Expected Returns and Large Language Models

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1. What are the research questions?

- How to better extract information from financial texts

2. Why are the research questions interesting?

- It shows that LLMs can outperform traditional models in predicting stock returns using news.

3. What is the paper's contribution?

- Existing:
  - Prior papers use bag-of-words methods to forecast returns, volatility, and macroeconomic conditions.
- Expandation:
  - This paper shows the advantages of LLM representations for effectively modeling stock returns.

4. What hypotheses are tested in the paper?

- LLMs can extract financial text information more accurately and comprehensively.

5. Comment on the appropriateness of the sample selection procedures

- The international analysis is overly concentrated on developed markets, with limited coverage of emerging markets, which may undermine the robustness of the findings across global markets.

6. Comment on the appropriateness of variable definition and measurement

- This paper argues that using a three-day return window for sentiment labeling is too long. Such a long window may include noise from unrelated market events. Using high-frequency data, like 15-minute returns, could better capture immediate market reactions.

7. Comment on the appropriateness of the model specification

- This paper's model specifications are parsimonious, focusing on economic intuition rather than complexity.

8. What difficulties arise in drawing inferences from the empirical work?

- The paper's results ignore the impact of macro news on individual stock returns. This may lead to an overestimation of the predictive power of firm-specific news.

9. Describe at least one and feasible extension of this research?

- Construct an investor belief disagreement measure for individual stocks using LLMs and comment data from China's Guba.
- Use LLMs to predict macroeconomic variables, such as macro expectations, inflation, GDP, and systemic risk.
- Use LLM-based sentiment indicators to predict future realized market sentiment.

10. What links exist among these papers?

- All three papers highlight the potential of large language models in extracting and understanding financial text. They suggest that LLMs may become a central tool for information processing and investment decision-making in the future.