

FUNDAMENTALS AIDED STOCK FORECASTING WITH LONG SHORT TERM MEMORY NEURAL NETWORKS

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ABSTRACT

We build a Long Short Term Memory (LSTM) neural network model to evaluate how such a network performs when regressing stock price data and to examine the impact of fundamentals data on the LSTM. LSTM models are often used as predictive models for temporal data due to their ability to retain information about long term pattern in data. There have been some attempts to utilize LSTMs for time series predictions like stock pricing, currency pricing, and stock volatility[1], but it seems that few have examined whether or not financial fundamentals such as balance sheet data can impact their accuracy. The results suggest that the LSTM does not effectively utilize the fundamentals information we provided.

Index Terms— Long Short Term Memory Neural Networks, Stock Forecasting, Recurrent Neural Network, Fundamentals data

1. INTRODUCTION

To analyse the price of stocks, generally one of two methods are employed: technical, or fundamentals analysis. Fundamentals analysis attempts to measure the intrinsic value of a stock by studying quarterly metrics such as a company's assets and liabilities, or macro trends like the performance of a whole sector of the economy. Technical analysis generally does not incorporate these data and instead relies mostly on figures like a security's price and volume traded, typically represented as a time series.

The accuracy of regression techniques to predict future stock prices is paramount in technical analysis because it is used to compute a stock's future value and volatility. The volatility and return potential of a stock relative to another dictates which stock is a better purchase.

LSTM models are a type of recurrent neural networks (RNNs) that can handle temporal data and be used to make time series predictions. LSTM models are of particular interest in the domain of time series prediction because they have the capability to pick up patterns in data spanning over long periods of time and unlike traditional RNNs they do not suffer from the vanishing gradient problem when picking up long term patterns and other temporal models. Neural networks in general have the capacity to pick up complex relationships be-

tween input data, so there is some chance that given the right data the LSTM could pick up difficult-to-spot but significant relationships between fundamentals data and stock prices.

Any overview of stock price prediction would be incomplete without mentioning the Efficient Market Hypothesis (EMH)[2] and its implications on the feasibility of trading systems. EMH (in its strong form) argues that it is impossible to "beat the market" because the stock price is always representative of its fair value. If EMH is correct, it would nullify the point of doing stock analysis at all and suggest that it would be better to purchase index funds.

Another potential problem for the incorporation of fundamentals data in stock price analysis is the risk that stock prices actually have little to do with the intrinsic value of a company. Behavioral economics suggests that investors are subject to cognitive biases when investing in a company. These biases can cause investors to pick growth stocks that are more frequently reported on over companies with good fundamentals. This behaviour inflates the price of "hot stocks" and leaves many companies unnoticed. The effect of human psychology could be good or bad for trading systems depending on if the trading systems are able to pick up on human patterns of undervalues and overvaluing.

2. DATA EXTRACTION

Historical stock price data is not frequently provided minute-by-minute, instead it is provided daily and only includes the opening price of the stock, the closing price, the highest price the stock reached, and the lowest price. This data is readily available online, we used the python backtesting framework 'bt' to obtain it.

The data prior to adding fundamentals was indexed by day and looked like the following:

	Open	High	Low	Close
2011-01-03	181.36	186.00	181.21	184.22
2011-01-04	186.14	187.69	183.77	185.00
2011-01-05	184.10	187.44	184.07	187.41

Table 1. Stock data before adding fundamentals information

Fundamentals data can be difficult to obtain because it

needs scraped off 10-K or 10-Q (yearly or quarterly) reports. All of these reports are available through an FTP server provided by the SEA, written in a standard format known XBRL. An open source tool called ScraXBRL can extract the data from these reports into a tree structure, however tree search algorithms had to be written to extract specific values from the report. Scripts were also required to be written to properly join fundamentals data (which only comes quarterly) with daily stock prices.

Out of the large amount of fundamentals data only "Cash and Cash Equivalents", "Net Assets", and "Net Liabilities" were selected as features for the LSTM. These features were selected because they are some of the simplest indicators of a company's financial success. Common financial ratios such as the P/E ratio would be a logical next step, however we only wanted to examine some of the most bare-bones fundamentals for our analysis.

After the addition of the fundamentals data our input vectors included below features in addition to previously mentioned stock features like this (note the fundamentals data is repeated because the same fundamentals apply for the whole quarter):

	Open	High	Low	Close	Cash	Assets	Liabilities
2011-01-03	181.36	186.00	181.21	184.22	3.77e+09	1.879e+10	1.037e+10
2011-01-04	186.14	187.69	183.77	185.00	3.77e+09	1.879e+10	1.037e+10
2011-01-05	184.10	187.44	184.07	187.41	3.77e+09	1.879e+10	1.037e+10

Table 2. Additional fundamentals data added to input vector

Our goal was to predict the "Close" column of each day using the other pieces of data in the columns. We also decided to include a "previous day close price" feature, which boosted accuracy. It is worth noting that including the the opening price on the same day in the training data would imply that the system would need to be re-run daily to predict new stock closing prices.

To demonstrate the correlation between the closing price and fundamentals data we measured the Pearson correlation between the Cash, Assets, and Liabilities columns and the closing prices for Amazon (ticker AMZN):

Fundamental	Pearson Correlation
Assets	.9411
Liabilities	.9017
Cash	.8562

Table 3. Pearson correlation for stock fundamentals

These were measured using the scipy.stats library. All of the values have strong positive correlations with the closing price, which suggests that the neural network might be able to find some link while utilizing them alongside the opening price data.

3. LINEAR REGRESSION BASELINE

A common approach used when predicting stock market data is to model past data with a series of linear regressions to predict future results. As a baseline to compare our prediction model, we used a linear regression model which trained on past open values versus same-day close values. This model was then used to predict future close values given the same-day open values as well as previous day close values in our datas test set. Below are the results we found:

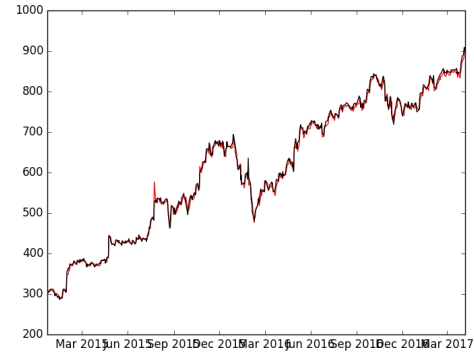


Fig. 1. Result of linear regression using same day open and previous day close values for Amazon (NASDAQ: AMZN)

Results produced by above mentioned linear regression model without using fundamentals data had RMSE of 8.23 on test dataset and 4.08 on training dataset. We also ran tests on a linear regression model that took into account the fundamentals data, training on not only the opening and closing values, but also the cash and cash equivalents at carrying value, assets, and current liabilities.

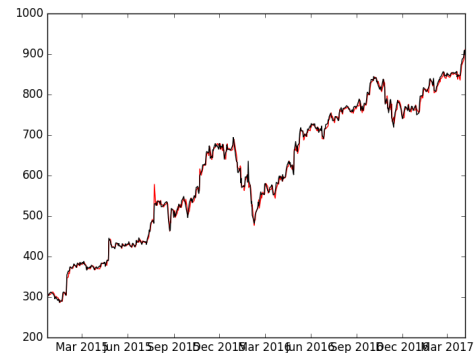


Fig. 2. Result of linear regression using same day open, previous day close values and fundamentals for Amazon (NASDAQ: AMZN)

Results produced by linear regression model while using

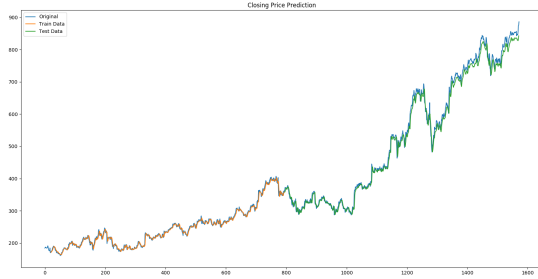


Fig. 5. Amazon(NASDAQ: AMZN) stock price prediction without using fundamentals data

	MSE (test dataset)
Without fundamentals data	12.0814
With fundamentals data	11.4807

Table 4. MSE values found while forecasting with and without fundamentals data included

6.2. Evaluating feature set for predicting closing price after stock splits

Predicting closing price of any stock immediately after its split is another challenge one could face during the process. Most likely the fundamentals data is going to remain same for before and after split dates considering the dates belong to same quarter with a high probability. Availability of features and choice of features used for prediction affect how accurate the prediction will be in this case. For example, Netflix (NASDAQ: NFLX) stock went under 7-for-1 stock split on 15th July 2015. Below table summarizes the effect of feature set selection on price prediction:

Date	Actual price	Prediction (FV + Prev day close) =	Prediction (FV + Prev day close + Same day open)
2015-07-14	702.600006	692.44	708.034
2015-07-15	98.129997	698.5301	355.1507

Table 5. Results for different feature vector configurations (FV = Fundamental data vector) for Netflix stock around day of split

As expected, the available quarterly fundamentals data remain same for both of these dates and don't contribute much towards making the correct prediction. Whereas, other features like same day open price, and previous day close price does affect the prediction which are summarised in table above. As expected, not using same day open price leads to incorrect prediction whereas using helps making a prediction closer to actual price.

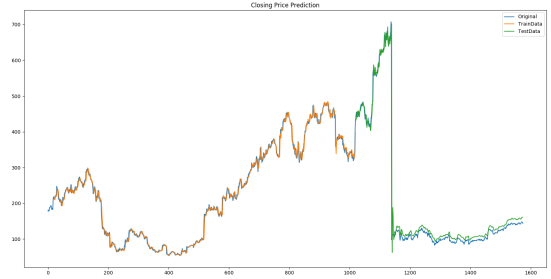


Fig. 6. Netflix(NASDAQ: NFLX) stock price prediction

7. CONCLUSION

LSTM models have paved the way for huge gains in problems with temporal data such as speech recognition, and in the past advances in natural language processing techniques just as Hidden Markov Models have led to better financial predictors. Although our models accuracy was not boosted by the addition of the fundamentals we chose, this does not exclude the possibility of different fundamentals having positive results, nor does it exclude the LSTM from having potential applications in other areas of finance. In future work we would like to explore more of the data in the 10-K and 10-Q reports such as the P/E ratio. We also believe the area of portfolio optimization could see some results from the incorporation of the LSTM.

8. REFERENCES

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