1998 |

* indicates an unscheduled meeting/conference call

Table A.1 – FOMC meetings.

| FOMC Meeting on | | | | | | | | | | FOMC Meeting on | | | | | | | | | |
|---|----------------|---------------|-----------------------|----------------------|-----------|----------|---|----------------|---------------|-----------------------|----------------------|-----------|----------|--|--|--|--|--|--|
| Date | $T_{gt_{low}}$ | $T_{gt_{up}}$ | $\Delta T_{gt_{low}}$ | $\Delta T_{gt_{up}}$ | day prior | same day | Date | $T_{gt_{low}}$ | $T_{gt_{up}}$ | $\Delta T_{gt_{low}}$ | $\Delta T_{gt_{up}}$ | day prior | same day | | | | | | |
| 27.09.2018 | 2.00% | 2.25% | 25 | - | 1 | 0 | 14.12.2004 | 2.25% | - | 25 | - | 0 | 1 | | | | | | |
| 14.06.2018 | 1.75% | 2.00% | 25 | - | 1 | 0 | 10.11.2004 | 2.00% | - | 25 | - | 0 | 1 | | | | | | |
| 22.03.2018 | 1.50% | 1.75% | 25 | - | 1 | 0 | 21.09.2004 | 1.75% | - | 25 | - | 0 | 1 | | | | | | |
| 14.12.2017 | 1.25% | 1.50% | 25 | - | 1 | 0 | 10.08.2004 | 1.50% | - | 25 | - | 0 | 1 | | | | | | |
| 15.06.2017 | 1.00% | 1.25% | 25 | - | 1 | 0 | 30.06.2004 | 1.25% | - | 25 | - | 0 | 1 | | | | | | |
| 16.03.2017 | 0.75% | 1.00% | 25 | - | 1 | 0 | 25.06.2003 | 1.00% | - | -25 | - | 0 | 1 | | | | | | |
| 15.12.2016 | 0.50% | 0.75% | 25 | - | 1 | 0 | 06.11.2002 | 1.25% | - | -50 | - | 0 | 1 | | | | | | |
| 17.12.2015 | 0.25% | 0.50% | 25 | - | 1 | 0 | 11.12.2001 | 1.75% | - | -25 | - | 0 | 1 | | | | | | |
| 16.12.2008 | 0.00% | 0.25% | -75 | -100 | 0 | 1 | 06.11.2001 | 2.00% | - | -50 | - | 0 | 1 | | | | | | |
| 29.10.2008 | 1.00% | - | -50 | - | 0 | 1 | 02.10.2001 | 2.50% | - | -50 | - | 0 | 1 | | | | | | |
| *08.10.2008 | 1.50% | - | -50 | - | 1 | 0 | *17.09.2001 | 3.00% | - | -50 | - | 0 | 1 | | | | | | |
| 30.04.2008 | 2.00% | - | -25 | - | 0 | 1 | 21.08.2001 | 3.50% | - | -25 | - | 0 | 1 | | | | | | |
| 18.03.2008 | 2.25% | - | -75 | - | 0 | 1 | 27.06.2001 | 3.75% | - | -25 | - | 0 | 1 | | | | | | |
| 30.01.2008 | 3.00% | - | -50 | - | 0 | 1 | 15.05.2001 | 4.00% | - | -50 | - | 0 | 1 | | | | | | |
| *22.01.2008 | 3.50% | - | -75 | - | 1 | 0 | *18.04.2001 | 4.50% | - | -50 | - | 0 | 1 | | | | | | |
| 11.12.2007 | 4.25% | - | -25 | - | 0 | 1 | 20.03.2001 | 5.00% | - | -50 | - | 0 | 1 | | | | | | |
| 31.10.2007 | 4.50% | - | -25 | - | 0 | 1 | 31.01.2001 | 5.50% | - | -50 | - | 0 | 1 | | | | | | |
| 18.09.2007 | 4.75% | - | -50 | - | 0 | 1 | *03.01.2001 | 6.00% | - | -50 | - | 0 | 1 | | | | | | |
| 29.06.2006 | 5.25% | - | 25 | - | 0 | 1 | 16.05.2000 | 6.50% | - | 50 | - | 0 | 1 | | | | | | |
| 10.05.2006 | 5.00% | - | 25 | - | 0 | 1 | 21.03.2000 | 6.00% | - | 25 | - | 0 | 1 | | | | | | |
| 28.03.2006 | 4.75% | - | 25 | - | 0 | 1 | 02.02.2000 | 5.75% | - | 25 | - | 0 | 1 | | | | | | |
| 31.01.2006 | 4.50% | - | 25 | - | 0 | 1 | 16.11.1999 | 5.50% | - | 25 | - | 0 | 1 | | | | | | |
| 13.12.2005 | 4.25% | - | 25 | - | 0 | 1 | 24.08.1999 | 5.25% | - | 25 | - | 0 | 1 | | | | | | |
| 01.11.2005 | 4.00% | - | 25 | - | 0 | 1 | 30.06.1999 | 5.00% | - | 25 | - | 0 | 1 | | | | | | |
| 20.09.2005 | 3.75% | - | 25 | - | 0 | 1 | 17.11.1998 | 4.75% | - | -25 | - | 0 | 1 | | | | | | |
| 09.08.2005 | 3.50% | - | 25 | - | 0 | 1 | *15.10.1998 | 5.00% | - | -25 | - | 0 | 1 | | | | | | |
| 30.06.2005 | 3.25% | - | 25 | - | 0 | 1 | 29.09.1998 | 5.25% | - | -25 | - | 0 | 1 | | | | | | |
| 03.05.2005 | 3.00% | - | 25 | - | 0 | 1 | | | | | | | | | | | | | |
| 22.03.2005 | 2.75% | - | 25 | - | 0 | 1 | | | | | | | | | | | | | |
| 02.02.2005 | 2.50% | - | 25 | - | 0 | 1 | | | | | | | | | | | | | |
| ΔT_{gt} are given in basis points | | | | | | | * indicates a target rate adjustment following an unscheduled meeting | | | | | | | | | | | | |

Table A.2 – Target rate adjustments since January 1, 1998.

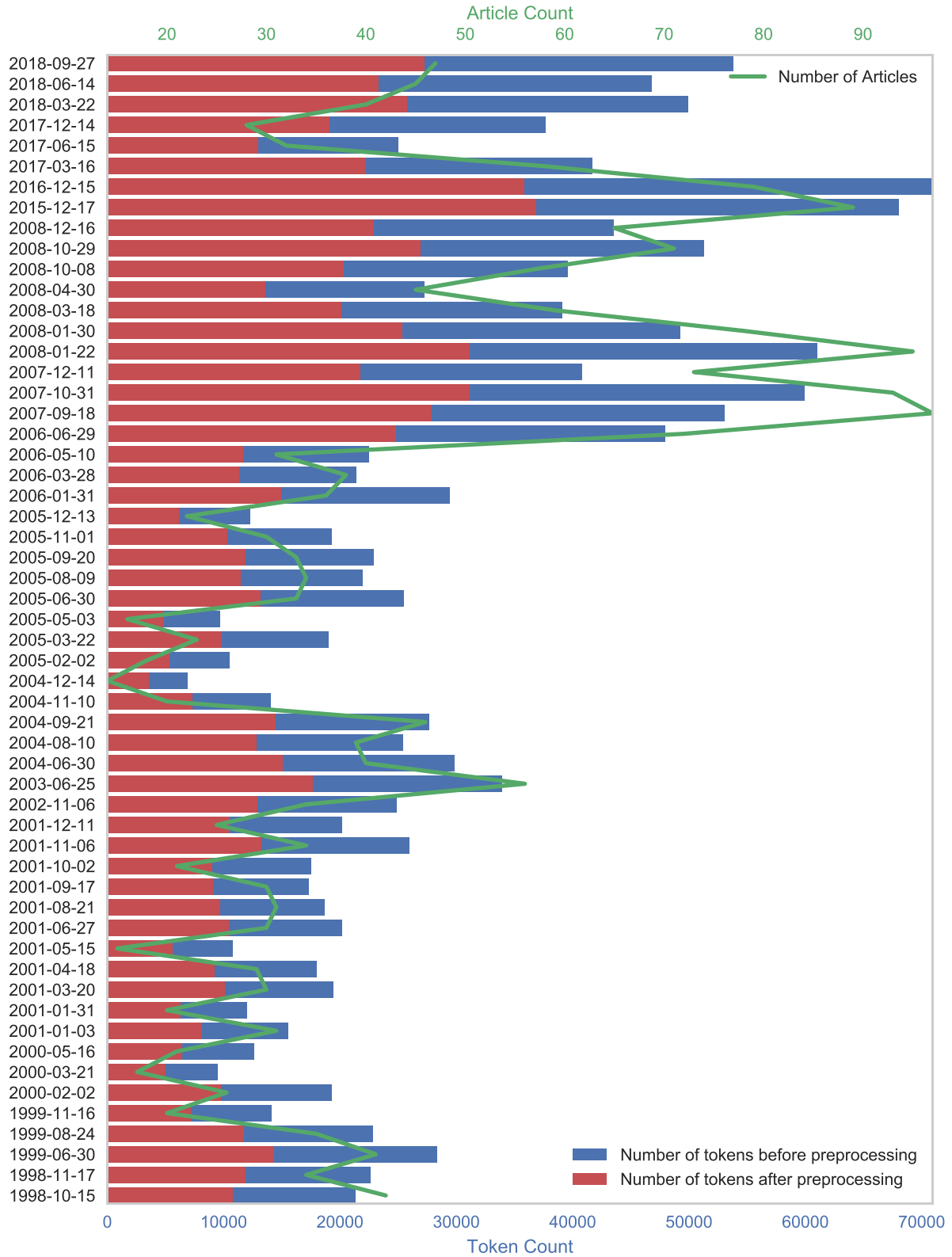
Figure A.1 – Target rate and treasury yields of all maturities.

Appendix B

Text Data

Figure B.1 illustrates the distribution of the token and article count of the text data across policy days. After tokenization, the text data collection encompasses more than 1'600'000 tokens (red bars). After the removal of stop words, the token count drops to roughly 1'100'000 tokens. Subsequently, the non-alphabetic characters, especially the punctuations marks, are removed and the final count amounts to approximately 850'000 tokens (blue bars). Note that the blue bars illustrate the token count after preprocessing but before feature engineering.

Figure B.1 – Token and article count across all policy days.



Topic Model Output

C.1 PLSA without Background Topic

Figure C.1 shows the classification of policy days according to the weight of narrative one and narrative two across all articles of a specific policy day. The classification utilizes the topic model output without background topic, that is with $\lambda_B = 0$.

Figures C.2 and C.3 show the weight of narrative one of each document for $\lambda_B = 0$, split according to policy days. The number of documents attributed to each day vary across policy days, as indicated by the number below each graph. Ideally, all documents of a policy day would have either a very high or a very low weight of topic 1. This would indicate a clean split of days that concentrate on narrative one and days that are influenced by narrative two. As it is, the weights of the narratives are mixed across articles and days and the final classification of any given day is the result of averaging across the different weights.

C.2 PLSA with Background Topic

Tables C.1–C.3 show the 20 top words of every topic depending on λ_B . The use of colors emphasizes the movement of words of interest across different specifications of λ_B .

Figures C.4 and C.7 illustrate the classification of policy days for $\lambda_B = 0.1$ and $\lambda_B = 0.9$, respectively. Analogously, Figures C.5–C.6 and C.8–C.9 show the weight of narrative one of each document for $\lambda_B = 0.1$ and $\lambda_B = 0.9$.

Figure C.1 – Policy day classification according to PLSA with $\lambda_B = 0$.

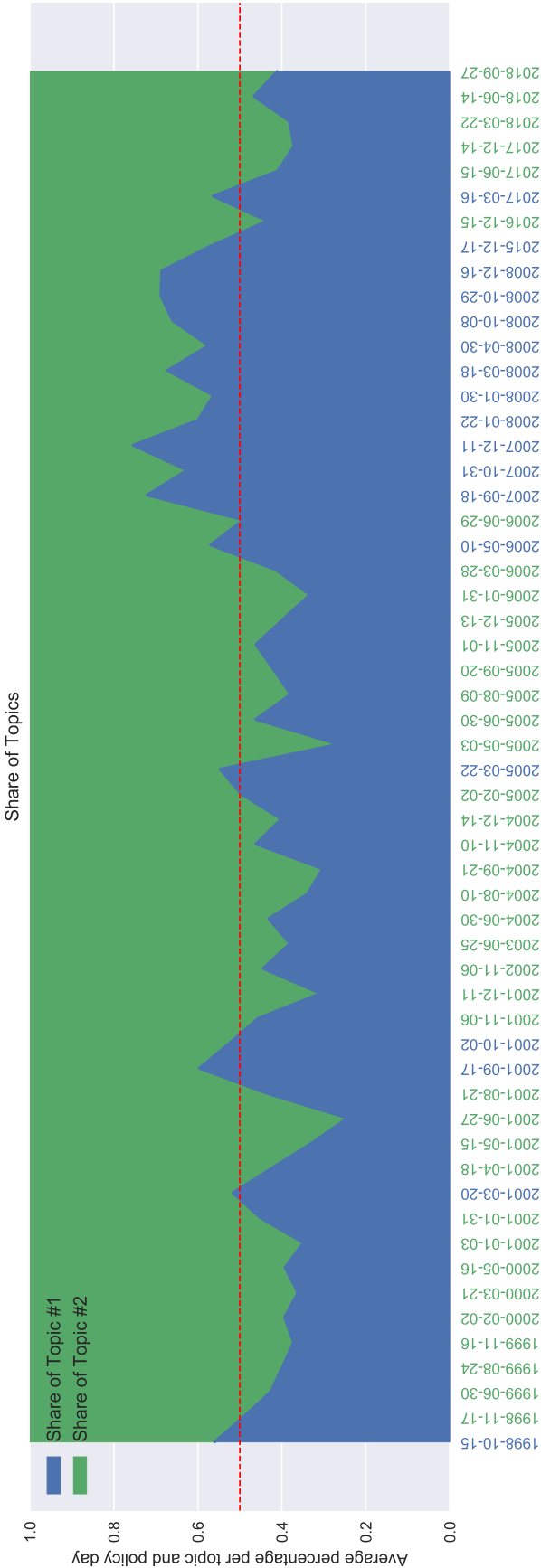


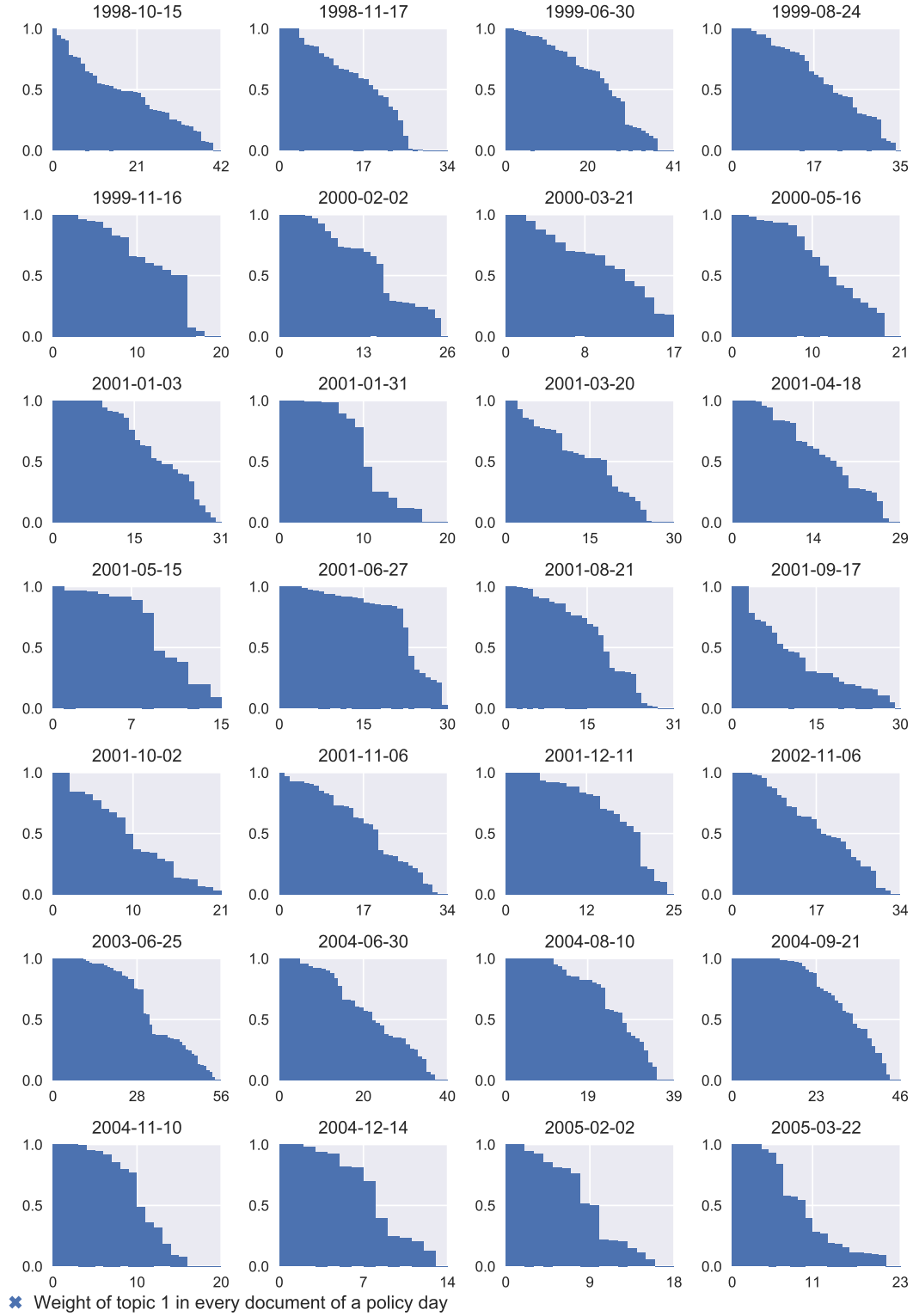
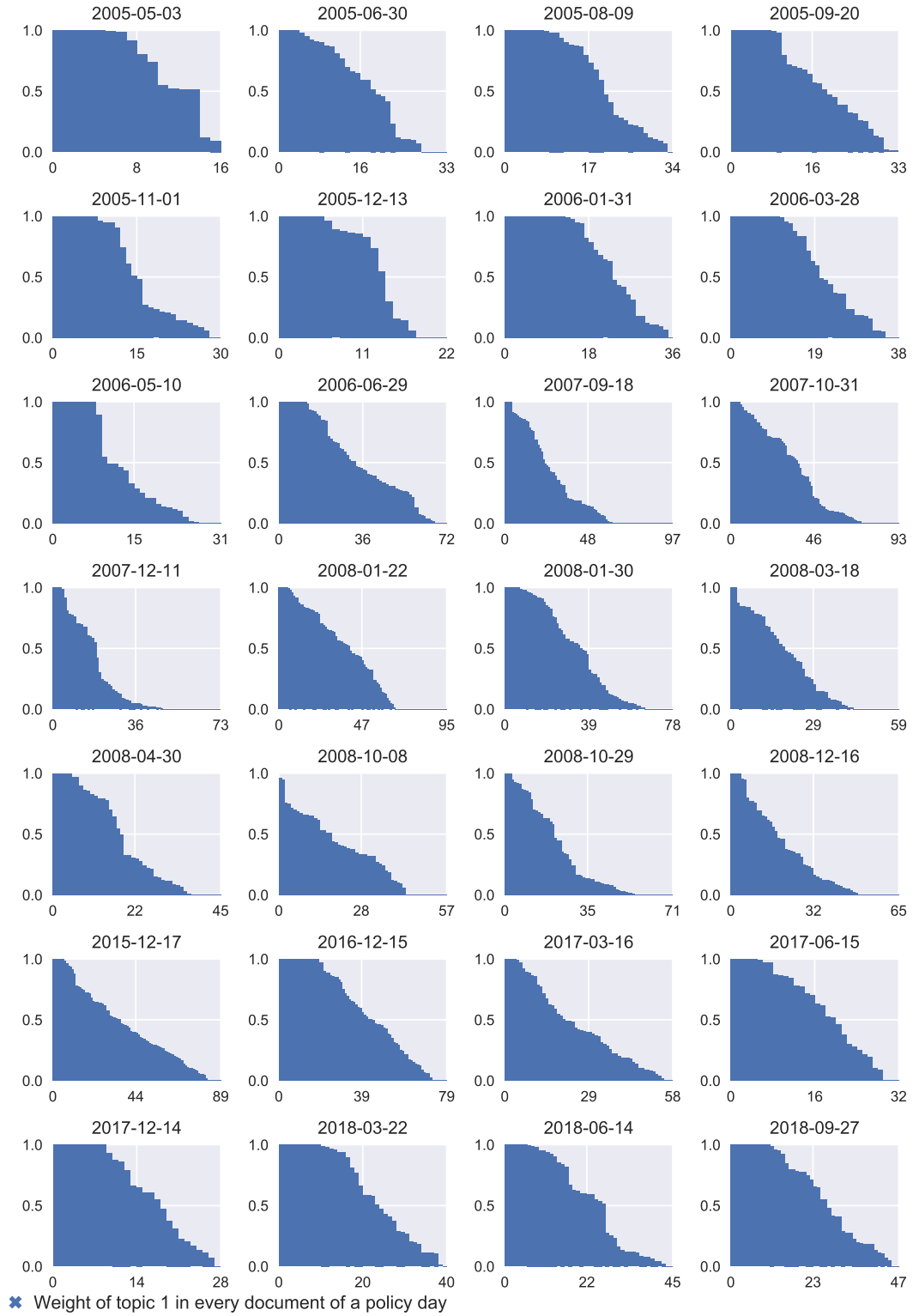
Figure C.2 – Document classification according to PLSA with $\lambda_B = 0$ - Part I.

Figure C.3 – Document classification according to PLSA with $\lambda_B = 0$ - Part II.

| Topic 1 | | | | | |
|-------------------|-------------------|-------------------|-------------------|-------------------|-------------------|
| $\lambda_B = 0.1$ | $\lambda_B = 0.2$ | $\lambda_B = 0.3$ | $\lambda_B = 0.4$ | $\lambda_B = 0.5$ | $\lambda_B = 0.6$ |
| said | year | year | year | year | year |
| year | said | said | said | percent | percent |
| percent | percent | percent | percent | market | market |
| market | market | market | market | said | dollar |
| rate | rate | dollar | dollar | dollar | said |
| dollar | dollar | rate | investors | investors | bank |
| cut | cut | bank | bank | bank | investors |
| bank | bank | cut | cut | cut | cut |
| rates | investors | investors | per cent | per cent | rate |
| investors | rates | rates | bond | bond | per cent |
| fed | interest rate | interest rate | interest rate | yield | yield |
| interest rate | fed | per cent | yield | rose | bond |
| per cent | per cent | bond | rate | interest rate | rose |
| federal reserve | bond | yield | us | us | interest rate |
| bond | federal reserve | markets | markets | markets | rates |
| markets | yield | federal reserve | rose | index | index |
| yield | markets | rose | expected | expected | fell |
| expected | rose | expected | index | fell | markets |
| interest rate | expected | index | fell | stocks | stocks |
| rose | index | us | stocks | month | month |

Table C.1 – Topic 1 produced by PLSA depending on λ_B .

| Topic 1 | | | | | Topic 2 | | | | |
|--|--|---|---|---|---|--|--|--|--|
| $\lambda_B = 0.7$ | $\lambda_B = 0.8$ | $\lambda_B = 0.9$ | $\lambda_B = 0.1$ | $\lambda_B = 0.2$ | $\lambda_B = 0.3$ | | | | |
| year dollar percent market investors bank cut yield said per cent rose bond index fell us stocks month markets euro trading | dollar year percent market investors bank yield rose cut per cent bond fell index stocks trading euro month us new york bonds | dollar investors yield bank rose per cent fell trading year bond index stocks yen euro currency bonds shares cents bps china | fed said inflation economy rate would year economic rates growth percent policy federal reserve interest rates could market meeting time statement interest rate | fed said inflation economy rate would economic rates year growth policy percent interest rates federal reserve could market meeting statement time interest rate | fed said inflation economy rate would economic rates growth year policy percent could interest rates federal reserve meeting statement market time one | | | | |

Table C.2 – Topic 1 and Topic 2 produced by PLSA depending on λ_B .

| Topic 2 | | | | | |
|-------------------|-------------------|-------------------|-------------------|-------------------|-------------------|
| $\lambda_B = 0.4$ | $\lambda_B = 0.5$ | $\lambda_B = 0.6$ | $\lambda_B = 0.7$ | $\lambda_B = 0.8$ | $\lambda_B = 0.9$ |
| fed | fed | fed | fed | fed | fed |
| said | said | inflation | inflation | inflation | inflation |
| inflation | inflation | economy | economy | economy | economy |
| economy | economy | said | said | said | economic |
| rate | rate | rate | would | economic | greenspan |
| rates | rates | would | rate | would | mr |
| would | would | economic | economic | growth | think |
| economic | economic | growth | growth | rate | growth |
| growth | growth | policy | policy | policy | would |
| policy | policy | rates | could | greenspan | bernanke |
| year | could | could | rates | statement | rate |
| percent | interest rates | meeting | meeting | meeting | chairman |
| interest rates | federal reserve | statement | statement | think | statement |
| federal reserve | statement | interest rates | time | could | policy |
| could | percent | time | think | mr | consumer |
| statement | time | federal reserve | mr | time | spending |
| meeting | year | mr | interest rates | bernanke | economists |
| time | mr | think | greenspan | chairman | washington |
| market | one | one | federal reserve | economists | time |
| one | think | greenspan | one | rates | fomc |

Table C.3 – Topic 2 produced by PLSA depending on λ_B .

Figure C.4 – Policy day classification according to PLSA with $\lambda_B = 0.1$.

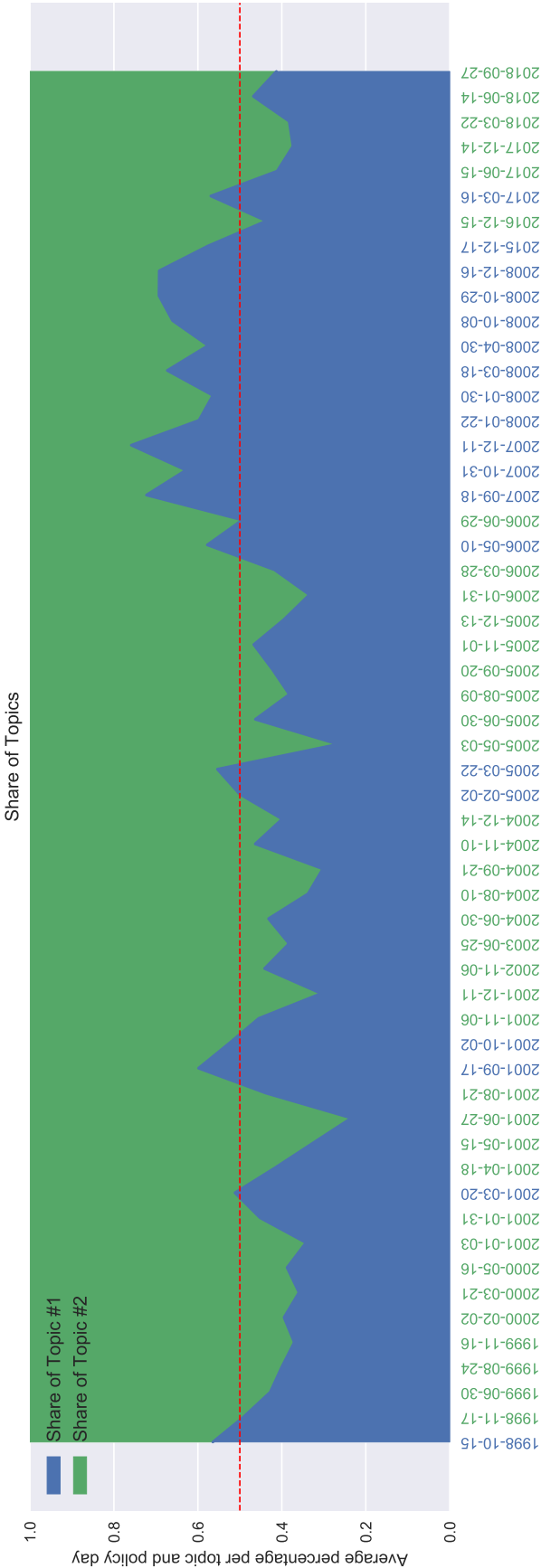


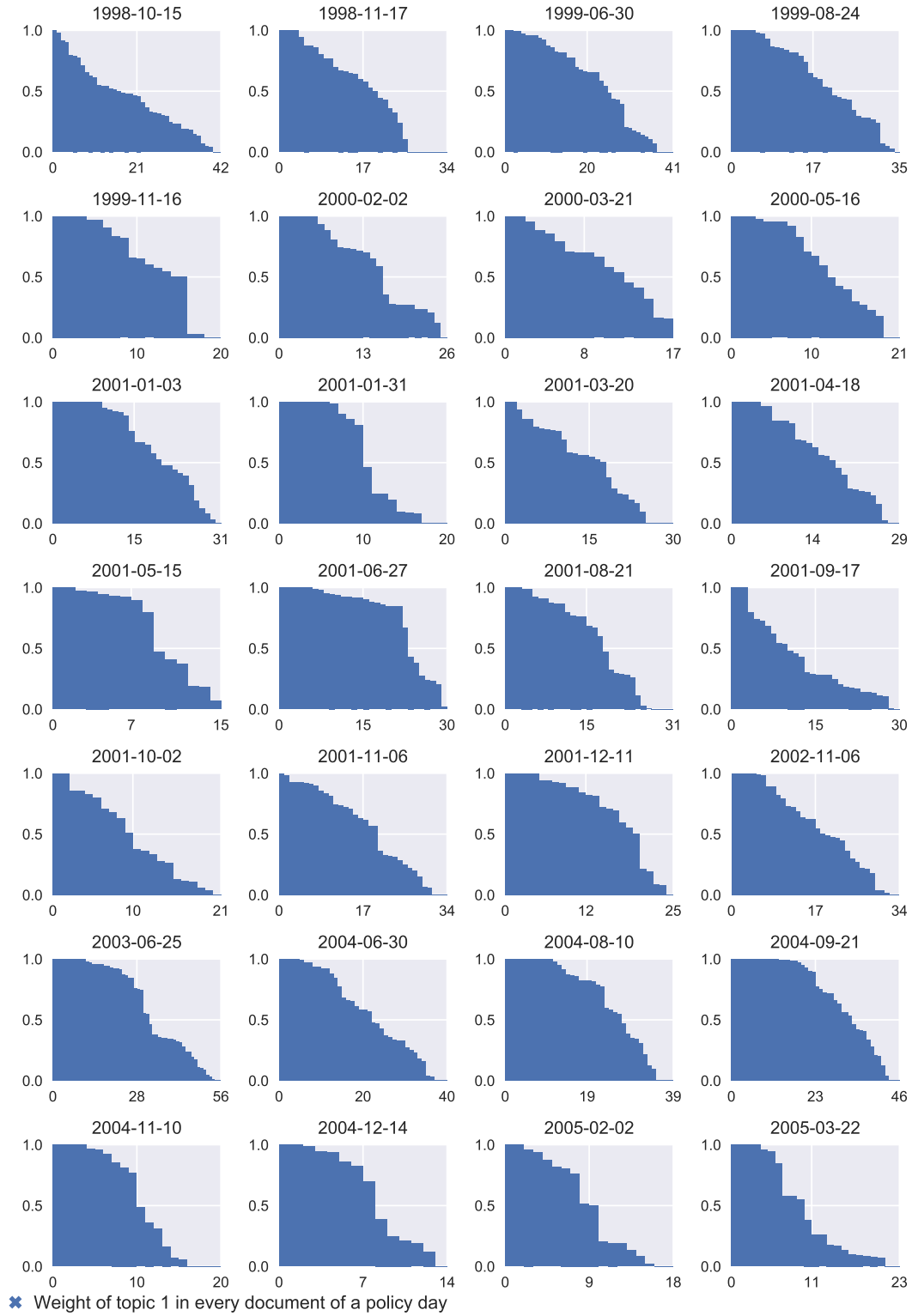
Figure C.5 – Document classification according to PLSA with $\lambda_B = 0.1$ - Part I.

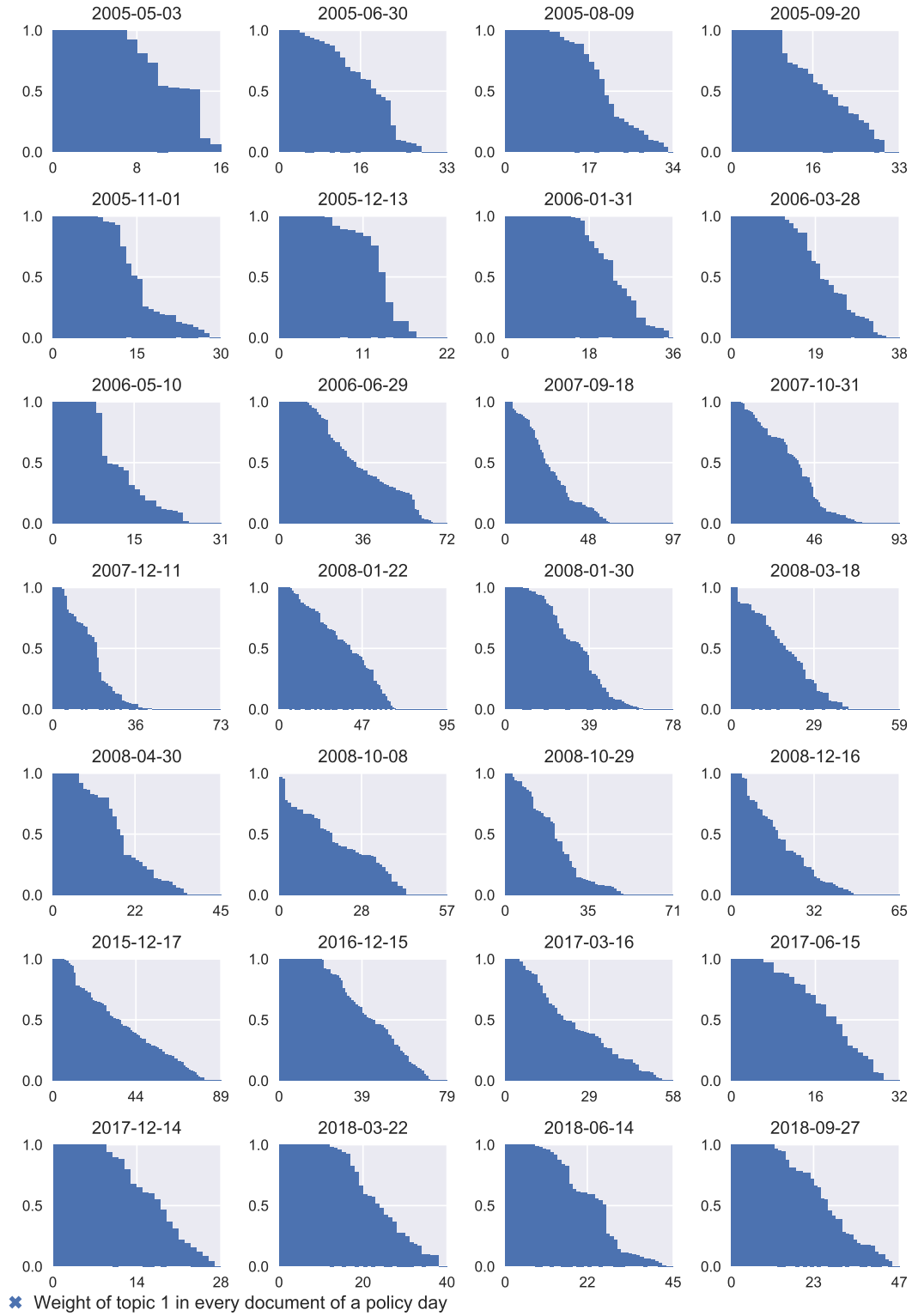
Figure C.6 – Document classification according to PLSA with $\lambda_B = 0.1$ - Part II.

Figure C.7 – Policy day classification according to PLSA with $\lambda_B = 0.9$.

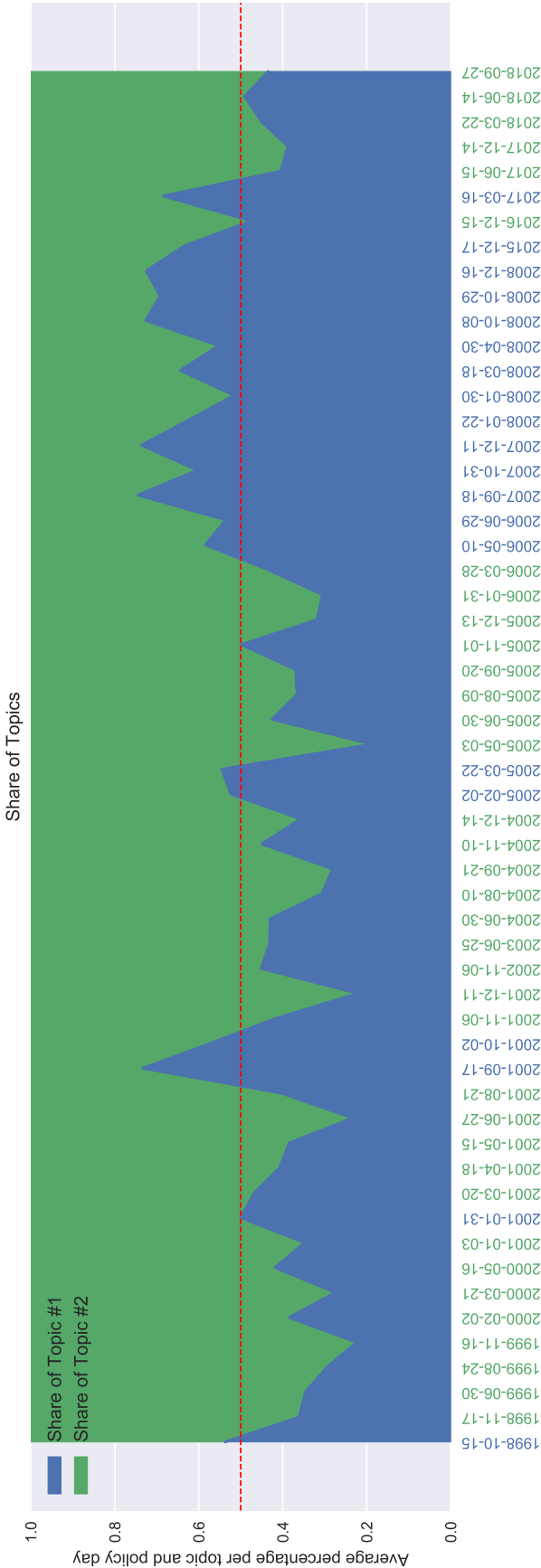


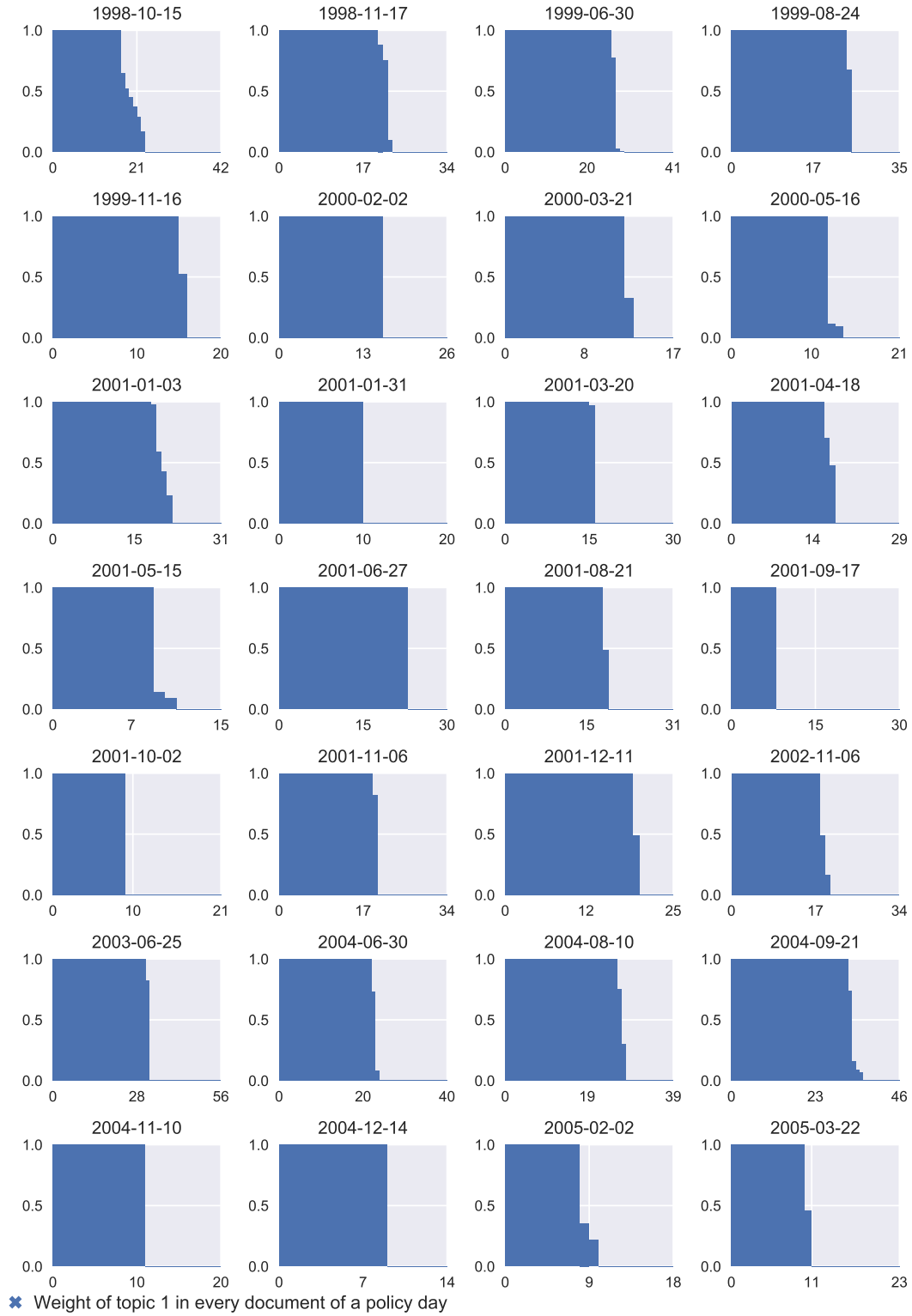
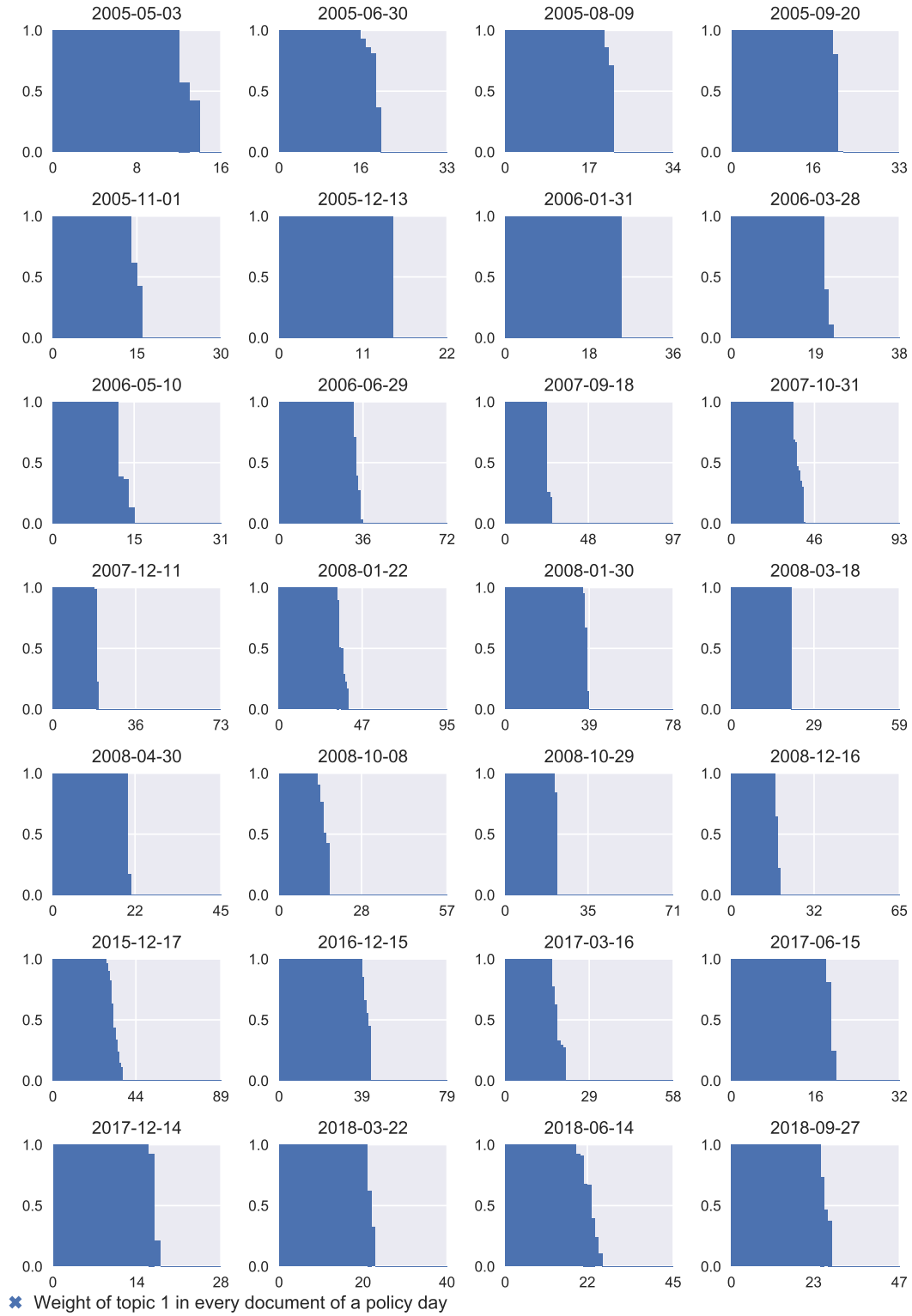
Figure C.8 – Document classification according to PLSA with $\lambda_B = 0.9$ - Part I.

Figure C.9 – Document classification according to PLSA with $\lambda_B = 0.9$ - Part II.

Classification and Regression Results

D.1 Classification Output

Figures D.1 and D.2 show the reaction of the 10-year rate to a change in the 3-months rate, with the policy days split up according to their classification by narratives and given the weight in the background topic $\lambda_B = 0.1$ or $\lambda_B = 0.9$, respectively. The figures allow an eyeball assessment of the success of the classification.

Figures D.3–D.4 show the classification of the policy days that have been classified as either endogenous or exogenous by Ellingsen et al. (2003, p. 11). There are only 18 data points available for a comparison. The classification according to narratives fails to separate the policy days in a similar fashion to Ellingsen et al. Both groups, endogenous and exogenous policy days, are classified as belonging to narrative two.

D.2 Regression Output

Figures D.5 and D.6 show the relationship of the slope coefficients for $\lambda_B = 0.1$ and $\lambda_B = 0.9$, respectively, including the 95%-confidence interval for each β_n . Similarly, Tables D.1 and D.2 show the regression result for policy day classifications with $\lambda_B = 0.1$ and $\lambda_B = 0.9$.

Figure D.1 – Response of the 10-year interest rate to a change in the 3-month rate (classification with $\lambda_B = 0.1$).

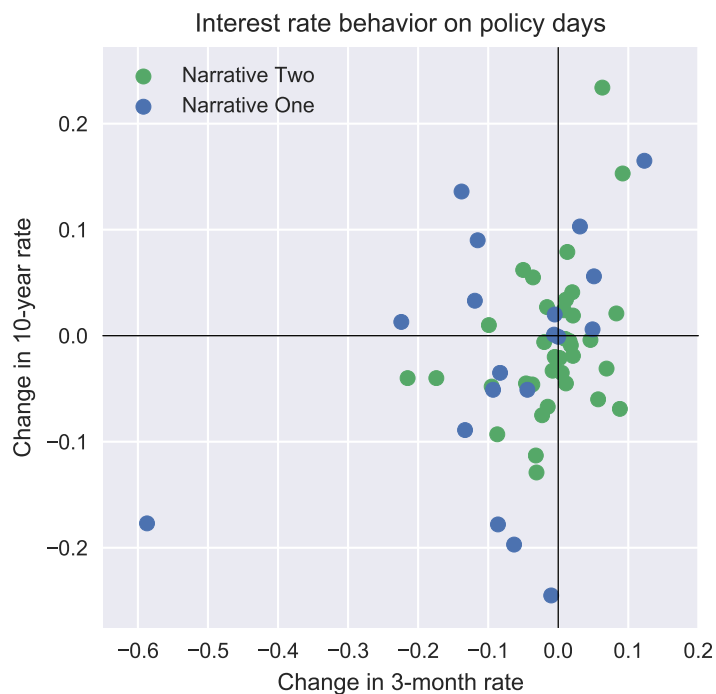


Figure D.2 – Response of the 10-year interest rate to a change in the 3-month rate (classification with $\lambda_B = 0.9$).

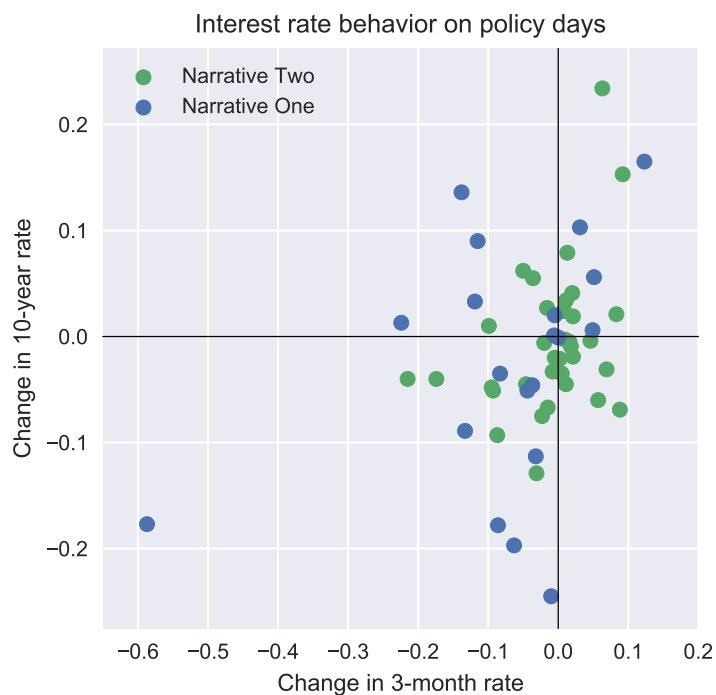


Figure D.3 – Boxplot showing the weight of narrative one (with $\lambda_B = 0$) on policy days classified as endogenous or exogenous by Ellingsen et al. (2003, p. 11).

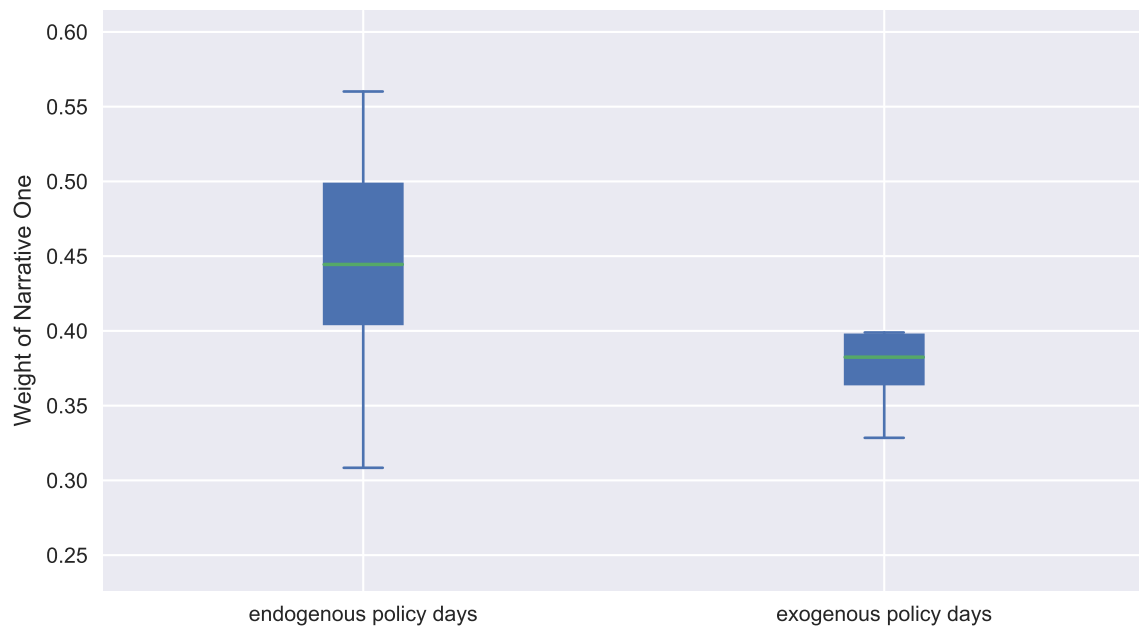


Figure D.4 – Boxplot showing the weight of narrative one (with $\lambda_B = 0.9$) on policy days classified as endogenous or exogenous by Ellingsen et al. (2003, p. 11).

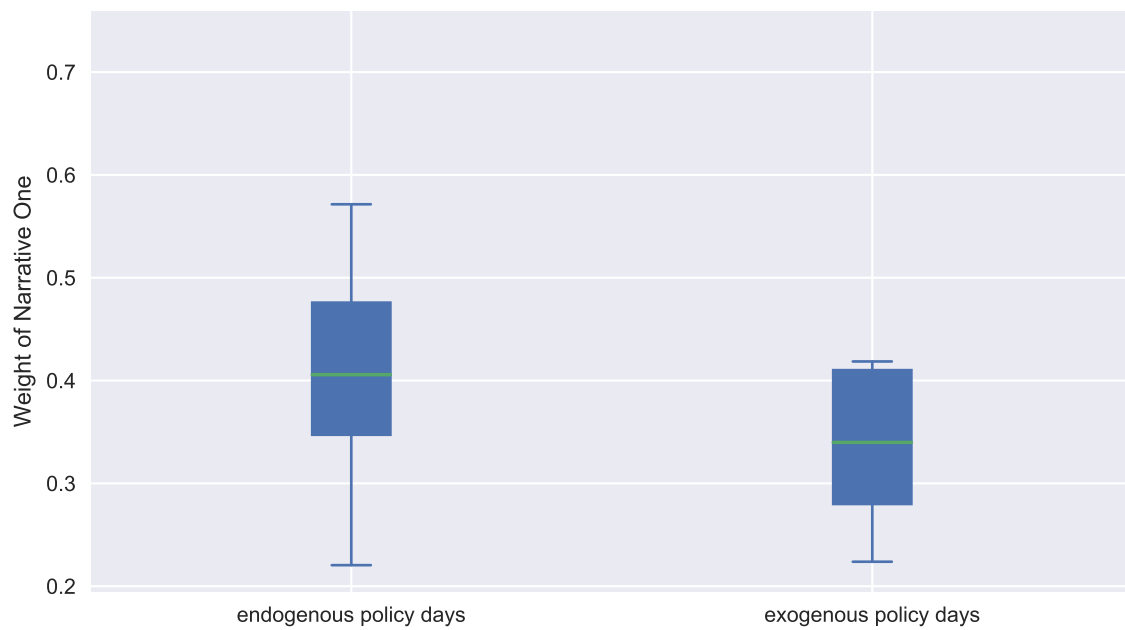
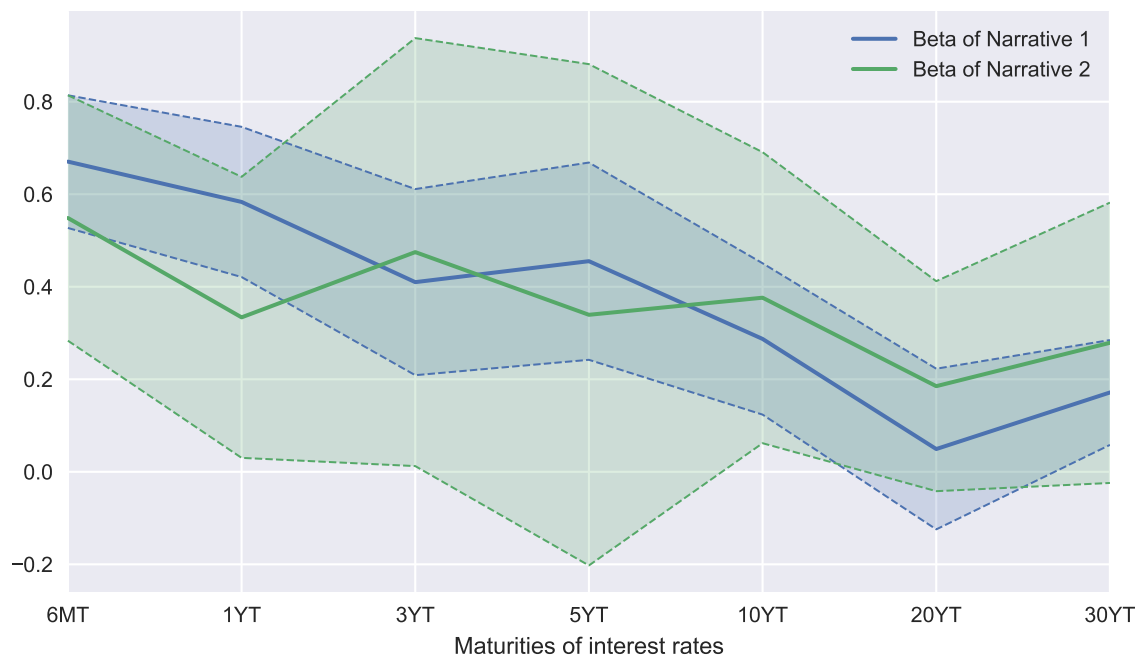
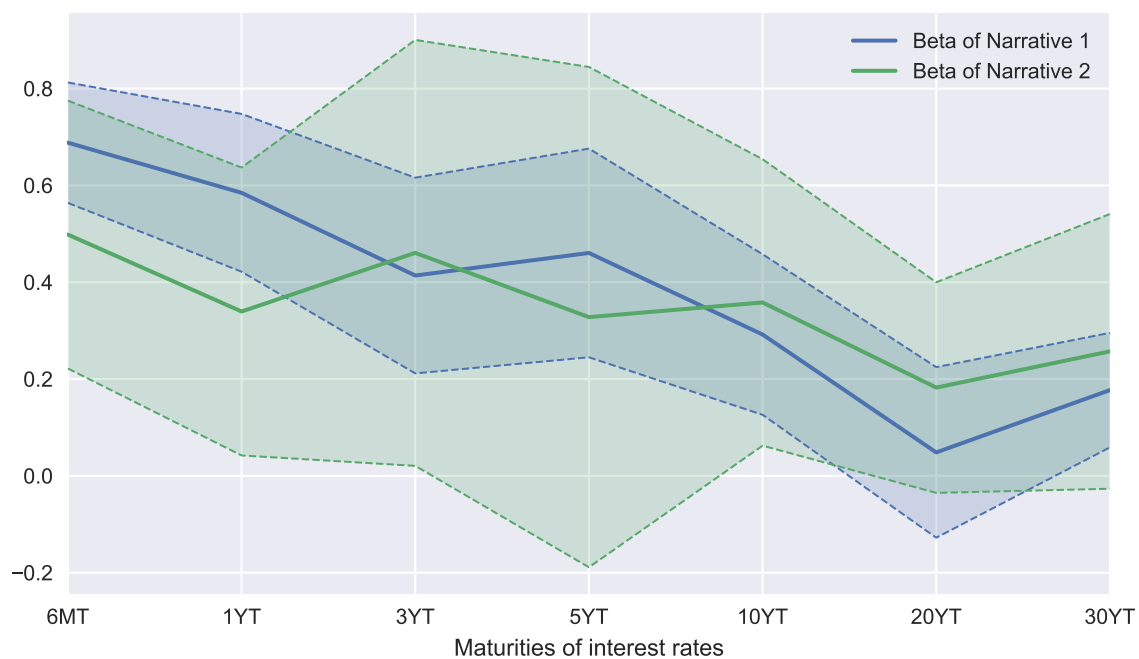


Figure D.5 – Regression coefficients for narrative one and two with $\lambda_B = 0.1$.**Figure D.6** – Regression coefficients for narrative one and two with $\lambda_B = 0.9$.

| | 6m | 1y | 3y | 5y | 10y | 20y | 30y |
|-------------------------------|------------------|------------------|------------------|------------------|------------------|------------------|------------------|
| α_n | -0.00 (0.00) | -0.00 (0.00) | -0.00 (0.00) | -0.00 (0.00) | -0.00 (0.00) | -0.00 (0.00) | -0.00 (0.00) |
| β_n^{NP} | 0.36** (0.05) | 0.30** (0.04) | 0.28** (0.04) | 0.25** (0.03) | 0.18** (0.03) | 0.13** (0.02) | 0.12** (0.02) |
| β_n^{N1} | 0.67** (0.07) | 0.58** (0.08) | 0.41** (0.10) | 0.46** (0.11) | 0.29** (0.08) | 0.05 (0.09) | 0.17** (0.06) |
| β_n^{N2} | 0.55** (0.14) | 0.33* (0.15) | 0.47* (0.24) | 0.34 (0.28) | 0.38* (0.16) | 0.19 (0.12) | 0.28 (0.15) |
| R^2 | 0.30 | 0.20 | 0.08 | 0.05 | 0.03 | 0.02 | 0.02 |
| $\beta_n^{N1} = \beta_n^{N2}$ | 0.12 | 0.25 | -0.06 | 0.12 | -0.09 | -0.14 | -0.11 |

**/* indicate significance on the 1% and 5% level, respectively.

Table D.1 – Regression results (classification with $\lambda_B = 0.1$).

| | 6m | 1y | 3y | 5y | 10y | 20y | 30y |
|-------------------------------|------------------|------------------|------------------|------------------|------------------|------------------|------------------|
| α_n | -0.00 (0.00) | -0.00 (0.00) | -0.00 (0.00) | -0.00 (0.00) | -0.00 (0.00) | -0.00 (0.00) | -0.00 (0.00) |
| β_n^{NP} | 0.36** (0.05) | 0.30** (0.04) | 0.28** (0.04) | 0.25** (0.03) | 0.18** (0.03) | 0.13** (0.02) | 0.12** (0.02) |
| β_n^{N1} | 0.69** (0.06) | 0.58** (0.08) | 0.41** (0.10) | 0.46** (0.11) | 0.29** (0.08) | 0.05 (0.09) | 0.18** (0.06) |
| β_n^{N2} | 0.50** (0.14) | 0.34* (0.15) | 0.46* (0.22) | 0.33 (0.26) | 0.36* (0.15) | 0.18 (0.11) | 0.26 (0.14) |
| R^2 | 0.30 | 0.20 | 0.08 | 0.05 | 0.03 | 0.02 | 0.02 |
| $\beta_n^{N1} = \beta_n^{N2}$ | 0.19 | 0.25 | -0.05 | 0.13 | -0.07 | -0.13 | -0.08 |

**/* indicate significance on the 1% and 5% level, respectively.

Table D.2 – Regression results (classification with $\lambda_B = 0.9$).

Alternative Classification: Median

E.1 Classification Output according to Median

Figures E.1 and E.2 illustrate the classification of policy days for $\lambda_B = 0.1$ and $\lambda_B = 0.9$ respectively, when the median is used as a classification threshold.

Figures E.3 and E.4 plot the change in the 3-month rate against the change in the 10-year rate on policy days for $\lambda_B = 0.1$ and $\lambda_B = 0.9$, respectively. Note that the policy days are split evenly between narrative one and narrative two: 28 policy days have been attributed to each narrative.

E.2 Regression Output according to Median

Based on the classification with the median as classification threshold, the regression formulated in Eq. 2.3 is run. Figures D.5 and D.6 show the relationship of the slope coefficients for $\lambda_B = 0$ and $\lambda_B = 0.9$ respectively, including the 95%-confidence interval for each β_n . Similarly, Tables D.1 and D.2 show the regression result for policy day classifications with $\lambda_B = 0$ and $\lambda_B = 0.9$.

Figure E.1 – Policy day classification according to median with $\lambda_B = 0$.

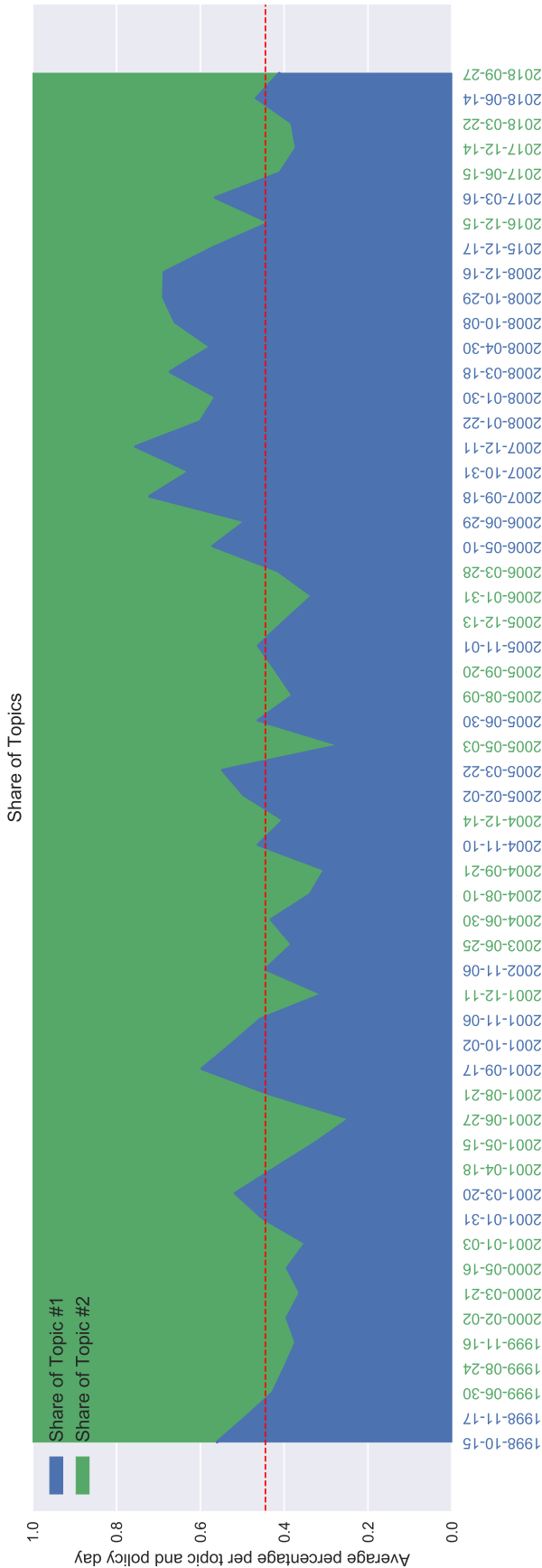


Figure E.2 – Policy day classification according to median with $\lambda_B = 0.9$.

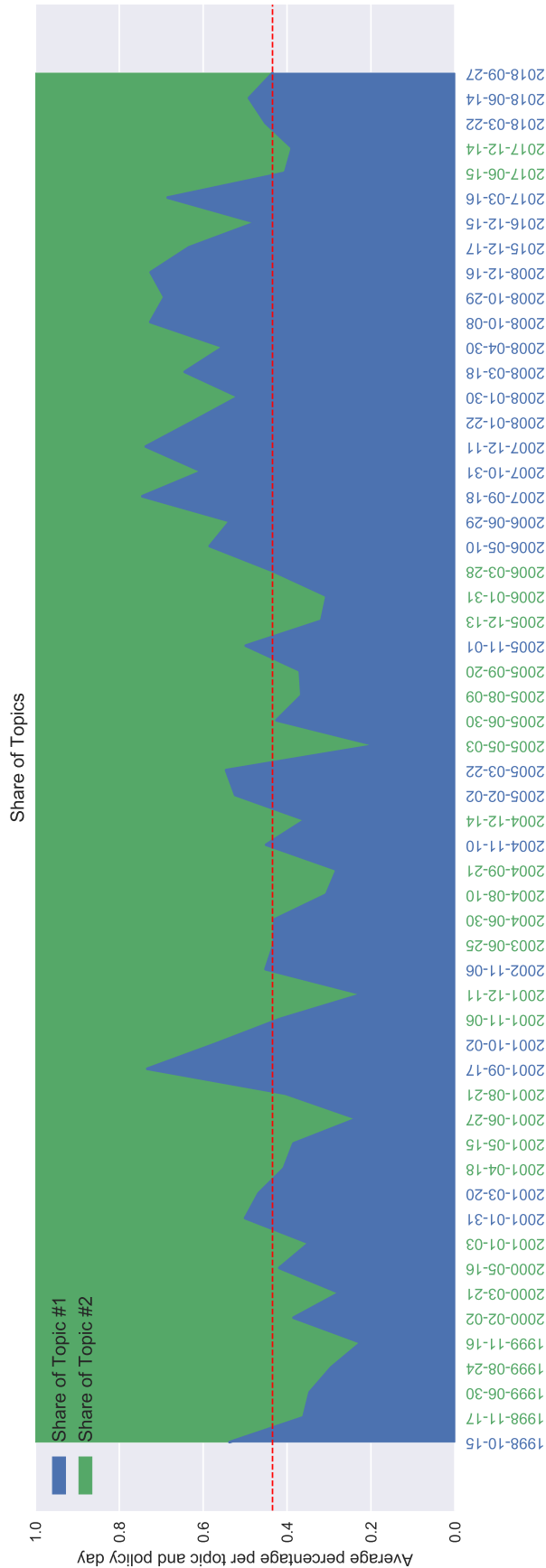


Figure E.3 – Response of the 10-year interest rate to a change in the 3-month rate (classification with $\lambda_B = 0$, applying median as classification threshold).

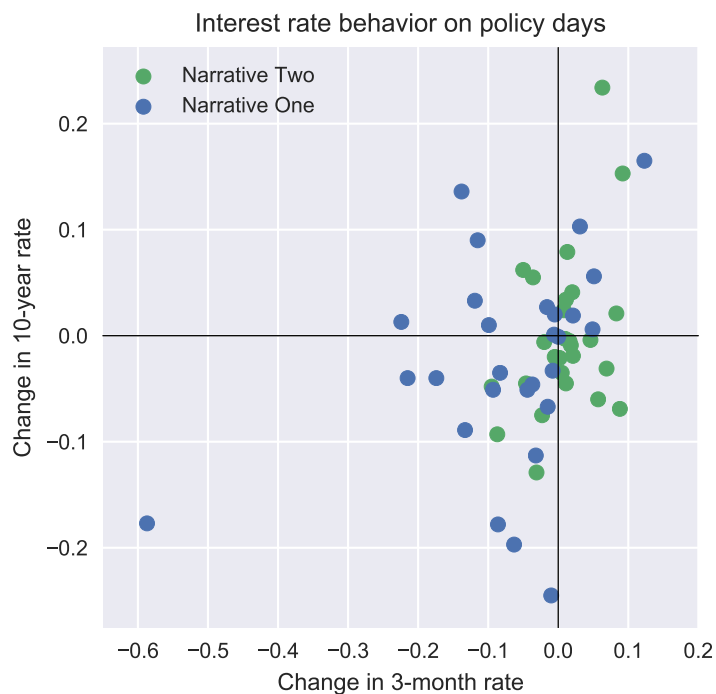


Figure E.4 – Response of the 10-year interest rate to a change in the 3-month rate (classification with $\lambda_B = 0.9$, applying median as classification threshold).

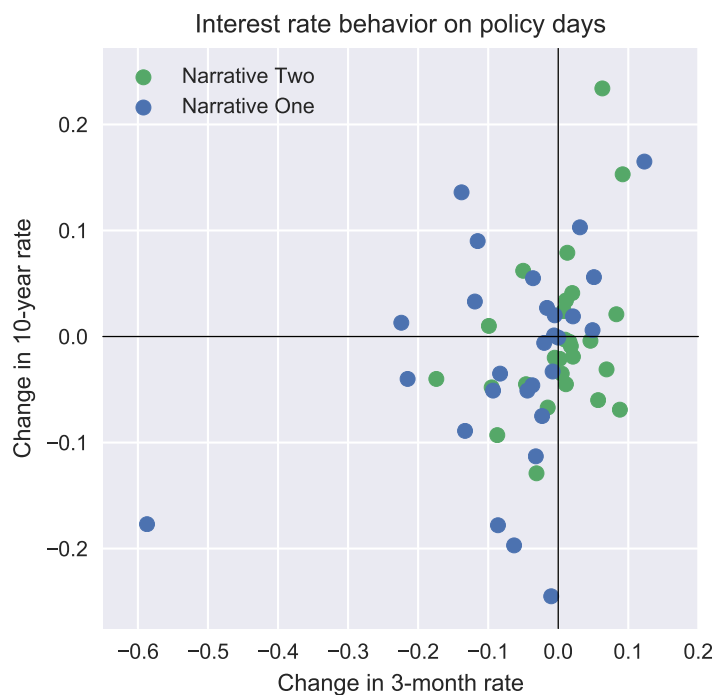


Figure E.5 – Regression coefficients for narrative one and two with $\lambda_B = 0$, applying median as classification threshold.

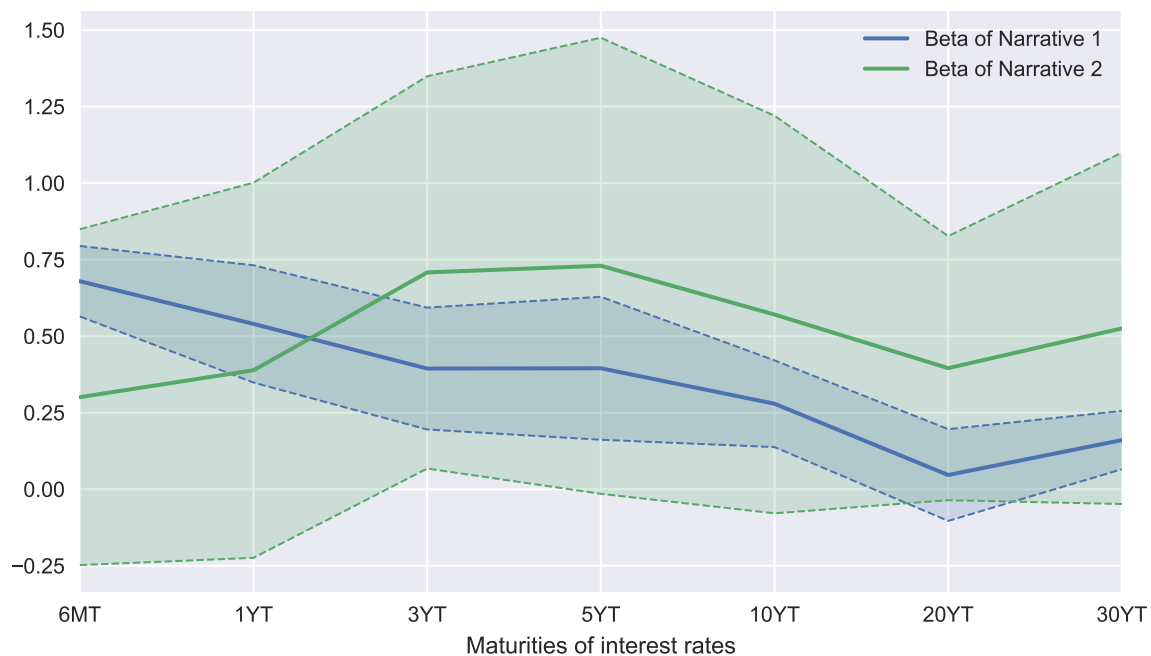
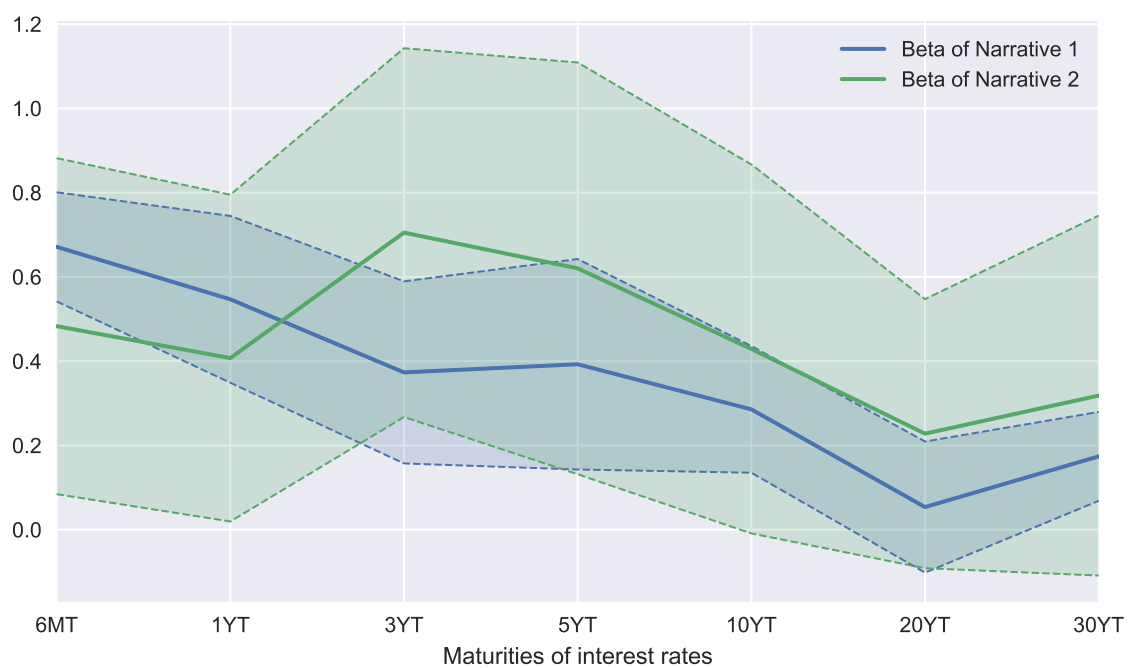


Figure E.6 – Regression coefficients for narrative one and two with $\lambda_B = 0.9$, applying median as classification threshold.



| | 6m | 1y | 3y | 5y | 10y | 20y | 30y |
|-------------------------------|------------------|------------------|------------------|------------------|------------------|------------------|------------------|
| α_n | -0.00 (0.00) | -0.00 (0.00) | -0.00 (0.00) | -0.00 (0.00) | -0.00 (0.00) | -0.00 (0.00) | -0.00 (0.00) |
| β_n^{NP} | 0.36** (0.05) | 0.30** (0.04) | 0.28** (0.04) | 0.25** (0.03) | 0.18** (0.03) | 0.13** (0.02) | 0.12** (0.02) |
| β_n^{N1} | 0.68** (0.06) | 0.54** (0.10) | 0.39** (0.10) | 0.40** (0.12) | 0.28** (0.07) | 0.05 (0.08) | 0.16** (0.05) |
| β_n^{N2} | 0.30 (0.28) | 0.39 (0.31) | 0.71* (0.33) | 0.73 (0.38) | 0.57 (0.33) | 0.40 (0.22) | 0.53 (0.29) |
| R^2 | 0.30 | 0.20 | 0.08 | 0.06 | 0.03 | 0.02 | 0.02 |
| $\beta_n^{N1} = \beta_n^{N2}$ | 0.38 | 0.15 | -0.31 | -0.33 | -0.29 | -0.35 | -0.37 |

**/* indicate significance on the 1% and 5% level, respectively.

Table E.1 – Regression results (classification with $\lambda_B = 0$, median as classification threshold).

| | 6m | 1y | 3y | 5y | 10y | 20y | 30y |
|-------------------------------|------------------|------------------|------------------|------------------|------------------|------------------|------------------|
| α_n | -0.00 (0.00) | -0.00 (0.00) | -0.00 (0.00) | -0.00 (0.00) | -0.00 (0.00) | -0.00 (0.00) | -0.00 (0.00) |
| β_n^{NP} | 0.36** (0.05) | 0.30** (0.04) | 0.28** (0.04) | 0.25** (0.03) | 0.18** (0.03) | 0.13** (0.02) | 0.12** (0.02) |
| β_n^{N1} | 0.67** (0.07) | 0.55** (0.10) | 0.37** (0.11) | 0.39** (0.13) | 0.29** (0.08) | 0.05 (0.08) | 0.17** (0.05) |
| β_n^{N2} | 0.48* (0.20) | 0.41* (0.20) | 0.71** (0.22) | 0.62* (0.25) | 0.43 (0.22) | 0.23 (0.16) | 0.32 (0.22) |
| R^2 | 0.30 | 0.20 | 0.08 | 0.05 | 0.03 | 0.02 | 0.02 |
| $\beta_n^{N1} = \beta_n^{N2}$ | 0.19 | 0.14 | -0.33 | -0.23 | -0.14 | -0.17 | -0.14 |

**/* indicate significance on the 1% and 5% level, respectively.

Table E.2 – Regression results (classification with $\lambda_B = 0.9$, median as classification threshold).

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