

COMP702 MSC PROJECT

STOCK PRICE PREDICTION

# SPECIFICATION AND DESIGN PROPOSAL

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**Statement of Ethical Compliance:**

This project falls under ethical compliance category A0. All the data used are publicly available, and there will be no involvement of human participants. I confirm that the project will follow the ethical guidelines outlined by the institution.

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### **Project Description:**

Stock price forecasting is the key area in finance. It plays significant role in investment strategies, risk management and economic planning. Accurate stock price forecasts can lead to informed investment decisions, optimised portfolio management, and improved risk mitigation measures. When we look at it clearly, stock price prediction is a time series forecasting problem, with each price point acting as a response to prior market behaviours. But the nature of financial markets is highly dynamic influenced by a wide range of factors such as market sentiment, economic indicators, geopolitical events and firm performance. These complexities make it difficult to drive a stock price prediction and requires sophisticated models capable of detecting linear and nonlinear trends in time series data.

Traditional statistical models such as ARIMA (AutoRegressive Integrated Moving Average) and its seasonal equivalent SARIMA have been widely used in time series forecasting due to their ease of use and effectiveness to model linear combinations. A more modern model called Facebook Prophet expands on these principles and is made to deal more strongly with outliers, seasonal effects, and missing data. However, the complex nonlinear data found in financial data are frequently difficult for these models to represent. On the other hand, deep learning models have shown great promise in solving this problem, especially long-term and short-term memory networks (LSTM), which are part of recurrent neural networks (RNNs). Time series forecasting tasks are a great fit for LSTM networks because of their ability to retain long-term dependencies.

So, for this project I’m using the Sensex dataset to build and compare deep learning approaches (LSTM) and conventional statistical models (ARIMA) to determine which method is more effective for stock price predictions.

### **Why Sensex Data?**

Sensex index also known as S&P BSE Index which consists of thirty reputable and stable company stocks that are listed in the Bombay Stock Exchange of India. This index represents all type of industries, includes technology, finance, healthcare, consumer goods, and energy and it is oldest and widely followed index in India. Historical data of Sensex index is well documented and readily available, and dataset offers diverse sample of stock price changes caused by both local and global economic situations, making it a great choice for this project.

**Aims and Requirements**

**Aims:**

* Develop and implement a traditional statistical time series forecasting model ARIMA for stock price prediction.
* Develop and implement a deep learning-based LSTM model for the same purpose.
* Compare the performance of the two models using various evaluation metrics.
* Analyze the reproducibility of the models across different stocks.

## **Requirements:**

**Essential**:

1. **Data Collection and Preprocessing:**
   * Collect historical stock price data for all the stocks in the Sensex index from the Yahoo Finance by using the Yahoo finance library and before training the model with dataset, preprocess the data to handle missing values and outliers.
2. **Development of Models:**
   * Develop and implement ARIMA model for time series forecasting.
   * Create a deep learning-based LSTM model.
3. **Model Evaluation and Validation:**
   * Generate stock price forecasts for a predefined future period by using both the models.
   * After prediction the results will evaluate the model’s performance by using different metrics like RMSE, MAPE, MAEand compare the accuracy of both models.
4. **Analysis, Documentation and Reporting:**
   * Conduct the through analysis of both the model’s strengths, weakness and real-world compatibility in financial forecasting.
   * Create visualizations comparing forecasted vs. actual stock prices.
   * Document every step of the project right from the data collection to comparison and result.
   * Create a detailed report of the findings including model suitability and reproducibility

**Desirable:**

* Integrate additional features such as sentiment analysis from financial news data to improve forecasting accuracy.
* Create a user-friendly interface to visualize stock price predictions and model performance.

**Key literature and background reading:**  
Stock price forecasting is a popular topic with a large amount of research work and literature present in traditional statistical methods and modern machine learning and deep learning techniques that have proven effective. Understanding the theoretical foundation is important which helps in guide the implementation process.

1. **Traditional Time Series Forecasting:**
   1. Adhikari and Agrawal (2013) provide an in-depth review of ARIMA models in stock market forecasting, highlighting its ability in capturing linear correlations in financial time series.
   2. The statsmodels Python package, which we'll use to create these models, is well-documented by Seabold and Perktold (2010) and provides a solid framework for statistical computation**.**
2. **Deep Learning Models (LSTM-Based RNNs)**
   1. Recently, LSTM networks have shown promise in financial forecasting: Fischer and Krauss (2018) demonstrated that LSTM networks could predict major index stock prices better than traditional methods, such as ARIMA
   2. Bao et al. (2017) researched how well LSTM networks could model highly volatile and non-linear patterns in financial data, outperforming other deep learning models such as Convolutional Neural Networks (CNNs) and standard RNNs.
3. **Evaluation Metrics and Model Comparison**
   1. RMSE, MAPE, and MAE are common metrics that quantify prediction accuracy, particularly when comparing models with various underlying assumptions. Studies by Hyndman and Athanasopoulos (2018) have emphasized the importance of these metrics in assessing model performance, especially when comparing models with different underlying assumptions.
   2. When A. Durgapal and V. Vimal (2021) tested several time series models using a range of measures, they observed that no single model always performed better under all circumstances. This result supports the goal of the project of using several assessment criteria to evaluate ARIMA and LSTM model performance in a comprehensive manner.

**Development and Implementation Summary:**

**Development Environment and Implementation Language:**

* I will implement the project using Python as it is the preferred language for both time series analysis and deep learning tasks due to its extensive libraries and strong community support.

**Libraries for Model Development:**

* **ARIMA**: I will be using the statsmodels library to implement the ARIMA model. This library in the python provides tools for statistical modeling, time series analysis, and forecasting, so it is ideal for developing the ARIMA model.
* **LSTM**: To build and train the LSTM (Long Short-Term Memory) network I will be utilizing the TensorFlow and Keras libraries. These libraries are used in deep learning as they are flexible and support the complex neural network architectures.

**Data Handling and Visualization:**

* **Data Handling**: Libraries like pandas and numpy will be used for data cleaning, manipulation, and transformation which are very essential steps in preparing the data before models are built.
* **Visualization**: Matplotlib library from python will be used to visualise the stock price trends. These libraries provide high-quality plotting capabilities and are effective for displaying time series data.

**Development Environment:**

* I will use Jupyter Notebooks/Google colab for the development process. This environment allows for interactive coding, data visualization, and easy documentation of the workflow.

Implementation plan:

I have a plan to complete this project in phases.

* **Phase 1:** Collect and preprocess historical stock price data and then handling missing values, normalizing data, and final part of this phase is performing exploratory data analysis.
* **Phase 2:** In this phase I will be developing the ARIMA model by testing stationarity, optimizing parameters, fitting the model, and evaluating its performance.
* **Phase 3:** Next phase consists of building and training LSTM model by designing the architecture, preparing data, and evaluating its performance.
* **Phase 4:** Compare and analyse the performance of the ARIMA and LSTM models, focusing on accuracy, efficiency, and robustness, with visualizations of predictions.
* **Phase 5:** Final phase of the project is document the development process, prepare a comprehensive report, and present findings and conclusions.

A diagram of data processing

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Fig: LSTM Model

A diagram of a check station

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Fig: ARIMA Model

**Workflow and Organization**

I’ll follow the Agile workflow with iterative development and regular review checkpoints.

* **Version Control:** Git is being used to manage the codebase of this project, by making the regular commits in GitHub to maintain version control.
* **Task Management:** I’ll use google sheets to manage tasks, deadlines, and project milestones.
* **Progress Reviews:** I’ll connect with the supervisor to review progress, discuss challenges, and plan subsequent tasks whenever necessary.

**Data Sources**

In this project I’m using historical stock price data of Sensex index which I will get by using Yahoo Finance library in Python. The Yahoo Finance library in python provides access to publicly available financial data through its API which allows users to retrieve stock prices, historical data by giving the required parameters. The use of Yahoo Finance data is legal with its terms and conditions and we can use if for non-commercial, research, and educational purposes.

Since the data is publicly available and does not contain any personal information, there are no confidentiality or anonymity concerns. I won’t misuse the data and will ensure that the data is used responsibly and only for the intended purpose of model development, analysis, and evaluation in this project.

**Features to be Used:**

* **Close Price:** The most used forecasting unit is adjusted closing price, which refers to the final closing price of the stock at the end of the trading day after taking into account corporate activities.
* **Volume:** The number of shares traded on a given day that can be used to weigh the market sentiment and trends.
* **High and Low Price:** Throughout the trading day, the highest and lowest price of a stock that provides an indication of volatility and price movement.
* **Moving averages**: Closing prices over several time periods like 10, 50 or 200 days are calculated to create more accurate and general pricing information.
* **Technical Indicators**: Moving Average Convergence Deviation (MACD), the Bollinger Band and the Relative Strength Index (RSI) tools are used to measure market momentum, growth momentum and volatility.

**Testing and Evaluation**

1. **Model Testing:**

* **Unit Testing:** Individual components of the data preprocessing pipeline, ARIMA model, and LSTM model will undergo unit testing to ensure they function correctly. This includes verifying data handling processes, checking model parameter optimization, and validating LSTM architecture setup.
* **Integration Testing:**  Perform integration testing to ensure that different components data preprocessing, model training, prediction and evaluation work seamlessly together. This will verify that the data flows correctly between modules and that the entire pipeline operates as expected without errors or inconsistencies.
* **Performance Testing:** Conduct performance testing to evaluate the computational efficiency and scalability of both the models. This will involve testing models on the datasets of different sizes to assess training time, memory usage and inference speed ensuring they meet the project performance requirements.
* **Cross-Validation:** Apply cross-validation techniques to test the model performance on different subsets of the data. This will help in assessing the good results of the models and avoiding overfitting.

**2. Model Evaluation:**

* The ARIMA and LSTM models will be evaluated using metrics such as RMS, MAE , and MAPE to measure predictive accuracy on the test dataset.
* Compare performance of both the models to a baseline to determine effectiveness of stock price prediction.
* The evaluation will also include visual analysis by plotting predicted values against actual values to visually assess the models' forecasting accuracy.

**Project ethics and human participants**

In this project I’ll use the historical stock price data obtained from the Yahoo Finance Library. It is available publicly and it does not include any personal or sensitive information. There is zero human participation in collecting the information. Though there are no data privacy concerns it is my duty to handle data ethically during and after the project.

1. **Current Use of Project Data:**
   1. **Purpose-Driven Data Use:** Data will use exclusively for processing, analysing and visualizing for research, educational and non-commercial purposes as part of this project.
   2. **Data Security and Storage:** All the data will securely store in a controlled environment and it is secured from the unauthorised access. Data access will be restricted to me and supervisors of this project.
   3. **Transparency and Reproducibility:** All the models, findings and results will be shared transparently by following all the open science principles.
2. **Restrictions of Future Use of Data:**
   1. **Destruction of Data:** After completing the project, the data will be either securely archived for academic purposes or destroyed by following the data retention policies. This ensures that the data is not accessed illegally or repurposed.
   2. **Ethical Reuse of Derived Outputs:** If in case there is any need to reuse the models or findings, it will be done responsibly and ethically and do not promote any high-risk financial activities or misinterpretation of financial forecasts.

**BCS Project Criteria**

The project main focus is to compare the ARIMA and LSTM models for stock price predictions and it aligns with all the six outcomes mentioned in the BCS, the Chartered Institute for IT.

1. **Application of practical and analytical skills:** The project needs all the practical and analytical skills gained throughout this degree program, such as data collection, preprocessing, model building and evaluation. Building models like ARIMA and LSTM shows the deep understanding application of time series analysis and deep learning knowledge. Data manipulation using Python libraries like NumPy, Pandas, data visualization are the skills applied in this project.
2. **Innovation and Creativity:** The unique feature of this project is its comparative approach which applies two different methods to the same problem of Sensex index price estimation: LSTM, a new deep learning method, and ARIMA, a traditional times series forecasting model. This comparison needs a creative approach to find the model performance, which sheds light on which models perform best under different circumstances when it comes to predicting stock prices.
3. **Synthesis of Information, Ideas, and Practices**: To deliver the best results, the project integrates data sets, concepts and techniques from financial analysis, machine learning, and statistics. It combines advanced neural networks with training techniques and time series analysis concepts, such as stationary testing and parameter optimization. Both use different metrics (RMSE, MAE, and MAPE) and visualizations tools which help the project to evaluate different models to better analyse their advantages and disadvantages in predicting stock prices.
4. **Meeting a Real Need in a Wider Context:** Forecasting the future price of a financial stock is a major issue that affects traders, analysts and investors. To find out whether the methods provide accurate and reliable forecasts, the study compares ARIMA and LSTM models with stock price forecasting. This information can help in decision making, risk management and strategical planning. The results can be useful for economists as well as academic studies.
5. **Self-Management of a Significant Piece of Work**: This project requires organizational skills, time management, and personal preparation to oversee multiple steps such as data collection, sampling, analysis, and evaluation The project plan outlines how each step takes place builds on the past. The work plan is carefully planned with deliverables and milestones to ensure continuous improvement and timely completion.
6. **Critical Self-Evaluation of the Process:** Throughout the project I’ll conduct my own critical assessments to determine how well the selected models, methods and techniques are working. Regular notes will be kept reflecting on decisions made, obstacles encountered and how these influenced the outcome of the project. This ongoing self-assessment will help improve the process and assure an outstanding final product.

### **UI/UX Mock-up**

Building and comparing ARIMA and LSTM models for stock price forecasting using Sensex data in a Jupiter Notebook environment in particular the Google Colab is the current major focus of this project. Right now, no plans in building a user interface (UI) or user experience (UX) part specific to project. But if time permits later in the project, I might consider creating a simple UI/UX to display performance metrics, model predictions in an interesting and dynamic manner. An easy-to-use dashboard that allows people to engage with the data, evaluate model outputs, and obtain insights might be offered by this potential UI/UX.

A screenshot of a graph

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**Fig: Dashboard design of stock price prediction**

### **Project plan**

### A screenshot of a computer Description automatically generated

**Notes:**

* **Functional overlap**: Since the ARIMA and LSTM model building phases are independent of each other, they may overlap. That way, both models can be created at the same time.
* **Dependencies**: Basic procedures such as data collection and preprocessing must be completed before the model can be developed. Model construction and tuning must be completed before analysis and documentation can begin.
* **Presentation and topic**: Time allotted for video editing and Q&A sessions will be used for presentation. Once the analysis and presentation are completed, writing of the thesis begins, with additional time allotted for final review and revision.

### **Contingency Plans:**

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| --- | --- | --- | --- |
| Risk | Contingency Plan | Likelihood | Impact |
| Data Source Unavailability | Have alternative data sources (e.g., Google Finance, Quandl) prepared in case Yahoo Finance data is inaccessible. Regularly check for any data access issues and ensure you have backup data sources. | Medium | High |
| Inadequate Data Quality | Perform data cleaning and validation before model training. Have procedures in place to handle missing values or anomalies. Use multiple sources to cross-check data integrity. | Medium | High |
| Model Overfitting or Underfitting | Use cross-validation techniques and parameter tuning to mitigate overfitting or underfitting. Regularly evaluate model performance using validation datasets and adjust complexity as needed. | Medium | High |
| Technical Issues with Software/Tools | Have backup software/tools and ensure compatibility. Keep software updated and access technical support or forums for troubleshooting. Maintain a list of alternative tools. | Low | Medium |
| Performance Metrics Not Meeting Expectations | Revisit and adjust model parameters, consider feature engineering or additional data preprocessing. Implement different metrics if necessary to better assess model performance. | Medium | High |
| Limited Computational Resources | Optimize code for performance and utilize cloud computing resources if needed. Have a plan for scaling up computational resources if the need arises. Consider local vs. cloud-based options. | Medium | Medium |
| Difficulty in Comparing Models | Standardize the evaluation metrics and ensure consistent testing conditions for both models. Document and explain any discrepancies in model performance clearly. | Low | Medium |
| LSTM Model Training Issues | Ensure sufficient training data and perform regular checkpoints during training. If issues arise, review the architecture, adjust hyperparameters, or consult literature for best practices. | Medium | High |
| Scope Creep or Changing Requirements | Keep the project scope well-defined and document any changes through a formal change management process. Regularly review and adjust the project plan as needed. | Medium | Medium |
| Inconsistent Results with Different Stocks | Analyse results thoroughly and consider model adjustments or retraining. Ensure robust validation to assess generalizability. Document findings and limitations transparently. | Medium | Medium |

**Explanation of Columns:**

**Risk**: Potential issues that could impact your project.

**Contingency Plan:** Actions to mitigate or handle the risk.

**Likelihood**: Probability of the risk occurring (low, medium, high).

**Impact**: Potential effect on the project if the risk occurs (low, medium, high).

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