

# Stock Price Indicator

## Project Overview

The Stock Market is a large collection of markets and exchanges where equities of publicly held companies can be traded. Trading in stocks has many benefits, and can be a lucrative income if the market is well understood. Companies are able to gain access to capital by selling off slices of ownership to investors, and the investors have the opportunity to gain income and assets. The Stock Market can also be one of the better predictors in determining the health and direction of an economy. It can help predict if economic and political policies are paying off, whether or not housing prices are going to rise, and influence the size of a nation's workforce (Leads, 2017).

For these reasons, predicting the Stock Market can be very advantageous. The issue is the market is very volatile and influenced by a large number of factors. Many argue that the market cannot be predicted, and in a strong definition that is likely correct. However, the market often does have concrete trends that can be analyzed, and therefore may still be able to be reasonably predicted in short periods of time.

In this project, I am going to combine Machine Learning concepts with a technical analysis of individual stocks from the NYSE or NASDAQ (American Stock Markets) in an attempt to predict their stock prices. I will report the stock predictions over a 14-day period in intervals of 7 days. Ex: 1 day out, 7 days out, 14 days out from the current date. All data sets were obtained from Yahoo Finances (Data Sets, N.d). The final implementation will be in the form of a web application that allows users to select up to 4 stock symbols, and the application will then output the predicted results and analysis of each stock.

My prior knowledge of the Stock Market was minimal, which was also a driving factor in my personal reasoning for taking on this project. Much of my understanding and knowledge of the Stock Market, and how to interpret it through technical analysis came from Udacity's course Machine Learning for Trading (Balch, N.d), Khan Academy's overview of Stocks and Bonds (Stocks and Bonds, N.d), and the book "How to Day Trade for a Living: Tools, Tactics, Money Management, Discipline and Trading Psychology" [4].

## Problem Statement

The goal of this project is to reasonably predict the price of individual stocks in the American Stock Market over a short period of time in the future, 14-days, with the expectation that the 14th day will be less accurate than the 1st. A secondary goal will be to advice an action on those predicted days of either "None", "Sell", or "Buy". The following outlines the steps involved in accomplishing the task:

1. Obtain data sets of 4 individual stocks and the S&P 500 (explained in detail in coming sections) from Yahoo Finances.
2. Process the data to ensure it includes any missing information, and does not include any dates the market was not trading.

3. Analyze each of the stocks individually, compare them against the S&P 500, and determine the best features to utilize in my predictions.
4. Train the data against a few classifiers to determine which delivers the best results.
5. Tweak the results of the classifiers if necessary.
6. Develop a web application that allows a user to select up to four stocks, run the stocks through the classifier, and present them an analysis of the stocks with predictions based on my chosen classifier.

The web application will be intended only for educational purposes, and not to be utilized in actual market trading.

## Metrics

In order to provide metrics for my solution I will be using the coefficient of  $R^2$  (R squared) of the prediction.  $R^2$  is used in models with the purpose of predicting future outcomes. The coefficient  $R^2$  is defined as:

*(1 - u/v), where u is the residual sum of squares, and v is the total sum of squares [7].*

Given all final predictions in my model occur in future dates, the metrics will be calculated by back-testing and scoring how accurately the classifier was able to predict historical dates.

## Analysis

### Data Exploration

During the data exploration phase of the project multiple sets of historical stock data was obtained. The data was downloaded from Yahoo finance in the form of CSV files. The reason for downloading the files in the beginning stages, instead of using the Yahoo API utilized in the final implementation, was to ensure any procedures were reproducible and not affected by stock market factors such as stock splits. The data sets used during this phase are included in the final project files, so any procedures can be reproduced in the future.

There are two main components needed for data exploration to satisfy the problem domain; A date range to gather historical values, and stock indexes that represent a company traded in the American Stock Market (NYSE or NASDAQ) on those dates. To satisfy the former the dates from July 7<sup>th</sup>, 2015 – July 7<sup>th</sup>, 2017 were chosen (At the time July 7<sup>th</sup> was the most recent trading date). This results in 2 years of historical data. To satisfy the latter stock indexes for Google (GOOG), Apple (AAPL), IBM (IBM), Nvidia (NVDA), and the S&P 500 (SPY) were chosen. Google, Apple, IBM, and Nvidia were chosen at random, and four indexes were chosen since that will be the max allowed in the final implementation of the user interface. The S&P 500, however, is a unique stock market index in that it is a weighted representation of around 500 American Stock Market indexes with the nice side effect that any null values in the data set will represent days not traded. By removing these dates, we are left with only dates the stock market was open and trading. This is useful information as it helps determine true null data values in other stocks such as dates it may not have existed, dates when the stock market was

trading but the stock was not, or just missing data. For this reason, the S&P 500 has been chosen as a benchmark index to evaluate all stock data against.

When retrieving data from Yahoo Finances multiple features of the stock are returned. These features include the chosen stocks “Open”, “High”, “Close”, “Adjusted Close”, “Volume”, and are all indexed by the dates traded. The below table is a visual representation from the S&P 500 data.

SPY						
Date	Open	High	Low	Close	Adj Close	Volume
2010-07-15	109.610001	110.059998	108.169998	95.017952	109.680000	232337900
2010-07-16	109.089996	109.209999	106.449997	92.401672	106.660004	282693400
2010-07-19	107.050003	107.629997	106.220001	92.947449	107.290001	186709000
2010-07-20	105.870003	108.559998	105.820000	93.978371	108.480003	258162400
2010-07-21	109.040001	109.070000	106.629997	92.756844	107.070000	264527000

The above data example represents various features of the S&P 500 over a 5-day period. They each have their own significance depending on what is trying to be determined, but ultimately, they mostly describe the price of a given Stock at different portions of the day. In the defined domain problem of this project, our target is the Adjusted Close prices of each day since our ultimate goal is to predict future Adjusted Close prices. Therefore, the other data features will be discarded and not used in our exploration and implementation. This is an interesting problem and divergence from many other data sets used for predictions. After dropping the other data features we are left only with our target values and no features in the given set to learn from. The solution will be to derive new features that are calculated from basic statistics and the previous days Adjusted Close. A few of these new features that will be processed and explored are the Standard Moving Average, Momentum, and the Bollinger Bands ratios. In upcoming sections, there will be discussion on how these features were processed and used, but for now they will only be defined.

**Simple Moving Average (SMA):** The SMA is derived by calculating the mean of the data over intervals. For example, an interval may be every 20 days, and the SMA for a particular day would be represented by the mean calculated from the previous 20 days. This is also referred to as the Rolling Mean. In order to use this as a technical analysis we use the following equation to obtain values around -0.50 to 0.50.

$$Simple\ Moving[day] = (price[day] / price[day - interval] .mean()) - 1$$

**Bollinger Bands (BB):** BB bands are simply the upper and lower bands created when calculating data points two standard deviations above and below the SMA. In order to use this as a technical analysis we use the following equation to obtain values around -1.0 to 1.0.

$$BB[day] = price[day] - sma[day] / 2 * std[day]$$

**Momentum:** Momentum gives directionality to a stock over a given interval. It indicates if the stock has a positive momentum (going up), or a negative momentum (going down). In order to

use this as a technical analysis we use the following equation to obtain values around -0.50 to 0.50.

$$\text{momentum}[\text{day}] = \text{price}[\text{day}] / \text{price}[\text{day} - \text{interval}] - 1$$

Now that we have our feature set the below table gives an example of what it would look like for the S&P 500.

	BB	Momentum	SMA
2015-07-28	-0.305356	-0.006408	-0.025181
2015-07-29	0.053972	0.000760	-0.018476
2015-07-30	0.108938	-0.006971	-0.018243
2015-07-31	0.082941	-0.009319	-0.019733
2015-08-03	-0.045573	-0.013171	-0.023039

Given the high volatility of the Stock Market it was decided it was not necessary to locate or remove outliers. In this situation, what may be seen as an outlier is still valuable information in understanding how a particular stock is behaving and therefore is not truly an outlier.

The below table list the basic statistics of the data sets used. The adjusted closing price has been normalized so each stock is evaluated on a level playing field. This allows for a more accurate representation of how the stocks are behaving compared to each other.

	Mean	Median	Standard Deviation
SPY	1.021891	1.008686	0.072933
NVDA	3.246513	2.654098	1.982375
IBM	0.910470	0.909703	0.078761
GOOG	1.357082	1.347870	0.154974
AAPL	0.927906	0.899809	0.134810

Of these basic statistical measurements, the Standard Deviation holds a lot of value. Higher values indicate the stock is more volatile which could result in less certain predictions. As we can see NVDA has a much larger standard deviation than the other stocks.

## Exploratory Visualization

The following graph (**Fig. 1**) is a visualization of the Rolling Mean and the Bollinger Bands. The visualization is useful to see how they relate to the Adjusted Close values over a given period of time.

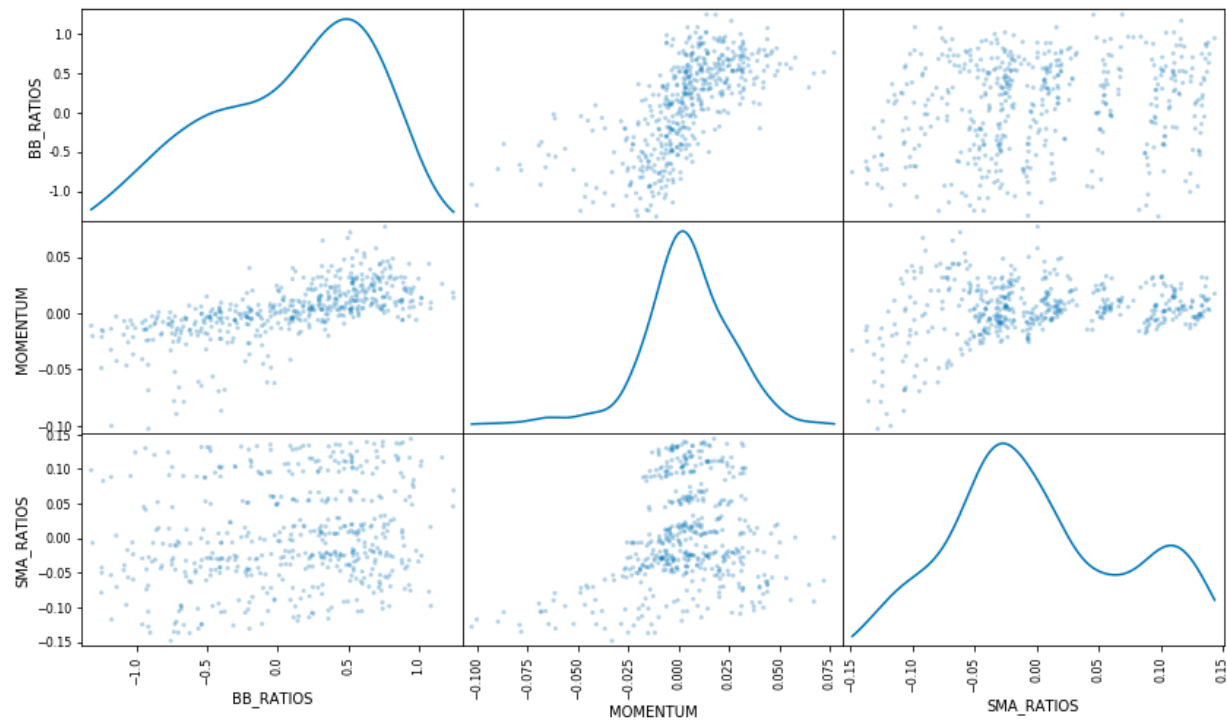
**Fig. 1 - SMA/Bollinger Bands of SPY**



The Bollinger Bands in **Fig 1.** will be how the action for a prediction is chosen. They represent a statistical indicator of 2 standard deviations above or below a day's SMA. An example situation of when a "Sell" action will be predicted, is when the Adjusted Closing value is outside the upper band the day before, and on the current day is between the upper band and the SMA. This indicates the stock may be coming back down after a statistically significant high, and therefore may be time to sell.

The following graph (**Fig.2**) illustrates the correlations between the selected features. If a feature is correlated to another feature it would be visualized in a linear fashion. If two features are highly correlated they may not offer unique enough information to the final model. Based on the visualization it would appear the features are unique enough to be useful.

**Fig. 2 - Feature Correlation Based on SPY**



## Algorithms and Techniques

The problem is a Supervised Learning problem given we are attempting to predict future stock prices based on learning and training from historical data. The continuous nature of the data makes it particularly suitable for regression type algorithms. After evaluating the types of algorithms available I have decided to use an Ordinary Least Squares Linear Regression algorithm, the K-Nearest Neighbor (KNN) Regression algorithm, and a Random Forest Regression algorithm to evaluate which returns the best results. Each of these algorithms are available in the Scikit Learn Python library.

**Linear Regression:** In this model, one technique that will be utilized is to pass the model what is known as a Standard Scalar. The idea of is to bring each of the features passed to the linear regression within the same numerical scale as well as try representing the features as a normal distribution. The goal of the Linear Regression model is to fit a line to the data that can best generalize any trends. The output of the model will be an equation that can then be used to make future predictions.

**K-Nearest Neighbor (KNN) Regression:** The K-Nearest Neighbor Regression is a regression variant of the class based K-Nearest Neighbor algorithm. In this model, the same Standard Scalar technique utilized in the Linear Regression model will be utilized. One of the fundamental differences in this model is the historical data the model is trained on needs to be retained in order to make future predictions, whereas in Linear Regression the historical data is no longer needed once the model equation is obtained. The idea behind this model is it will use a variable amount of the closest historical values, take their average, and use that to make its predictions.

Different variable amounts will be tested to see what number of neighbors return the best results. The weights parameter will also be set to “distance” so that closer query points will have greater influence than those further away.

**Random Forest Regression:** A Random Forest Regression is a model that fits multiple Decision Trees and uses averaging to improve predictive accuracy and control overfitting. In this model, we will not need to use the Standard Scalar used on the previous models because the decision-making process is not affected by features of differing scales. The only parameter that will be tuned is the `n_estimators` parameter which determines the number of trees the model will use.

One technique that will be utilized for all three models is Time Series Splitting for cross-validation. Cross-validation is a useful technique for training and testing a model by utilizing all the available data for testing and training. The goal is to reduce overfitting. However, traditional cross-validation does not preserve data ordering in the process which is important in our problem domain. Time Series Split will preserve the ordering solving this issue.

## Benchmark

I will benchmark stock predictions against the online Stock Forecasting tool found at <https://www.stock-forecasting.com/RealtimeDemo.aspx>. During my research, this was the only free and accessible stock predicating tool that I could locate. The tool attempts to predict a few more variables than my model will and only for the next trading day, but they both will predict closing values and a possible action for a chosen stock such as “Buy”, or “Sell”.

As mentioned earlier a secondary benchmark for the model will be the S&P 500. The S&P 500 is a weighted representation of around 500 American Stock Market indexes and attempts to capture the market as a whole. By using this as a Benchmark we can properly prepare the data for our predictions, and ensure we are not using erroneous values generated from non-trading days. We can also visualize a stocks historical data against the S&P 500 along the way to evaluate how each stock is doing against the market as whole, and we can use it to help determine if our features are appropriate. In the end, we can attempt to predict the S&P 500 along with other stocks and see if it follows a similar trend.

## Methodology

### Data Preprocessing

During the preprocessing stage I began by pulling data for the S&P 500, and used it as a benchmark for finding null values in other stocks. The following steps were taken:

1. Decide on a historical date range to explore. The dates July 7<sup>th</sup>, 2015 – July 7<sup>th</sup>, 2017 where used in the analysis process.
2. Gather data on the S&P 500 based on the chosen dates.
3. Gather data on 4 other stocks based on the chosen dates. GOOG, NVDA, AAPL, and IBM where used during this phase.
4. Drop all data values except for the Adjusted Close values.

5. Drop all dates in all chosen stocks where the S&P 500 is null. These represent dates the stock market was closed.
6. Locate null values in the other stocks and fill in values forward. This means taking the last known value that was not-null, and filling that value forward until you reach the next non-null value.
7. Locate any more null values in the other stocks and fill backwards. If a particular stock has null values at the start of the date range, find the first non-null value and use that value to fill back to the start of the date range.

At this point the data is ready to be explored. There is no need to search for outliers, as all historical data values represent the nature of the stocks.

Now that the data has been pre-processed the next step is to calculate the desired features from the Adjusted Close values. The technical indicators chosen for the purposes of this project were the stocks Momentum, the Bollinger Band values, and Simple Moving Average values. These indicators were talked about more thoroughly in the Data Exploration section.

The features are not on the same scale and so they were scaled using Scikit Learn's Standard Scalar. This was required for the Linear Regression classifier and the KNN classifier.

## Implementation

Once the data was fully processed and features were evaluated I decided to run the data through 3 different types of classifiers to determine which gave the best results. The algorithms chosen were a simple Linear Regression, A KNN Regression, and a Random Forest Regression.

To begin I ran the data and the classifiers through the Scikit Learn Pipeline. A pipeline is a chaining of estimators applying a fixed sequence of steps. It was used to first scale the features before running the code through the classifier. This was used for the Linear Regression classifier as well as the KNN classifier. There was no need to use it for the Random Forest as that particular classifier does not benefit from scaling of data.

A common procedure in training a classifier is cross-validation (CV) with K-folds being one of the more common CV techniques. In K-folds you split the data into  $k$  smaller sets, then use  $k - 1$  folds as training data, validate on the remaining data, and then repeat until all the folds have been used for training and testing. However, this technique does not work in situations where the order of the data is important such as a time series. In order to achieve similar effects, a technique known as a Time Series Split was used. In each split of a Time Series Split CV, the test indices are higher than the previous split preserving order while still maximizing the data used for training and testing.

The CV was set to  $N$  splits, and therefore the data was put through  $N$  sets of training and testing for each algorithm. The  $R^2$  scores for each split was collected and an overall mean score was calculated as the metrics value. The score was calculated for the training sets as well as the testing sets to determine if there was any overfitting.



During the final split, where the training set was the largest, the predicted values and actual values were plotted on a scatter plot and fit with a linear line as a visual metric.

Once the final classifier was decided upon, the final application was built using the Python web development micro framework Flask for the server side code, Angular JS to handle the front-end code presentation, and D3.js for data visualization. During each load of the application, a user selects up to 4 stock symbols to explore, then each stock is trained on the classifier, and the user is presented with the predictions and analysis of each stock.

## **Refinement**

After the first few runs of training the classifiers the results were not as expected. The KNN classifier and the Random Forrest classifier performed very poorly. The Linear Regression classifier, however, had pleasing results. I decided to move forward with the Linear Regression classifier and see if it could be improved upon.

Over all the scores of the Linear Regression were considered acceptable compared to the metrics, so refinement strategies were minimal. The first parameter that was tested was the number of splits in the Time Series Split CV. After multiple trial and error attempts setting the number of splits to 3 had good results while still performing at reasonable speeds.

A few other areas that were tweaked to increase performance did not relate directly to the classifier itself, but how the data was processed, and the calculation of the features. Multiple date ranges were testing to see what was the least amount of data needed to increase speed and still obtain good metric scores. Ultimately, I settled on 1 year of data to be analyzed during the classifier training.

To calculate the features, it was required to use what is referred to in the documentation and project code as a window size. What this represents is how many previous days were used to calculate a particular days Momentum, Bollinger Bands, and SMA values. The window size was adjusted to see if it had an effect on the final results. The final chosen window size was 10 days.

## **Results**

### **Model Evaluation and Validation**

The original intent was to use an Ensemble model that took the average of multiple classifiers. However, after the initial testing it was decided to only use the Linear Regression for the final model. The contents of the following table are the training and testing mean scores for each classifier.

	Training Mean Score for SPY	Testing Mean Score for SPY
KNN Regression	1	-1.95
Linear Regression	0.92	0.93
Random Forest Regression	0.9	-1.6

The values in the previous table illustrate that the KNN classifier and the Random Forest Classifier generalized very poorly to unseen data. The values for the Linear Regression suggest it did well in generalizing to unseen data, and had scores that satisfy the solution.

The model was tested against the four other sets of stock data and similar results were obtained.

As anticipated due to the problem domain, the further out the predictions are made the worse the model does. There is also a tapering effect of further out predictions that cause a distinct visual pattern (**Fig. 3**). I believe this pattern is evidence that predicting the stock market more than a few days out is unreliable. However, I do believe the model can be trusted if approached appropriately. Predicting exact values is highly unlikely, but can give insight as to how the stock may behave a few days into the future.

**Fig. 3 Normalized Adjusted Closing Values of SPY**



## Justification

To visualize the final model's solution against the benchmark, I will compare my model with the stock prices of eBay. I chose eBay specifically because the benchmark forecasting tool found at Stock-Forecasting.com does not offer a wide range of available stocks but both models have eBay as an option, and eBay was at the time unseen data to my model. The values in **Fig. 4** are the predicted values reported by Stock-Forecasting.com, with a next day closing value of 34.88 and a reported accuracy of 99.12%. The reported values from my model has the next day adjusted closing value at 34.82 (**Fig. 5**) and a reported accuracy of 92.07% (**Fig. 6**) for the testing set. A few differences are Stock-Forecasting.com lists the action as a "Buy" strategy and my results list the action as "None". The difference here is most likely explained by a difference in how the action is calculated. Stock-Forecasting.com does not mention the exact mathematical calculations involved in their predictions. Stock-Forecasting.com also does not outline their accuracy methods.

The second part of my benchmark strategy was to compare the eBay stock to the S&P 500. All along the way the eBay data was processed utilizing the trading dates from the S&P 500 ensuring no erroneous values were added in skewing results. As you can also see in **Fig. 7** and **Fig. 8** the prediction trend over the 14 predicted days is similar. While this does not suggest the predicted prices are correct it is another reassurance that nothing went askew in the processing and prediction steps. Ultimately, I consider the final model to be significant enough to be a success.

**Fig. 4 – Stock-Forecasting.com Predictions**

### Predicted Data. EBAY - Next Business Day

Date	Open	Close	Low	High	Vector**	Strategy***
Aug 21, 2017	35.12	34.88	34.75	35.23	▲ +0.20%	Buy
Accuracy, %*	98.95	99.12	99.00	98.93		

**Fig. 5 – Model Predictions for eBay and Spy**




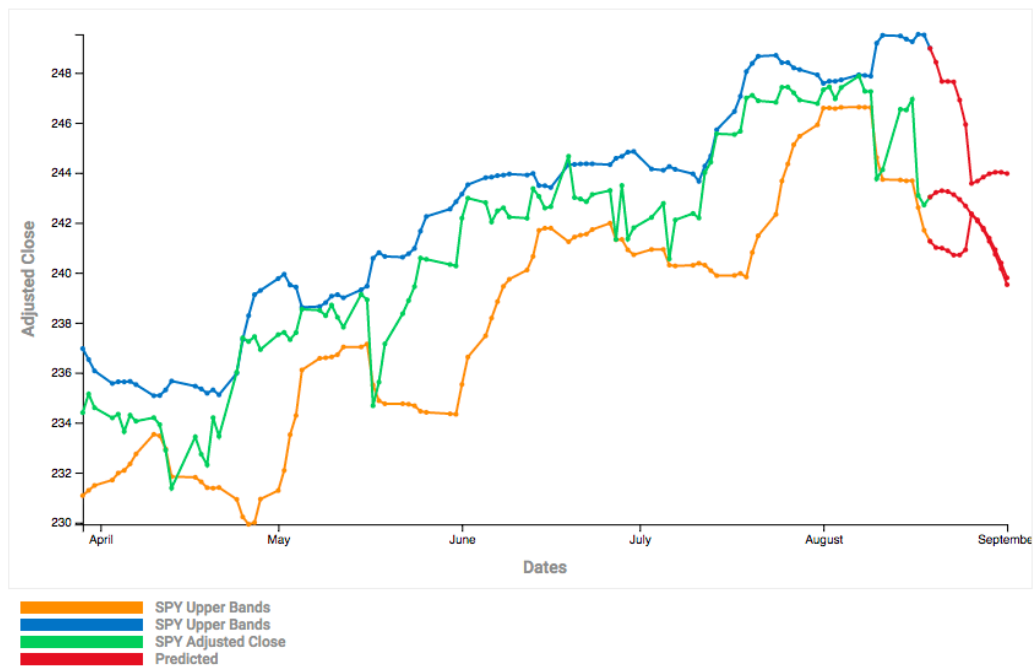
	18-08-2017 1 Day Out	25-08-2017 7 Days Out	31-08-2017 14 Days Out
Prediction Confidence			
SPY	\$243.03 Action: None	\$242.34 Action: None	\$239.79 Action: None
EBAY	\$34.82 Action: None	\$34.56 Action: None	\$34.25 Action: None

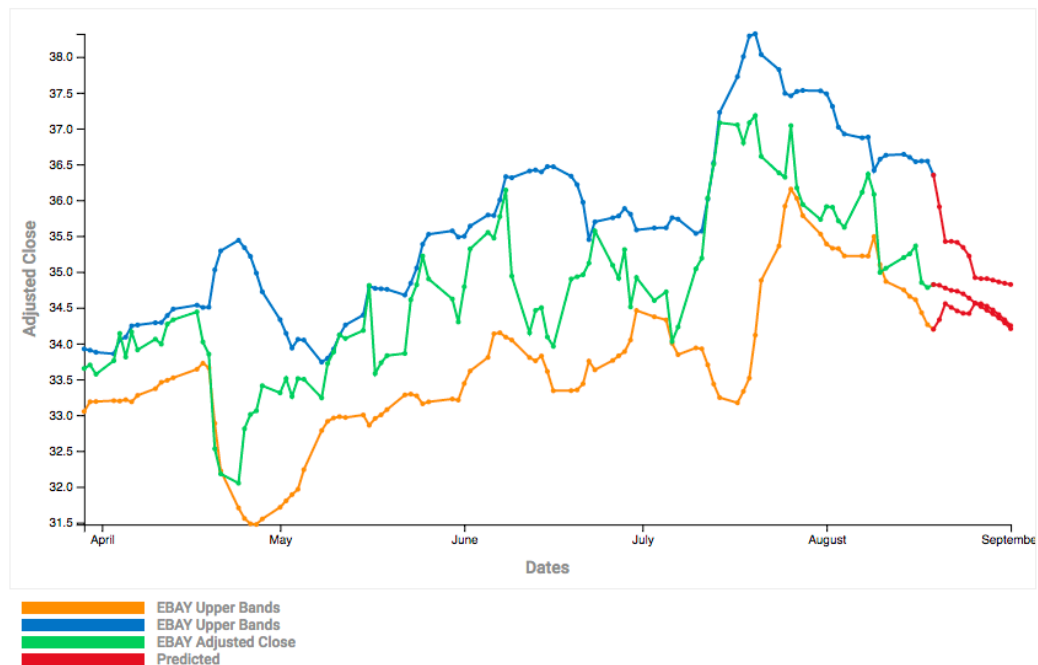
Fig. 6 – Model Metric Scores for eBay and SPY

	Training Score Mean	Testing Score Mean
SPY	%95.07	%95.33
EBAY	%95.14	%92.07

Fig. 7 – SPY Adjusted Close and Bollinger Band Visualizations



**Fig. 8 – eBay Adjusted Close and Bollinger Band Visualizations**

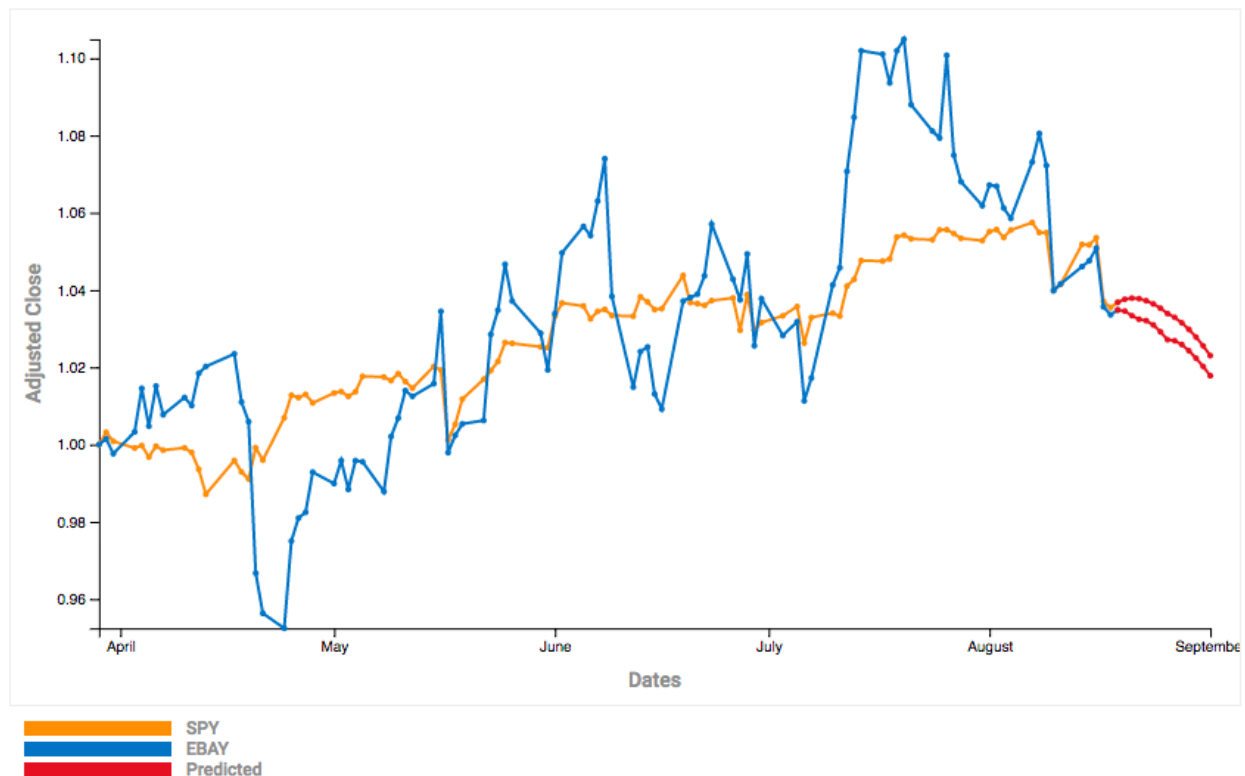


## Conclusion

### Free-Form Visualization

One interesting quality about the problem domain of the project is how dependent a stock prediction is on close previous historical dates and values. Given its continuous nature one can reason why predicting the future of a stock over long periods of time purely from technical analysis is a futile task. In my model that surmounts to only a few days. A stocks motion (rise or fall in value) is only evident in comparison to a defined amount of dates prior. This concept is illustrated by the trend noticed in the predicted values. In the final model, the further out the prediction dates are the prediction values start to see a steady decline. If the stock is in an upward trend prior to the predictions, the predictions will create an arch that rises for a few days before its steady decent. The more significant the upward motion is the more significant the arch will be. This can be seen in **Fig. 9**.

**Fig. 9 – Normalized Adjusted Close of SPY and EBAY**



## Reflection

The final steps in conducting the project where:

1. Define a problem statement
2. Define a metric to score the final solutions accuracy
3. Define a benchmark to evaluate the final solution
4. Locate and process the required data
5. Analyze the data and determine the appropriate features
6. Determine the best classifier appropriate to the data and the features
7. Train and test the classifier with the processed data and features
8. Analyze the results
9. Adjust the classifier if necessary
10. Extend the final solution to a web application that can generalize unseen data from a set of user chosen stocks.

One of the most interesting and troubling portions of the project for me was the nature of the features. Features for a particular day were concocted entirely from the previous days target values. This was a new use case for me and took some time for me to fully understand the idea.

The hardest aspect of the project was understanding the domain. Since features did not come with the data set one could not learn about the domain from the features and the values

themselves. It required understanding the nature of the Stock Market, and that took a lot of research and time.

Ultimately, the final model and solution fits my expectations for the problem. The solution should not be used to make stock predictions on its own, and it was not intended to. It should be considered another tool in a kit to analyze stocks before making a final trading decision.

## **Improvement**

To achieve stronger results future iterations of the solution should consider more features to be utilized. Given my weak understanding of the domain when I began the problem the selected features were what I was able to gather. If I improve on the project in the future I would certainly do more research into the domain.

Ideally more classifiers should also be considered. The chosen classifier works as intended but could possibly be enhanced by more modern techniques or an ensemble of techniques. I have read of successful results obtained from Neural Net Classifiers and would consider looking more into one as a solution.

The final improvement that should be made is to ensure the predicted days are actual trading days. The predictions given were just “days out”, and did not take this into consideration.

## References

Aziz, A. N.d. *How to Day Trade for a Living: Tools, Tactics, Money Management, Discipline and Trading Psychology*. AMS Publishing Group

Balch, T. N.d. Machine Learning for Trading. *Udacity*. Retrieved from <https://www.udacity.com/course/machine-learning-for-trading--ud501>

Data Sets. N.d. *Yahoo Finance*. Retrieved from <https://finance.yahoo.com/>

Leads, P. 2017. Economic Indicators Are Your Secret Weapon. *The Balance*. Retrieved from <https://www.thebalance.com/economic-indicators-are-your-secret-weapon-2637037>

Stocks and Bonds. N.d. *Khan Academy*. Retrieved from <https://www.khanacademy.org/economics-finance-domain/core-finance/stock-and-bonds>