

Summary

While several studies explore the importance of media content in the U.S stock market, it has yet to be shown how news sentiment can affect the implementation of a value strategy. This paper intends to close said gap in the literature. Media tone may reflect new information regarding fundamentals which has yet to be incorporated into prices, pure noise with a fleeting effect on prices or a mixture of the two. As such, it may offer support in identifying turning points. To test this hypothesis, a double classification mechanism is applied to the S&P 500 stock universe from 2003 to 2015. Companies are initially sorted into quintiles based upon quarterly book-to-market (B/M) ratio in order to identify those which are considered to be undervalued. Several papers prefer sorting into deciles. However, these studies consider a far greater number of stocks, oftentimes spanning the entire NYSE universe.} Within this category, a secondary sorting occurs along the dimension of quarter-over-quarter news sentiment. The so-called "Value in the News" strategy invests in the resulting 50 stocks over a period of three months. An analysis of the aforementioned strategy yields several interesting results. In line with traditional measures of risk and return, incorporating media content within the context of a value portfolio generates a significant annual performance of \$10.04% - far beyond that of the S&P 500 composite index or a simple B/M sorting. This is matched by an increase in annualised volatility. The ability of news sentiment to drive returns on a quarterly basis speaks to the presence of relevant information regarding fundamentals and turning point detection. This lends support to the view that media content is comprised of a mixture of both information and noise. Furthermore, the performance of the "Value in the News" strategy remains robust throughout various time periods, including the financial crisis. The tone of media reporting is thus an adept indicator of timing for value companies. These findings remain valid when viewed through one of many alternative frameworks for choices under risk and uncertainty, namely prospect theory. The "Value in the News" strategy therefore provides a lower probability of losses as well as high losses than the benchmark and a pure value strategy.