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Abstract

Trade tensions between China and US have played an important role in swinging global stock markets but effects are difficult to quantify. We develop a novel trade sentiment index (TSI) based on textual analysis and machine learning applied on a big data pool that assesses the positive or negative tone of the Chinese media coverage, and evaluates its capacity to explain the behaviour of 60 global equity markets. We find the TSI to contribute around 10% of model capacity to explain the stock price variability from January 2018 to June 2019 in countries that are more exposed to the China-US value chain. Most of the contribution is given by the tone extracted from social media (9%), while that obtained from traditional media explains only a modest part of stock price variability (1%). No equity market benefits from the China-US trade war, and Asian markets tend to be more negatively affected. In particular, we find that sectors most affected by tariffs such as information technology related ones are particularly sensitive to the tone in trade tension.

JEL Classification: F13, F14, G15, D80, C45, C55

Keywords: Stock returns, Trade, sentiment, Big Data, neural network, Machine Learning

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1 Introduction

Trade tensions between China and US have played an important role in swinging stock markets during 2018-19 (BIS, 2019). However, empirical evidence that evaluates the impact of these trade tensions on equity markets is still scant. This paper contributes to the ongoing debate by using a novel identification approach and introducing a new trade sentiment index (TSI) analysing the tone regarding trade tension in Chinese media and examining its capacity to explain the behaviour of 60 global stock markets.

Our paper contributes to two main strands of literature. The first one is the literature on trade protectionism that has more recently analysed trade war tensions applying an event study approach. These papers analyse the behaviour of the equity market around specific ad-hoc announcements by both the US and Chinese governments of their intentions to raise tariffs over a comprehensive lists of goods imported from each other (Huang et al, 2018; Sun et al, 2019, Ferrari et al, 2020). Differently to this strand of the literature we do not analyse the effects of exogenous shifts due to trade tension episodes but rather we try to quantify the contribution of trade sentiment in explaining equity price movements. To do this, we take a more prolonged horizon and develop a daily available index based on textual analysis of Chinese media over a three-year horizon (2017:04-2019:06), excluding from the analysis the more recent Covid-19 pandemic period.¹

The paper is also related to the strand of literature that analyses the role of investor sentiment in financial markets (Da et al, 2014). We differ in two aspects from previous media news-based studies (Tetlock, 2007), and the more recently developed Economic Policy Uncertainty (EPU) index by Baker et al (2013), which extract the sentiment by counting keywords in traditional media news. First of all, our study uses the positive or negative tone of the media coverage instead of relying only on the frequency of media coverage by counting keywords/articles.²

¹ In 2020 markets were largely driven by sentiment towards the pandemic. See Amstad et al (2020) for example.

² We differ from others who extract the tone by relying on a lexicon based approach by applying a multilayer convolutional neural network (MC-CNN) to construct a trade sentiment index that differentiates between positive (e.g. "trade tension wanes") and negative (e.g. "trade tension intensifies") tone.

This allows us to differ between the impact of e.g. "trade war ends" versus "trade war intensifies", which from a purely frequency based approach by counting the keyword "trade war" would be the same. Additionally, our dataset covers broad types of media outlets including social media outlets and is not limited to traditional newspapers. Specifically, our dataset entails 3.5bn articles from 74'020 media sources. We are able to disentangle the contribution of these different media outlet in explaining equity market dynamic and find the index derived from social media to be significant while the index derived from traditional media is not.

Using the newly constructed TSI, we perform a comprehensive analysis of the impact of trade war tensions on 60 global equity markets. In particular, we show that neither traditional drivers of equity markets – such as changes in the value of the US dollar, oil prices, measures of risk aversion – nor monetary policy measures are able to fully capture the evolution of stock market prices during the trade war period.

We find that China-US trade tensions measured by our TSI has a broad and significant impact on global equity markets. A corresponding frequency-based index that simply counts relevant keywords shows not or much less significant results. This represents a first attempt to show that the use of tone instead than simple frequency of terms could improve upon the analysis of investors' sentiment. Moreover, our paper shows differences between the signals given by the tone of social media versus those obtained by traditional media, whose analysis is currently standard in the literature.

Our results show that in the trade war no equity market wins, but only loses to varying degree. Looking at the effects across jurisdictions, we find that the effects of trade tensions are larger in Asia, especially among the countries playing an important role in the China-US value chain.³ Among firms in the US (China), the equity returns of firms with larger revenue from China (US) are more sensitive to trade sentiment changes. These effects remain also when controlling for geographical distance of the jurisdiction to the country where the sentiment is measured.

The rest of the paper is organised as follows. Section 2 reviews the literature on trade protectionism focusing on the current trade tension

³ This is consistent with Ferrari et al (2020) which use a measure of trade tension based on tweets by US President Trump and find a limited impact on the US equity markets compared to Chinese ones.

between China and US as well as papers that use textual analysis and different types of sentiment indices. Section 3 describes the data and the empirical methodology to uncover positive and negative tone in media news. We also compare our TSI to a simpler frequency based index, as well as to popular economic policy uncertainty indices. In Section 4, we evaluate the impact of our TSI on daily equity returns on 60 equity markets as well as sector and firm level data for China (A-shares Shanghai, Shenzhen) and US. The robustness of the results are checked in several ways: i) the presence of different monetary policy conditions; ii) the existence of possible non-linearities or asymmetries in the response of equity prices to TSI changes; iii) and differences in time zone and trading hours. The last section concludes.

2 Literature review

Our paper contributes to two main strands of literature: the long-standing discussion on trade protectionism including the recent trade tension between China and the US and the literature on the role of sentiment in financial markets, including the new developments in textual analysis.

2.1 Trade protectionism and recent China-US trade war

The long-standing literature on the limit of *trade protectionism* starts with the seminal work of Adam Smith's (1776) who elaborated on the benefits of product specialization and free trade. David Ricardo's (1817) further reinforced these points, focusing on the costs of tariffs in his theory of comparative advantage. Until today, these views are shared among the vast majority of economists,⁴ but not necessarily in the broader public and policy debate (Poole, 2004).

The debate on the effects of trade protectionism revamped more recently during the so-called "trade war" between the US and China. The latter is often seen as starting on March 31, 2017, when the US president signed executive orders for tighter tariff enforcement in anti-subsidy and anti-dumping trade cases. Since then the US

⁴ Indeed, 95% of economists agreed or strongly agreed with the statement "freer trade improves productive efficiency and offers consumers better choices, and in the long run these gains are much larger than any effects on employment" in the IGM economic expert panel conducted on March 13th 2019. See <http://www.igmchicago.org/surveys/free-trade> [accessed in December 2019].

administration imposed higher tariffs in other occasions with China doing the same on US imports.⁵

The macroeconomic impact of the China-US trade war has been already widely analysed (Berthou et al, 2018; Carstens, 2018; IMF, 2019). Overall, a 10-percentage point increase in global tariffs is found to reduce global GDP by around 1% after two years. Indirect effects, caused by a worsening of capital markets, could amplify these effects up to 3%. Macroeconomic effects have been shown to be widespread and not limited to the trade sector. For US consumers and producers, welfare losses take place mainly because of increase in prices of intermediate and final goods (Amiti et al., 2019; Fajgelbaum et al., 2019). There is also evidence that investments diverted from China to other Asian markets, such as Malaysia, Taiwan and Vietnam, altering global value chains (Casselmann, 2019; Nomura, 2019). The analysis of equity markets in the fall of 2019 reveals that equity prices of firms operating in sectors most exposed to trade tensions (such as automobile, metals, technology and telecommunications, and transportation sectors) have suffered more than others (BIS, 2019; IMF, 2019).

2.2 Sentiment indices and textual analysis

Our paper contributes also to the literature on how to measure investor “sentiment” in financial markets, including new developments in textual analysis. The notion of “sentiment” generally refers to an investor’s pessimistic or optimistic belief with respect to a rational arbitrageur (Tetlock, 2007). The literature suggests four different types of indices to measure investors’ sentiment: market-based, survey-based, search-based and news or media-based indices (Baker and Wurgler, 2007).

The first type are *market-based* indices (using eg trading volumes or option-implied volatility; Borochin and Yang, 2017). While these indices are easily observable and readily available, they could be conceptually flawed, being the equilibrium outcome between demand and supply, rather than reflecting changes in behaviour on the demand side.

⁵ For detailed and regularly updated timelines of key events see eg Reuters (<https://www.reuters.com/article/us-usa-trade-china-timeline/timeline-key-dates-in-the-us-china-trade-war-idUSKBN1WP23B>) or ChinaBriefing (<https://www.china-briefing.com/news/the-us-china-trade-war-a-timeline/>).

The second type of indices are *survey-based* (eg consumer/investor confidence indices; Lemmon and Portniaguina, 2006).⁶ These measures could be able to disentangle supply and demand but lack the daily frequency needed for stock market analysis. Moreover, one potential disadvantage is the well-documented “survey bias”, caused by the fact that survey answers might be different from actual behaviour, particularly for survey topics perceived as delicate.

The third type are *search-based indices* that provide a possible solution to the disadvantages of the two measures discussed above, by leveraging on the availability of new analytical tools like Google Trends.⁷ These indices reveal the attitude directly as the search has no intermediary between the consumer or investor. A widely popular indicator of this type is the Financial and Economic Attitude Revealed by Search (FEARS) index (Da et al, 2014), which aggregates the frequency of internet search queries of terms such as “recession”, “bankruptcy” and “unemployment” from millions of U.S. households. FEARS is shown, for daily data between 2004 and 2011, to predict short-term equity return reversals,⁸ temporary increases in volatility, and mutual fund flows out of equity funds into bond, funds. One limitation of these measure is that they cannot measure directly the tone. For example, “unemployment reduction” is counted in the same way as “unemployment increase”.

The fourth types are *news or media -based sentiment indices* exploring keywords in newspapers. While the analysis of how news influence stock prices is not novel,⁹ the construction of these indices have become more popular in the recent years because of the increased accessibility and computation of unstructured big data pools. A relevant example is Tetlock (2007) that measures the interactions between the media and the stock market using daily content from the popular Wall Street Journal column “Abreast of the Market”. In

⁶ Examples are Michigan Consumer Sentiment index, AAll Sentiment Survey Report of US Investor sentiment by the American Association of Individual Investors or UBS/Gallup Index of Investor optimism.

⁷ Google Trends makes, for a given search term, the Search Volume Index (SVI) publicly available. SVI represents the history of the volume scaled by the time-series maximum (<http://www.google.com/trends/>).

⁸ FEARS index is correlated with low returns today but predicts high returns tomorrow, a reversal pattern consistent with sentiment induced temporary mispricing.

⁹ The capital market literature has focused on how stock price returns react to news and no-news either of specific companies (Chan, 2003; Vega, 2006) or to macroeconomic news (Birz et al, 2011).

particular, he finds that high media pessimism predicts downward pressure on market prices followed by a reversion to fundamentals.

These types of indices have been also used to evaluate the effect of uncertainty on stock price returns.¹⁰ In particular, Baker et al. (2013) initiated (and regularly update) a suite of economic policy uncertainty (EPU) indices. The first one is based on queries on US newspapers and later on they extended such measure for a range of countries. They are all based on frequency of keywords, traditional print media and available on a monthly basis. For China, three EPU versions exist: (a) China-EPU^e, based on English keywords in the South China Morning Post (Baker et al, 2013); (b) China-EPU^c, based on Chinese keywords in Chinese in the Renmin Daily and the Guangming Daily; (c) the Trade Policy Uncertainty index (TPU) that runs from January 2000 to present (for keywords see Table 1).¹¹ Li et al (2016) find that the association of EPU and stock returns for China (and India) is quite weak.

So far, news-based indices have been focusing on the frequency (also referred as “counts” or “volumes”) of specific keywords. A disadvantage of this approach is that a simple count does not qualify the tone (positive or negative) associated with the keyword. Classification procedures that try to extract the tone have been so far mainly lexical based, where pre-defined positive or negative lists of keywords are needed to extract the tone from a text. This proved not only to be time-consuming but also to be quite inflexible because the context in which the list is used may differ. Further, in many papers news outlets were limited to traditional print media, neglecting other sources which gained in volume and accessibility, like the web, forums (also called microblogs) and other social media.

The trade sentiment index we use in this paper, as will be explained more in detail in the next section, tries to overcome both limitations. We explore the tone instead of a pure frequency of keywords using deep learning techniques¹² and our analysis disentangles the

¹⁰ Pástor and Veronesi (2013) show in a theoretical model that political uncertainty determines a risk premium, makes stocks more volatile and more correlated, especially when the economy is weak. Ozogus (2009) investigates empirically the dynamics of investors' beliefs and Bayesian uncertainty and finds a negative relationship between the level of uncertainty and asset valuations.

¹¹ China-EPU^c starts in October 1949, TPU in January 2000 and both measures are regularly updated (Davis et al, 2019).

¹² Deep learning techniques allow the identification of patterns or the representation of data by means of artificial neural networks. The learning can be supervised, semi-supervised or unsupervised. In this research, we use supervised deep learning for tone analysis.

information gained from social media versus traditional media such as newspapers.

3 Trade sentiment index (TSI)

This section describes the construction of our trade sentiment index (TSI). We discuss in turn the characteristics of the database, the keywords used and the methodology to extract the tone. As a control, we also construct a trade count index (TCI) that simply counts the same keywords as done in the traditional approach. The comparison of the results obtained using the TSI versus those obtained using the TCI will help us to shed some light on the existence of a bias, if any.

3.1 Data base characteristics and keywords

The statistical population to construct our TSI is the publicly available text in all Chinese media, independent of the country or media outlet where the text is published. Our broader approach in terms of Chinese media coverage represents a significant novelty because all currently available indices are calculated on the base of a few traditional print media (such as newspapers) or a single social media source (e.g. Weibo or Twitter). Further, we aim for a measure that is available on a daily basis since the start of the China-US trade tension in 2017 and could be potentially updated on a regular basis.

We use Wisers data, a comprehensive and one of the world's largest Chinese media database.¹³ The raw data set used in this paper consists of approximately 3.5 bn articles from a broad spectrum of 74,020 media sources over 2.5 year's span between 1 January 2017 and 30 June 2019, equivalent to about 3 million articles per day.

A broad spectrum of media outlets is covered. The left-hand panel of Graph 1 presents the data set by publication type. "Traditional media" from 4,040 newspapers (such as People's Daily, China Daily, South China Morning Post, and Hong Kong Economic Times) and magazines (such as China Newsweek, iMoney, and Wealth Magazine) account for only 2.6% of the database. "Social media" outlets splits into three subclasses: (a) "Web" covering media articles from websites such

¹³ The Wisers full data base consists of approximately 85 billion articles from 570'000 media sources, with a daily new volume of around 96 million articles; it does not include sources as books, papers, maps, posters and slides.

as AASTOCKS.com, Chinese World Net, and Finance Asia alike account for the largest part with around 50% of the data set.¹⁴ (b) "WeChat" covering publicly available posts on social APPs represent around 20% of the articles and (c) "Forum" covering posts on discussion boards and other microblogs such as Baidu Tieba account for slightly less than 28%.

Our database is not only broad in terms of media outlet but also in terms of topics. Only 6,694 or 9% of the total sources directly focus on finance and economics (such as Hong Kong Economic Journal, Investment Knowledge, Cmoney). The right-hand panel of Graph 1 shows the data set by region, where 92% of the articles are originated from publishers in Greater China including 72% from Mainland China and 9% from Hong Kong and 11% from Taiwan. Among other countries, 4% of data are from the USA, while the residual 4% comes from 81 other countries of the rest of the world (Pakistan, India, UAE and UK sources account for half, around 2%).

To cover different levels of severity in textual expressions about trade war, we carefully selected a number of *keywords* in both Chinese (simplified and traditional characters) and English (singular and plural forms) that are to be used for retrieving trade-war-relevant articles from the raw database. Table 2 shows the keywords in simplified and traditional Chinese and its English translation.

3.2 Methodology

3.2.1 Tone Analysis

Existing sentiment indices are mostly lexicon based. Those indices are based on pure frequency (or counts) of subject-matter keywords (e.g. "trade war") sometimes additionally combined with keywords reflecting the tone (eg "intensify", "end", etc). However, this methodology entails the disadvantage that sentences such as "the trade war intensifies" versus "the trade war is unlikely to intensify" or "the trade war will end soon" versus "the trade war sees no signs of ending any time soon" are interpreted as the same, while their underlying tone and therefore expected impact on financial markets are completely opposite. An example of this lexicon based approach is Bollen et al (2011) who identifies the sentiment in stock prices by counting how often sentiment keywords such as "calm" or "happy" appear in tweets.

¹⁴ The web category includes also eCommerce websites such as Taobao and JD.com. In our sample, the social media Xiaohongshu was not yet available for the years 2017 and 2018.

A newer class of sentiment analysis uses deep learning techniques to uncover the “tone” or technically speaking the sentiment polarity (eg positive, negative or neutral) expressed in a text. In order to evaluate the sentiment in the sense of positive or negative tone, we use a standard text classification approach, the *Convolutional Neural Network (CNN)* approach in the form of a multi-channel model. This method allows to capture the semantic context¹⁵ in which the word has been used to decide in which category the text belongs, instead of using a predefined library. CNNs belong to the broader class of Neural Networks developed since the early 1950s and further refined by LeCun et al (1989, 1998). CNNs initially were used in image classification tasks such as object detection and face recognition, but have since been applied to text classification (Kim, 2014; Santos et al, 2014; Zhang et al, 2015)¹⁶ that tags an article with a pre-defined class label, e.g. *spam vs no spam* for spam detection and *positive vs neutral vs negative* for sentiment analysis. More recently, CNNs for text classification have been further popularised via *fastText* (Joulin et al 2016) a software developed by Facebook's AI Research lab.

Compared to standard text analysis we face an additional challenge due to specific differences between the Chinese and English language. Specifically, Chinese knows no alphabet nor word delimiters but instead has three types of representations as word, as character, or as pinyin (phonetic romanization). In the methodology, all three representations are considered, which technically involves the application of a three-channel-CNN - one channel per representation. Such a technique is known as *Multi-Channel Convolutional Neural Network (MCCNN)*. See Appendix A for a discussion of key equations of a MCCNN.¹⁷

¹⁵ An intuitive way to describe deep learning methods in the semantic context is to see them as imitating what the human brain does with a sentence like the following: “Yuo abilty to exaimne hgiher-lveel fteaures is waht aollws yuo to unedrtsand waht is hpapening in tihs snetecne wthiout too mcuh trouble”.

¹⁶ The main advantage of CNNs versus other text classification methods is their superior performance in extracting effective local features from a sequence of text; and CNNs outperform other neural networks such as Recurrent Neural Networks (RNNs) in several sentiment analysis tasks. RNNs are computationally much more demanding than CNNs particularly when processing large-scale datasets (Kim, 2014; Zhang et al 2015).

¹⁷ Liu et al (2018) of Wisers AI Lab illustrate that in the case of Chinese language MCCNNs are at least as effective or even outperform (single channel) CNNs as implemented by fastText.

3.2.2 The construction of the indices

We construct TCI and TSI indices by searching our data set described in 3.1 for the keywords in Table 2.

In order to control and rationalise the outcome of the neural network sentiment output, we start with the calculation of a simple count of the previously defined keywords and articles. The TCI is simply defined as the sum of all articles with at least one keyword in an article (see equation (1)) or the sum of all keywords (see equation (2)).

$$TCI_t^{article} = \sum_{t,i=1}^{A_t} \text{Sign}(\text{article}_i \text{ consists of at least 1 keyword at time } t) \quad (1)$$

$$\text{with } \text{sign}(x) = \begin{cases} 1, & x \text{ is True} \\ 0, & x \text{ is False} \end{cases} \text{ and } A_t \text{ being all articles}$$

where $TCI_t^{article}$ is the series of t daily counts of all article consisting of at least one of the predefined keywords.

Similarly, $TCI_t^{keyword}$ is the series of t daily counts of all keyword occurrences. For example, if the keyword "trade war" appears 3 times in an article and the keyword "trade tension" appears 5 times in another article, the total count of these two keywords would be 8. Mathematically,

$$TCI_t^{keyword} = \sum_{t,i=1}^{A_t} \text{count}(\text{occurrence of all keywords in article}_i \text{ at time } t) \quad (2)$$

In order to uncover the "tone" instead of the simple frequency, we apply the MCCNN on each article x_i that entails at least one of the predefined keywords and obtain an estimate for the sentiment *polarity* $p(x_i)$ as well as the corresponding sentiment score $s(x_i)$, with

$$p(x_i) = \begin{cases} 1 & x_i \text{ is positive} \\ 0 & x_i \text{ is neutral} \\ -1 & x_i \text{ is negative} \end{cases} \quad (3a)$$

and

$$s(x_i) = \text{probability of the sentiment polarity of } x_i \text{ being } p(x_i) \quad (4a)$$

Following this approach, we can construct two *trade war* sentiment indices that are based on articles. $TSI_t^{polarity}$ as the t daily sums of the

sentiment *polarities* over all articles $i = 1, \dots, A_t$ consisting of at least one of the keywords:

$$TSI_t^{polarity} = \sum_{t,i=1}^{A_t} p(x_{i,t}), \quad (3b)$$

TSI_t^{score} as the t daily sums of the sentiment *scores* over all articles $i = 1, \dots, A_t$ consisting of at least one of the keywords:

$$TSI_t^{score} = \sum_{t,i=1}^{A_t} s(x_{i,t}), \quad (4b)$$

During periods when trade tensions were foremost against the background of a negative sentiment – such as during most of 2018 versus towards mid of 2019 – we expect the TSI and TCI to be highly correlated. It is worth mentioning that results for (1) and (2) on one hand and (3a,b) and (4a,b) on the other hand are very similar. Table 3 shows indeed that the correlation between the two indices is very high, and proximate to 1. From here on, we will therefore use only $TSI_t^{polarity}$ and $TCI_t^{article}$ (equations (3a,b) and (1)) and refer to them as TSI and TCI, respectively.

3.3 Trade tone indices and the trend tension timeline

TSI and TCI are shown separately in Graph 2. For ease of comparison and given the mostly negative tone particularly throughout 2018 TCI representing the number of counts is multiplied by -1.

Differences between the TSI and TCI are evident matching local highs and lows with major events in the China-US trade war timeline. A list of major events in the China-US trade war is presented graphically in Graph 3. Given the low keyword counts in 2017 we focus from 2018 until mid-2019.

The first trough in TSI and TCI coincides with the US president signing a memo to file a WTO case on March 22 and USA imposing tariffs of 25% on steel and 10% on Aluminium. On May 20 US Treasury Secretary Mnuchin announces the end of the trade war, which translates in low TCI while the TSI increases, entering into the positive territory. TSI swings back to negative territory to reach three lows that coincide with lows in the TCI on (1) June 15, when Trump threatens to further increase tariffs if China retaliates, (2) June 18, when the US identifies \$200bn for add tariffs at 10% and (3) on July 6, when tax on different products for approximately \$34bn worth of import from China begins. As a follow up to the announcement of additional US tariffs on \$200 bn Chinese products imported, on September 17th and on 18th

China announces retaliation. This shows as a local trough in the TCI. TSI also remains negative, however does not show a visible trough. On Dec 2, 2018 the US and China agree to temporary truce. Again, TSI and TCI both clearly identify the date but go in opposite direction: the TCI drops while the TSI increases. This is an example that shows the superiority of the TSI index with respect to the TCI index.

Different from 2018, most of the first half of 2019 has seen less events which can be clearly identified as negative or positive news and if so, the conflicting news followed each other in a brief window and therefore were overlapping. Consequently, TSI and TCI move within a limited range without reaching visible peaks or troughs. Among the few clearly identifiable events are May 13 when the US increased tariffs from 10 percent to 25 percent. Showing as trough in TSI and TCI. Meanwhile, in late May the U.S tariffs on \$200 billion began to be effective and on June 1 China increased tariffs on US\$60 billion worth of products. Both events show as troughs in the inverse TCI, while they are indicated more positively in the TSI, possibly reflecting expectations of more pronounced tariffs. At the end of June, trade tension eased with Trump's tweet on agreeing to talk at G20 meetings. TSI prints slightly positive while the inverse TCI reaches a moderate local trough. We conclude that major events in the China-US trade war timeline are both confirmed in the evolution of TSI and the simpler measurement of TCI. Despite the similar behaviour of the two indices, the correlation is, however, not perfect. Table 3 indicates that the correlation between TSI and TCI is -0.75. Overall, this illustrates the potential need to differentiate news in the tone and confirms the possibility that the TSI is more closely connected to the China-US trade war timeline.

It is also interesting to see if the TSI and the TCI behave similarly to the Trade Policy Uncertainty (TPU) index developed by Davis et al (2019). The comparison is shown graphically in Graph 4, while Table 3 reports simple correlations. While, the TSI shows a similar dynamic with the TPU index in some parts of the sample, the correlation is only -0.13 over the full sample, which is mostly driven by observations in 2019 when the trade tension somewhat eases. The difference can be ascribed to three factors: i) the different methodology based on sentiment; ii) the number of sources (larger for the TSI with respect to the TPU); iii) the type of sources (mostly social media for TSI versus exclusively print media for TPU). However, the methodology seems to greatly contribute to the different behaviour. Indeed the TCI based on pure keyword frequencies but sharing the difference ii) and iii) with the TPU, has a correlation with of 0.55 with the TPU.

4 Market responses to the TSI

After constructing the trade sentiment index, our first goal is to evaluate whether and by how much the TSI correlates with global equity markets.¹⁸ We evaluate the impact on daily equity returns at a sectorial level as well as at the firm level for the US and China. Then, we run robustness tests for nonlinearity and asymmetry and extend the analysis to Hong Kong equities. Finally, we disentangle the impact from sentiment entailed in social media from sentiment in traditional media. In each case we employ the model, that regresses t daily log returns for i market, sector or firm on TSI controlling for changes in oil prices, the dollar index and a measure of risk aversion.¹⁹

4.1 Impact of the TSI on equity prices at the country level

The baseline model for each country i is given by:

$$\Delta(\log(Equity Price_{it})) = \alpha_i + \beta_i' \begin{pmatrix} \Delta(\log(Oil_t)) \\ \Delta(\log(Dollar_t)) \\ \Delta(\log(VIX))_t \\ \Delta TSI_{i,t} \end{pmatrix} + \varepsilon_{i,t} \quad (5)$$

where the dependent variable is the log change of equity market prices at time t ($\Delta(\log(Equity Price_{it}))$). The explanatory variables include: (i) the change in the logarithm of oil prices ($\Delta(\log(Oil_t))$), which is measured as Brent crude oil prices; (ii) the change in the logarithm of the trade-weighted US dollar index ($\Delta(\log(Dollar_t))$);²⁰ (iii) the log change in the market volatility index VIX ($\Delta(\log(VIX_t))$), which measures the implied volatility of options on the Standard and Poor's 500 stock index; (iv) the country-specific TSI to reflect the attitude (or concern) of investors about withstanding the trade war shock.

¹⁸ A different approach not taken here would be to study exogenous shifts in trade sentiment index by running an event study as is done in Huang et al (2018).

¹⁹ ADF test for $\log(Equity Price_{it})$, $\log(Oil_t)$ and TSI indicate that the series have a unit root and therefore we include them in the model in first differences. The $\log(VIX)$ is borderline stationary and therefore for precaution we also used the first difference of the $\log(VIX)$ in our baseline specification. However, results are largely robust using the $\log(VIX)$ in level (see below).

²⁰ We include in the model the change in the trade-weighted US dollar index, which captures US dollar shortages – particularly relevant in several emerging market economies (Bruno and Shin (2015); Avdjiev, Eren and McGuire (2020)). It is worth noting that all the variables are expressed in local currency and therefore isolated from other possible feedback loops on returns by shifts in exchange rates.

Regression results for the model including all countries are reported in the first column of Table 4. We use a mean group estimator that allows us to synthesise the results of country-specific estimates. When using all 60 markets, including those without strong trade relations with the US, the changes in the TSI index have not a significant effect on equity price dynamic. The R^2 of the model is 27.4% and the change in TSI contributes for only 1.4% of equity price variability that is around 5% of the overall variability explained by the model.

The lack of significance in the average coefficient for TSI is probably due to the fact that not all the countries analysed in our study have strong trade links with US and China and this is reflected in the mean group estimator for TSI. It is therefore interesting to analyse the impact of the TSI on each domestic equity market by means of the country coefficients of regression (5). Graph 5 reports the estimated change in stock prices in each country from a one standard deviation decrease in the TSI index. This represents the case of a deterioration in the trade sentiment.

The impact of TSI is statistically significant in more than half of the stock markets we study.²¹ This is consistent with the idea that a worsening in sentiment ($\Delta TSI_t \downarrow$) triggers a significant selloff in equity markets for those countries with trade linkages with US and China.

Asian equity markets are particularly exposed. As our TSI represents the tone in Chinese media it is not a surprise that Chinese equity markets are most affected. A one standard deviation deterioration on in the trade sentiment index leads to a drop in Shanghai equity prices by 0.4%. The next eight more affected equity markets are all in the Asian-Pacific region (Hong Kong, Japan, Taiwan, Korea, Indonesia, Vietnam, Singapore and Australia).²² More specifically our results confirm and expand the 22-March-2018-event-study-based findings by Sun et al. (2019) for Japan that documents that the impact of the

²¹ The ranking of countries broadly holds when frequency (TCI) instead of tone (TSI) is used. However, the frequency-based TCI is significant only for the Asian countries and about a fifth of the covered markets (see Graph B1 in Appendix B).

²² Interestingly, this list includes also countries that industry reports indicated initially as potentially benefiting from a shift in manufacturing and value chains (Nomura, 2019): Vietnam and Taiwan (for their electric devices for phones, and parts for office and automatic data-processing machines), Malaysia (due to semiconductors and natural gas) and Hong Kong (due to its role in gold markets). This report also points out that China as the material supplier to most of these named beneficiaries might not necessarily been hurt by those shifts. Similar results are found in Casselman (2019) that indicates that Chinese investments diverted to other south-east Asian countries.

trade war has been felt beyond the two countries that were directly involved.²³

Major European markets such as Switzerland, Germany, France and UK follow at position 22, 24, 26, and 33 respectively. The deterioration in US market is marginally significant and only about one sixth of the magnitude of the Chinese impact (position 34 of 50 markets). In no country the effect reverts to indicate a significantly positive effect on the equity market.²⁴ This first set of results indicate that a worsening of trade tone produces no winners, only losers to varying degree.

4.1.1 The role of global value chains

In an event study using a three-day window around 22 March 2018, Huang et al (2018) show that whether a firm will win or lose during China-US trade war depends on the extent of its participation in the global value chains shared by the two countries.²⁵

Looking into the drivers behind the country ranking in Graph 5 we can notice that the individual country's sensitivity is significantly related to an economy *role in the China-US value chain*. The latter can be measured as the value for added to China exports to final demands in the US (provided by OECD²⁶) as a percentage of GDP. As reported in the left hand panel of Graph 6, the more important a country role is in the China-US value chain the more sensitive its stock market returns

²³ Japan is one of the most important trading partners of US and China. Sun et al (2019) show using quarterly sales data and stock market returns, that the operations in China of Japanese multinational corporations have been negatively affected by the trade war, especially when Chinese affiliates rely heavily on trade with North America. This has led to a reduction in their stock prices.

²⁴ Equity markets in Argentina, Russia, Estonia, Malta, and Brazil react positively but these effects are insignificant at conventional level.

²⁵ Huang et al (2018) show that in the 3-day window centred around the event date, a 10 percentage points increase in a firm's share of sales to China is associated with a 0.8% lower average cumulative returns, while firms that directly offshore inputs from China have a 0.8% lower average cumulative return than those that do not. In addition, the authors document that firms that are more exposed to trade experienced higher default risks gauged by the growth rate in implied CDS spread over the same 3-day window.

²⁶ See: https://stats.oecd.org/Index.aspx?DataSetCode=TIVA_2018_C4#. "Gross exports by origin of value added and final destination, presented here, is derived from the latest version of the OECD's Inter-Country Input-Output (ICIO) Database and provides estimates of gross exports by industry *i* in country *c*, broken down by the value added originating from source country/region *s* and, according to the final demand destination country/region *p*. The indicator *FD_EXGR_VA* presents gross exports of final and intermediate products by industry *i* in country *c*, broken down by both the source country/region *s* origin of value added and, according to final demand destination country/region *p*."

react to a deterioration in the TSI. This negative relationship holds for almost all markets. Hong Kong and Japan show a higher sensitivity and Taiwan a slightly lower sensitivity than average. Similar results are found in Sun et al (2019).

These findings are confirmed when individual countries' equity market sensitivities to the TSI are related to *trading relationship* with China (see right panel of Graph 6),²⁷ but not to trading relationship with US (not reported). The more a country imports from and export to China the more its equity market reacts negatively to a deterioration of the TSI index. Looking at the correlation between the TSI effect on equity and *import plus export* with China as a share of a country GDP, the stock markets of Japan, Korea and Hong Kong show a higher sensitivity while Vietnam's equity market seems more resilient. Moreover, the results reported in Graph 6 are also robust against the inclusion in the model of measures of geographical distance from China (See Table B2).

Column (2) of Table 4 reports the regression results of equation (5) estimated only for those countries that are more exposed in the China-US value chain (those with a global value chain indicator above the median). In this case the TSI index have a strong and significant effect on equity price dynamic. The change in TSI contributes for 2.6% of the R^2 that is around 10% of the equity price variability explained by the model. By contrast, the results obtained using the TCI (see the second column of Table B1 in the Appendix B) indicate a lower contribution, less than 5%.

4.1.2 Robustness checks

We checked the robustness of the results in a number of ways.

First, we included in the regression the log of the VIX rather than its first log difference (see column (3) of Table 4). The VIX is indeed borderline stationary and some models include this variable in level rather than in changes. The results remains very similar but we observe a reduction in the R^2 of the model.

Second, we considered a model that also includes the change in the money market rate to control for different monetary policy stances over time (test conducted for 16 of our 30 countries). The results are qualitatively very similar (see column (4) of Table 4).

²⁷ HK is removed from trading relationship with China regressions as an outlier.

Third, we tested for the possible existence of non-linear effects in the response of equity prices to TSI changes. In particular, we test whether the impact is different for very negative trade tension developments than for other news. We included in the model a dummy that takes the value of 1 for episodes in which TSI is above 25 percentile and zero elsewhere. Results reported in the column (5) of Table 4 do not indicate significant non-linear effects among the countries.

Fourth, we test whether the effect of TSI on equity prices is asymmetric in case of positive and negative changes in the tone. In particular, we included in the model a dummy variable that takes the value of 1 in case $\Delta(\text{TSI}) > 0$ and zero elsewhere. The results indicated no significant asymmetric effects between positive and negative changes in the TSI (see column (6) in Table 4).

Fifth, we find our results to be robust to market differences in time zone and trading hours.²⁸ When regressing equation (5) with two day cumulative returns between t-2 and t instead of t-1 versus t the before mentioned results still hold but the R^2 drops to 13.7% (see column (7) in Table 4).

4.2 Impact of the TSI on equity prices at the sectoral and firm level

After assessing the impact of the TSI on domestic equity markets, we explore its impact at the sectoral and at the firm level in China (A-share²⁹ in Shanghai, Shenzhen) and the US.

This test is particularly useful to insulate the effects of the trade tensions because the tariffs typically target specific sectors and trading partners. The US motivates tariffs with concerns of market-distorting government interventions and policies by trading partners such as technology transfer, subsidies to state-owned enterprises, or even concerns regarding national security interests. For these reasons, industry reports often expect that the areas of intellectual property,

²⁸ For countries like US, news in China at time t would impact US equities at time t-1 given the 12/13 hr difference.

²⁹ A-share stocks are denominated in Chinese Yuan Renminbi and issued to domestic investors (and qualified foreign institutional investors). The other type is B-share stocks that are quoted in HK dollars or US and issued to offshore investors. The B-share market accounts for below 0.3% of the entire A-share market.

technology transfer, agriculture, financial services should be more affected than others (JPMorgan, 2019).³⁰

Similarly, to the analysis conducted at the country level, we find no winners: all sectors tend to be negatively affected by the trade tensions, but to a different degree.

4.2.1 China

Greater China's equity market is composed of three approximately equally sized stock exchanges: Shanghai (SSE), Shenzhen (SZSE) and Hong Kong (HKEX). All together, these three equity markets reach a size similar to that of Japan and second only to the US equity markets.

The two mainland equity markets (SSE and SZSE) are quite specialised: Shanghai focuses on big state-owned firms, while Shenzhen includes more smaller and younger firms. Liquidity in both markets has greatly improved over past decades, with remarkably high turnover rates (SSE 160%, SZSE 264%) that exceed the ones of the US markets (NYSE 60%, Nasdaq 116%).

Using the coefficient estimated from equation (5) at the sectorial level, Graph 7 reports the effects of a one standard deviation drop of the TSI on equity prices in mainland China markets. In both SSE and SZSE, all sectoral equity price evaluations drop following a deterioration of the TSI, with the exception of agriculture. Results are similar using the TCI, but the effects are quantitatively smaller, probably reflecting a reduced precision of the index (see Graph B2 in Appendix B).

Despite the differences in types of listed firms in SSE and SZSE markets, IT related sector are most responsive to a deterioration of the trade sentiment. In *Shanghai* telecommunication services and IT stand out. Those are broadly the sectors most affected by tariffs and this result is in line with industry reports cited earlier. By contrast, utilities and financials are the most resilient sectors. In *Shenzhen*, smaller and younger firms seem overall more sensitive to trade tensions. Here conglomerates, IT and R&D are the most sensitive sectors, with real

³⁰ The report specifically points out that: (a) home appliances (vacuums, air conditioners, refrigerators, furniture, water heaters, etc.) are an important part in the \$200bn basket of goods facing additional tariffs since Sep 2018; (b) consumer electronics (such as smartphone and laptops) and particularly the Apple supply chain is largely affected; (c) property sector, airlines, and some consumer sector suffer under a less stable Chinese Yuan Renminbi and possible depreciation due to tariffs.

estate, financials, media and before mentioned agriculture the least sensitive sectors.

Interestingly, when looking into the drivers behind these sectoral findings we find that Chinese firms in Shanghai with larger revenue from the US are more exposed to our trade sentiment index. Using information provided by Refinitiv, in Graph 8 we show that Chinese firms with larger revenue from US are those that are more exposed to a deterioration of the TSI.

As a final step of the sectorial analysis for China, we also consider the impact of the TSI on HKEX. As reported in Graph 9, the effect on firms quoted on the Hong Kong market are similar to those for mainland China. Most sectors are significantly affected with Software & services, mainland properties and Internet & IT the most affected. Meanwhile, Real Investment Estate Trusts (REIT) is the HK sector less affected by a deterioration in TSI.

4.2.2 United States

For the US we consider the New York Stock Exchange (NYSE) and National Association of Securities Dealers Automated Quotation (NASDAQ). Market capitalization is the largest in the world with USD 22 trillions for the NYSE and USD 10 trillions for the NASDAQ. These equity markets are widely considered the most liquid in the world.

Using also in this case the coefficients estimated from equation (5) at the sectorial level, Graph 11 shows that US equities react by less than Chinese equities to a (one standard deviation) drop in trade sentiment in Chinese media. This result could reflect at least in part the fact that our TSI index is constructed using Chinese media. The US sectors that lose the most after a worsening of TSI are financials, IT, consumption discretionary³¹ and industrials. Meanwhile, equity prices in the other sectors do not react significantly to a deterioration of the TSI. Interestingly, IT emerges as one of the most sensitive affected US sector, as some big tech firms located in the US were at the center of the trade tensions. Overall, the pattern that those sectors hit the most by tariffs are most sensitive to tone is also confirmed in the US market.

Also in this case, we find heterogeneous effects among firms with different sources of revenue. Using information provided by Refinitiv,

³¹ Consumption discretionary are defined as businesses that tend to be the most sensitive to economic cycles, including hotels, restaurants, and other leisure facilities, media production and service, and consumer retailing and services.

the US firms with larger revenue from China are those that are more exposed to a deterioration of the Chinese trade sentiment (Graph 12).

4.3 Disentangling TSI effects: traditional media vs social media

So far we have documented that the TSI explains a substantial part of equity variability, especially for those countries and sectors that are most exposed to the China-US value chain. This section explores the difference between a TSI based on articles published in social media and a TSI based on articles published in traditional media. While others have analysed sentiment based on social media³² we are - to our knowledge - the first to compare the impact on equity prices disentangling the sentiment derived from social media from that derived from traditional media in the context of the trade war.

In order to construct the TSI-social media and the TSI-traditional media, we apply the same methodology described in section 3.2 to two different databases: one for social-media, constructed with information from Web, WeChat and Forum, and another one for traditional-media only. We report graphically the two new indexes in the left hand panel of Graph 12. The correlation between the two indexes is not so high and equal to 50 per cent (see Table 3).

In Table 5 we rerun equation 5 and reproduce the different columns for sensitivity analysis replacing TSI with TSI-social-media and TSI-traditional-media. Interestingly, in all specifications, TSI-social-media is always significant while TSI-traditional-media is not. Specifically, TSI-social media contribution to the overall equity variability is very similar to that of TSI, while the contribution of TSI-traditional media is very limited. All other results remain the same.

The country level analysis also confirms the results from the aggregate analysis. TSI-social-media is significant for roughly the same third of the markets as TSI composite (Graph 13). Meanwhile TSI-traditional-media is not significant or barely significant for most of the countries (Graph 14). Results are robust to including TSI-social-media and TSI-traditional-media separately instead of jointly in the specifications of Table 5.

³² Studies have evaluated the impact on equity markets using sentiment indexes derived from Twitter (Bollen et al (2011)), Yahoo! Finance (Antweiler and Frank (2004), Kim and Kim (2014)) or from postings to the investment website SeekingAlpha.com (Chen et al (2014)).

The right-hand panel of Graph 12 reports the TCI-social media and the TCI-traditional media. In this case the correlation between these two indexes is 0.83, indicating that when simply counting the frequency of specific keywords, the differences between the information derived from social media and traditional media could be more limited. However, running equation 5 replacing TCI with TCI-social-media and TCI-traditional-media, the greater contribution of the first index in explaining equity variability is confirmed (see Table B3 in Appendix B).

5 Conclusions

Trade tensions between China and US have played an important role in swinging equity markets in the last years. This paper contributes to the ongoing debate by constructing a trade sentiment index (TSI) using textual analysis in Chinese and examining how this index explains the behaviour of 60 global financial markets. With the help of machine learning techniques we explore the tone (positive vs negative) rather relying only on the frequency of specific keywords. Further, we employ a big data approach that covers a broad set of media outlets and allows us to disentangle the impact from articles published in social media versus those in traditional media.

We contribute to the literature in three ways. First, by showing that the China-US trade war affects capital markets globally and that no market wins from a worsening sentiment due to an intensification of the trade war. Those markets with a more important link to the China-US value chains lose the most. Consequently, Asian markets are most exposed and show the highest sensitivity to the TSI. At the firm level, we find that firms in the US (China) with larger revenue from China (US) are more sensitive to trade sentiment changes. In particular, we find that sectors most affected by tariffs such as information technology related sectors are particularly sensitive to tone in trade tension. Taken together, our results are broadly consistent with theories of investor sentiment.

Second, we show that a sentiment index that represents the positive or negative tone (TSI) explains better equity market variability than an index that simply counts the frequency of specific keywords (TCI). Overall the TSI contributes 10% of the model capacity to explain equity price variability, while the TCI contributes only 5%. This result is consistent with the weak correlation found by Li et al (2020) between equity returns and the policy uncertainty index, which is also a simple frequency indicator based on traditional media outlets.

Third, we show that TSI using social media (web, forum, WeChat) contributes about 9% of the explained model variability, while a TSI based on traditional media only contributes 1%. This result suggests caution when using – as it is quite standard in the current literature - sentiment indices based only on traditional media.

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Terms sets for trade policy uncertainty (TPU) in China

Table 1

Category	English terms	In Chinese characters
Uncertainty	Uncertain/uncertainty/not certain/unsure/not sure/hard to tell/unpredictable/unknown	不确定/不明确/不明朗/未明/难料/难以预计/难以估计/难以预测/难以预料/未知
Economic	Economy/business	经济/商业
Trade Policy	Import tariffs/import duty/import barrier/WTO/world trade organization/trade treaty/trade agreement/trade policy/trade act/Doha round/Uruguay round/GATT/General agreement on Tariffs and Trade/dumping/protectionism/trade barrier/export subsidies	进口关税/进口税/进口壁垒/WTO/世界贸易组织/世贸组织/贸易条约/贸易协定/贸易政策/贸易法/多哈回合/乌拉圭回合/GATT/关贸总协定/倾销/保护主义/贸易壁垒/出口补贴

Sources: Davis et al (2019).

Keywords used for TSI and TCI construction

Table 2

Simplified Chinese	Traditional Chinese	English – singular (plural)
贸易战	貿易戰	trade war
贸易摩擦	貿易摩擦	trade friction(s)
贸易争端	貿易爭端	trade conflict(s)
贸易关系紧张	貿易關係緊張	trade tension(s)
贸易环境	貿易環境	trade environment
贸易条件	貿易條件	trade condition(s)
贸易情绪	貿易情緒	trade sentiment(s)

Source: Authors' representation

Correlation between trade indexes

Table 3

	Coefficient
Corr (TSI polarity, TSI score)	0.99
Corr (TCI article, TCI keywords)	0.96
Corr (TCI, TSI)	-0.75
Corr (TPU, TCI)	0.55
Corr (TPU, TSI)	-0.13
Corr (TSI social media, TSI traditional media)	0.50
Corr (TCI social media, TCI traditional media)	0.83
Corr (TSI social media, TCI social media)	-0.78
Corr (TSI traditional media, TCI traditional media)	-0.08

All correlations are based on a sample 2017 to mid-2019, except for TCI (article, keywords) which is based on 2017 to end of 2018 due to the computer intensive calculation of TCI keywords.

Source: Authors' calculation.

Regression results using TSI

Table 4

	All countries	Baseline regression (countries exposed in GVC)	Controlling for the level of VIX instead of its change	Controlling for the policy rate	Testing non-linear effect in TSI	Testing asymmetric effect for positive TSI changes	Using return between t-2 and t
	(1)	(2)	(3)	(4)	(5)	(6)	(7)
$\Delta(\text{TSI})$	0.086 (0.055)	0.130*** (0.058)	0.129** (0.058)	0.119*** (0.061)	0.140** (0.070)	0.196*** (0.077)	0.193** (0.087)
$\Delta\text{Log}(\text{Oil Price})^1$	0.044 (0.031)	0.043 (0.030)	0.043 (0.031)	0.036 (0.031)	0.042 (0.030)	0.039 (0.030)	0.060 (0.046)
$\Delta\text{Log}(\text{Trade-weighted US dollar index})^2$	-1.388*** (0.227)	-1.259*** (0.201)	-1.422*** (0.199)	-1.365*** (0.205)	-1.261*** (0.200)	-1.280*** (0.199)	-1.265*** (0.302)
$\Delta\text{log}(\text{VIX}) (\%)$	-0.020*** (0.007)	-0.020*** (0.007)		-0.023*** (0.006)	-0.020*** (0.007)	-0.020*** (0.007)	-0.013* (0.008)
VIX			-0.026** (0.013)				
Δ Policy rate (bp)				0.012 (0.016)			
1(TSI above 25 percentile)					-0.026 (0.116)		
1(ΔTSI larger than zero)						-0.154 (0.126)	
Number of countries	60	30	30	16	30	30	30
R ²	27.4%	26.2%	23.5%	27.7%	26.5%	26.7%	13.7%
TSI R ² contribution	1.4%	2.6%	2.4%	2.4%	2.7%	3.0%	1.9%

Notes: Mean group estimator. Average coefficients across country specifications. The first column includes results for all 60 countries. Columns (2) to (7) include results only for countries more exposed in China-US value chain. These are defined as those with a global value chain indicator above the median. See Graph 5 for details and the list of countries. ¹ Brent crude oil price. ² Trade-weighted US dollar index: broad, goods and services. Significance level: *p<0.1; ** p<0.05; *** p<0.01.

Disentangling the effects of TSI social media and TSI traditional media

Table 5

	All countries	Baseline regression (countries exposed in GVC)	Controlling for the level of VIX instead of its change	Controlling for the policy rate	Testing non-linear effect in TSI	Testing asymmetric effect for positive TSI changes	Using return between t-2 and t
	(1)	(2)	(3)	(4)	(5)	(6)	(7)
$\Delta(\text{TSI-social-media})$	0.084 (0.057)	0.129** (0.061)	0.127** (0.061)	0.117* (0.064)	0.143* (0.080)	0.203** (0.080)	0.171** (0.084)
$\Delta(\text{TSI-traditional-media})$	0.009 (0.051)	0.005 (0.052)	0.007 (0.054)	0.009 (0.055)	-0.030 (0.082)	-0.037 (0.077)	0.087 (0.076)
$\Delta\text{Log}(\text{Oil Price})^1$	0.044 (0.032)	0.042 (0.030)	0.043 (0.031)	0.035 (0.031)	0.043 (0.030)	0.039 (0.030)	0.059 (0.046)
$\Delta\text{Log}(\text{Trade-weighted US dollar index})^2$	-1.389*** (0.227)	-1.259*** (0.201)	-1.423*** (0.199)	-1.366*** (0.205)	-1.255*** (0.201)	-1.280*** (0.199)	-1.276*** (0.301)
$\Delta\text{log}(\text{VIX})$ (%)	-0.020*** (0.007)	-0.020*** (0.007)		-0.023*** (0.006)	-0.020*** (0.007)	-0.020*** (0.007)	-0.013 (0.009)
VIX			-0.026** (0.013)				
Δ Policy rate (bp)				0.011 (0.017)			
1(TSI social above 25 percentile)					-0.038 (0.121)		
1(TSI traditional above 25 percentile)					0.054 (0.097)		
1($\Delta\text{TSI social}$ larger than zero)						-0.177 (0.124)	
1($\Delta\text{TSI traditional}$ larger than zero)						0.092 (0.115)	
Number of countries	60	30	30	16	30	30	30
R ²	27.5%	26.4%	23.7%	27.8%	26.9%	27.2%	14.1%
TSI social R ² contribution	1.3%	2.4%	2.3%	2.3%	2.6%	3%	1.4%
TSI traditional R ² contribution	0.2%	0.2%	0.2%	0.1%	0.4%	0.4%	0.5%

Notes: Mean group estimator. Average coefficients across country specifications. ¹ Brent crude oil price. ² Trade-weighted US dollar index: broad, goods and services. Significance level: *p<0.1; ** p<0.05; *** p<0.01.

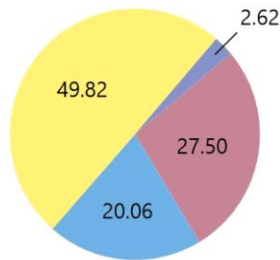
TSI social-media is constructed with information from Web, WeChat and Forum, while the TSI traditional media is obtained from newspapers (such as People's Daily, China Daily, South China Morning Post, and Hong Kong Economic Times) and magazines (such as China Newsweek, iMoney, and Wealth Magazine). Baseline regression includes only countries more exposed in China-US value chain defined as those with a global value chain indicator above the median. See Graph 5 for the list of countries.

Data set characteristics for the construction of the trade tone indices

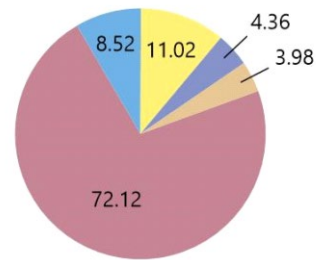
In per cent

Graph 1

Data set by publication type



Data set by countries



Social media: Web Forum WeChat HK CN Others US TW
 Traditional media

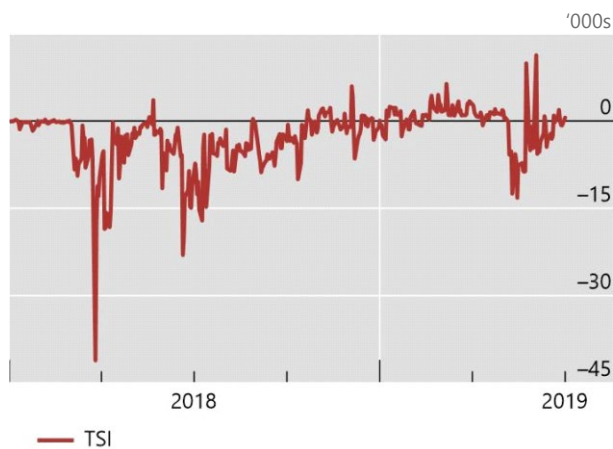
Note: Left panel: *News* includes classic media sources such as (People's Daily, China Daily, South China Morning Post, and Hong Kong Economic Times). *Social Media* posts cover publicly available post in WeChat and Weibo and other microblogs. *Forum* covers posts on discussion boards and blogs such as Baidu Tieba; *Web* includes websites such as AASTOCKS.com, *Others* include magazines such as China Newsweek, iMoney, and Wealth Magazine. Right panel: Others include 81 countries of the Rest of the world within Pakistan, India, UAE and UK sources account for 50%. TSI uses the full data set. TSI-social-media is based on the subdatasets web, WeChat and Forum only. TSI-traditional-media is based traditional media government and non-government.

Sources: Authors' calculation.

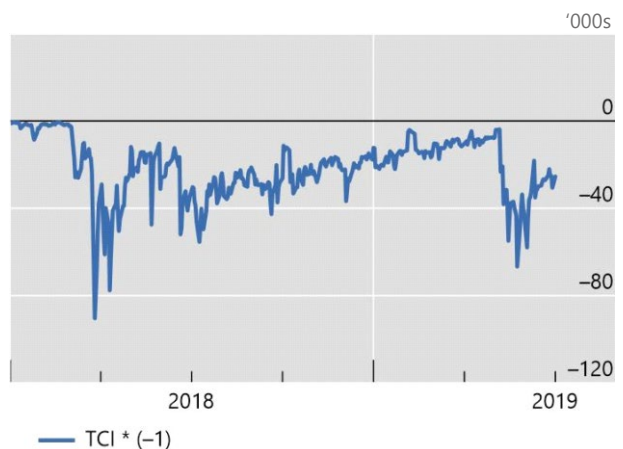
Trade sentiment index (TSI) and trade count index (TCI)

Graph 2

TSI



TCI*(-1)



Note: TCI and TSI are defined in equation (1) and equations (3a,b) respectively.

Source: Authors' calculation.

Time line of major events in China US trade tension¹

Index

Graph 3



The dots indicate 25 Jan 2018, 23 Mar 2018, 21 May 2018, 19 Jun 2018, 6 Jul 2018, 19 Sep 2018, 3 Dec 2018, 14 May 2019 and 23 May 2019 and 1 Jun 2019.

The major events in the China US trade tension are: 20 May 2018 (Mnuchin announced the end of the trade war), 22 Mar 2018 (Trump signs memo on file WTO case), 23 Mar 2018 (USA impose 25% steel, 10% aluminium tax), 2 Apr 2018 (China: #128 products, 15%-25%), 15 Jun 2018 (Trump threatens increases if CN retaliates), 18 Jun 2018 (Identified \$200 billions for add tariffs at 10%), 6 Jul 2018 (tax on \$34 billions begins), 17 Sep 2018 (US tariffs on \$200 billions), 18 Sep 2018 (China announces retaliation), 2 Dec 2018 (US and China agree to temporary truce), 13 May 2019 (US increases tariff from 10% to 25%), late May 2019 (US tariffs on \$200 billions begin), 1 Jun 2019 (China increases tariffs on \$60 billions worth of products; Announced meeting Mnuchin & PBoC) and mid Jun 2019 (calls and G20 meeting)

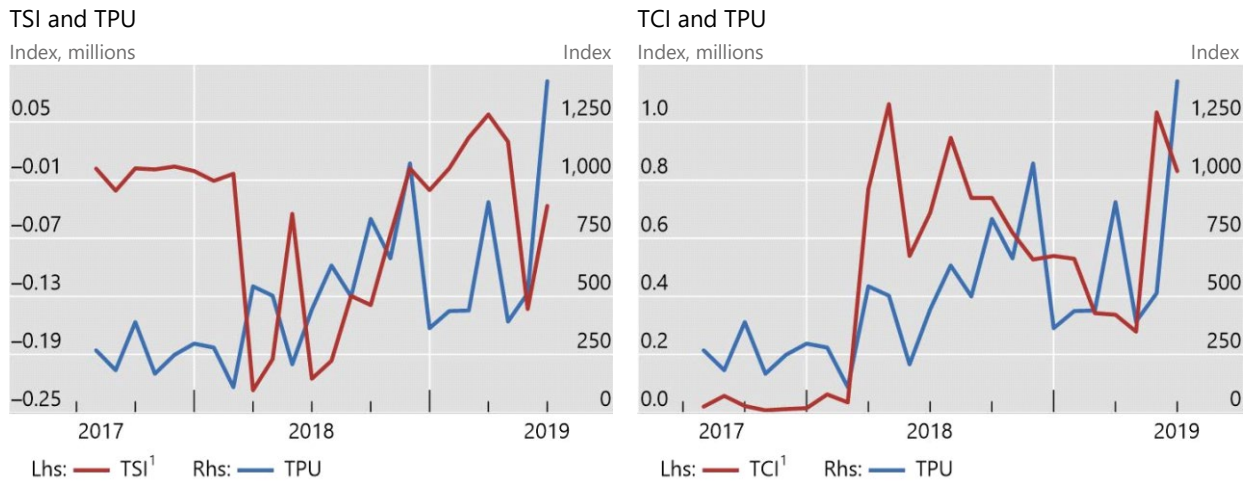
¹ TSI and TCI are available from 2017. Given the low volumes in 2017 we focus in the comparison on 2018 until mid-2019.

² For ease of comparison and given the mostly negative tone particularly throughout 2018 TCI - representing the volumes - is simply multiplied by -1.

Source: Authors' representation.

TSI and TCI versus Trade Policy Uncertainty Index (TPU)

Graph 4

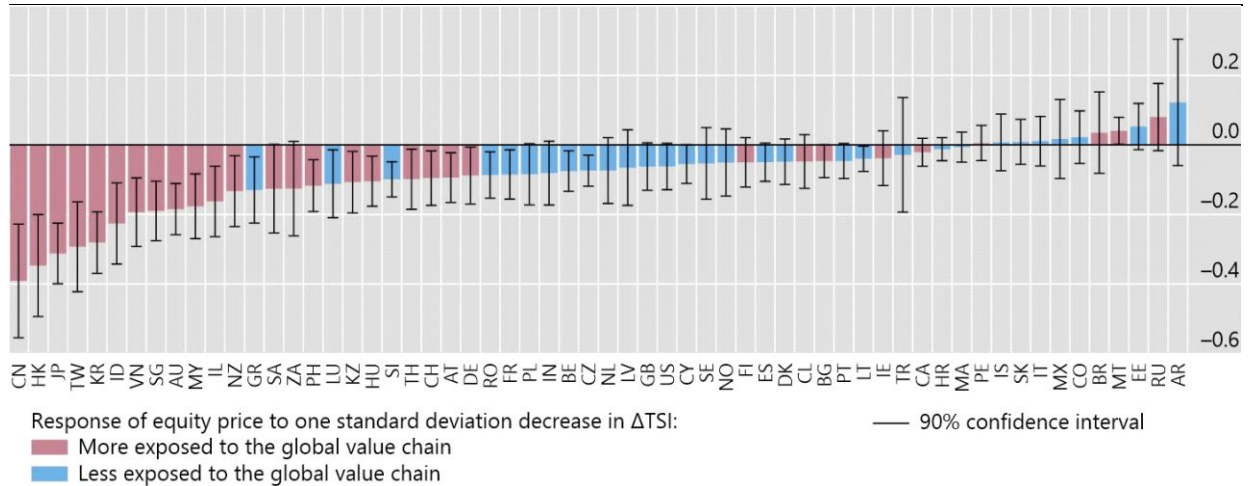


¹ Monthly aggregate of daily series.

Source: Authors' calculation and Davis et al (2019).

Impact of TSI deterioration on domestic equity markets

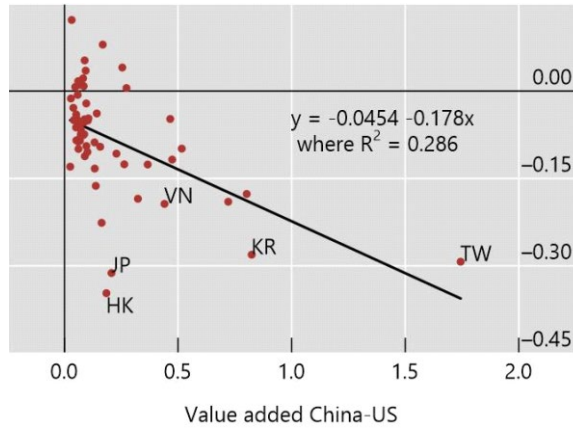
Graph 5



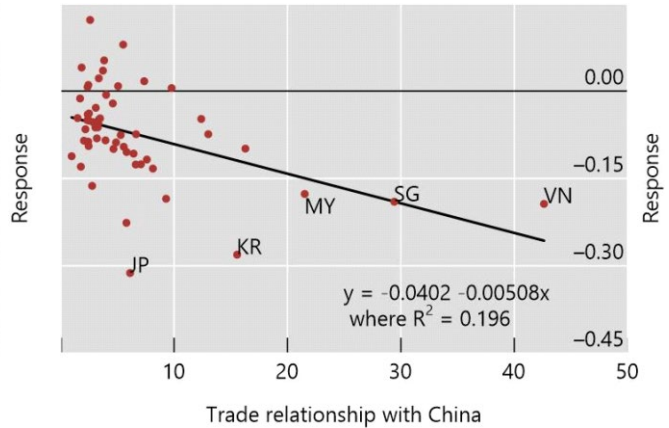
Note: CN is represented by Shanghai. Countries more exposed in the China-US value chain defined as those with a global value chain indicator above the median.

Source: Authors' calculations.

Impact of TSI and value-added in China export to the US¹



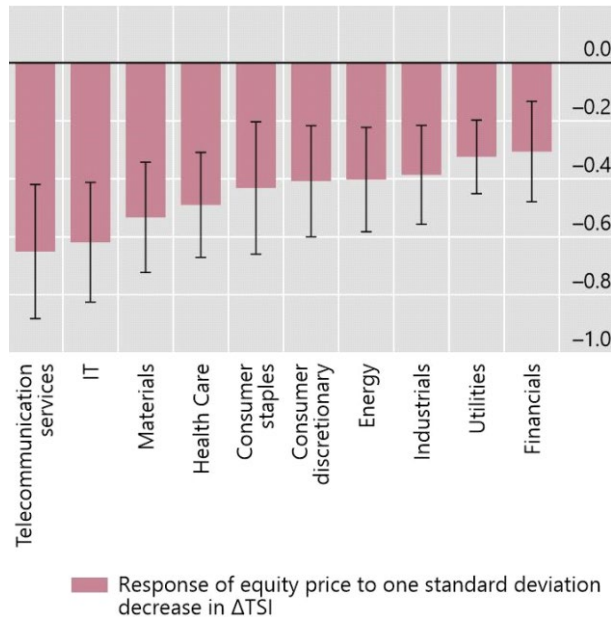
Impact of TSI and trade relationship with China²



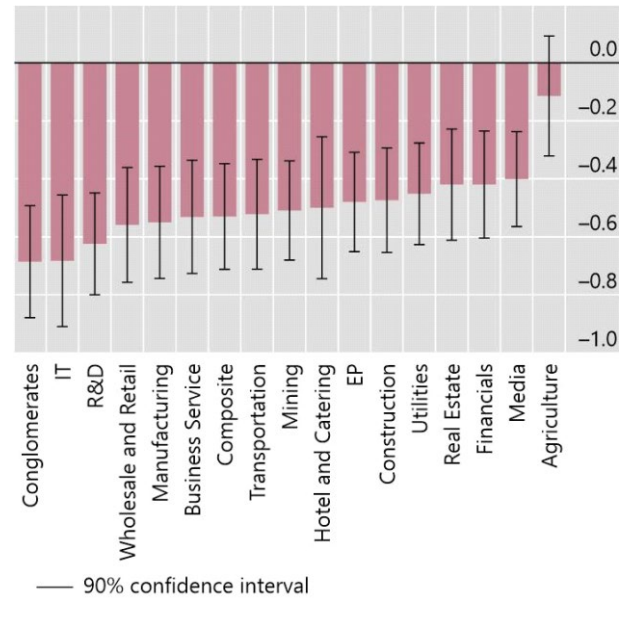
¹ Value added is measured as the value for added to China exports to final demands in the US (as provided by OECD) as a share of GDP. ² The intensity of trade relation with China is measured as import from China plus export to China as a share of GDP. The response measured on the y-axis indicates the effect of a one standard deviation decrease in ΔTSI on equity price, using the coefficient estimated in Equation (5). The relationships are significant at 1% significance level. The relationships are robust against the inclusion in the model of measures of geographical distance from China. See Table B2.

Source: Authors calculations.

Shanghai stock exchange index by sectors



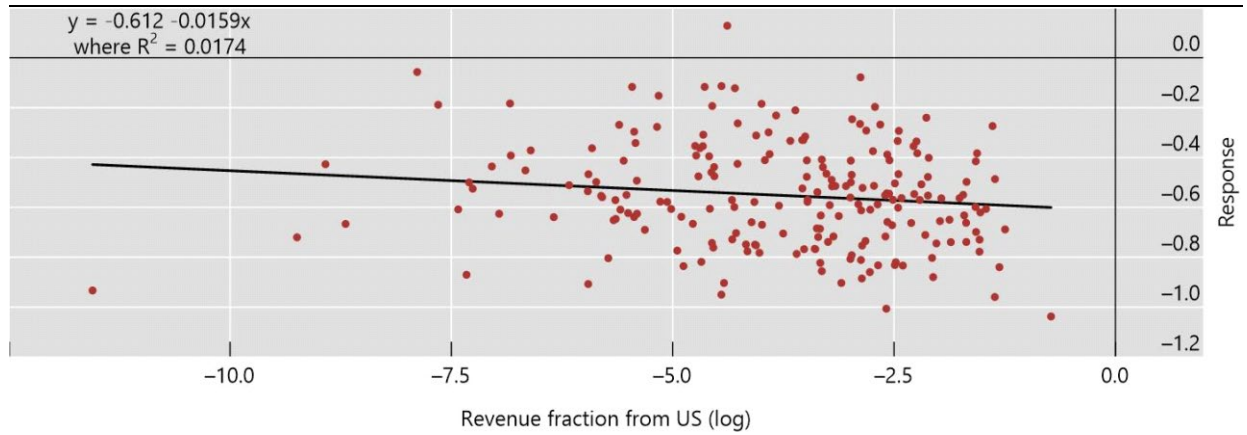
Shenzhen stock exchange index by sectors



Source: Authors' calculation.

Impact of TSI deterioration on Shanghai exchange stocks and revenues from the US

Graph 8

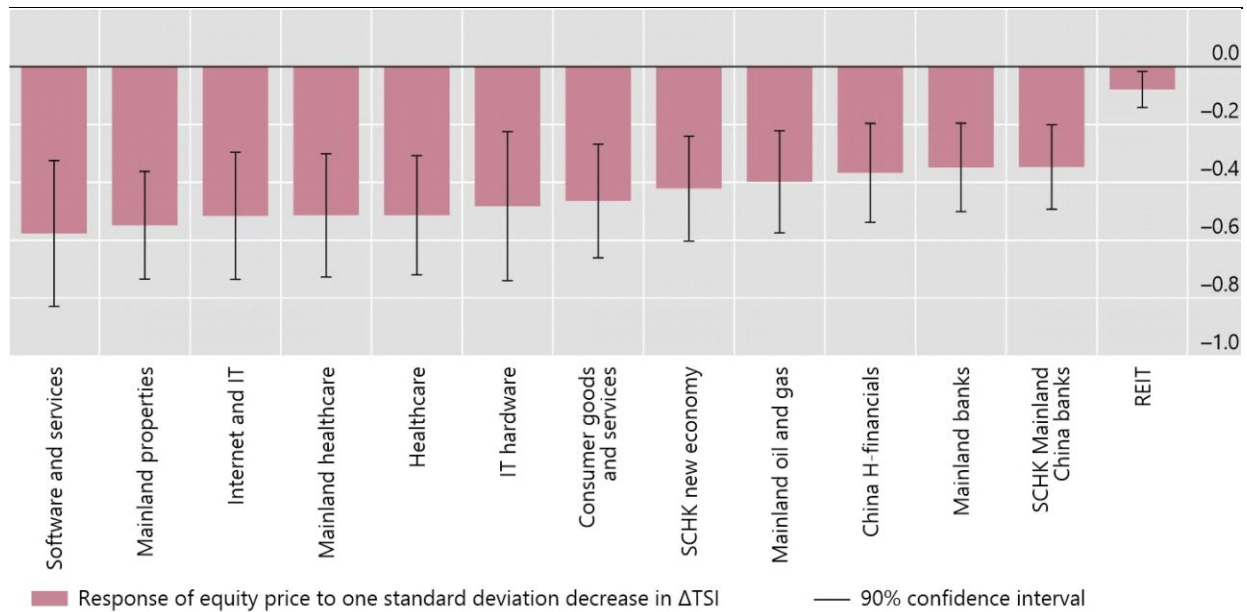


Note: Data for revenue from US is from Refinitiv. The response measured on the y-axis indicates the effect of a one standard deviation decrease in ΔTSI on equity prices. The regression coefficient to measure the impact of ΔTSI on equity prices is taken from Equation (5). The relationship is significant at 10% confidence level.

Source: Authors' calculation.

Impact of TSI deterioration on Hang Seng index

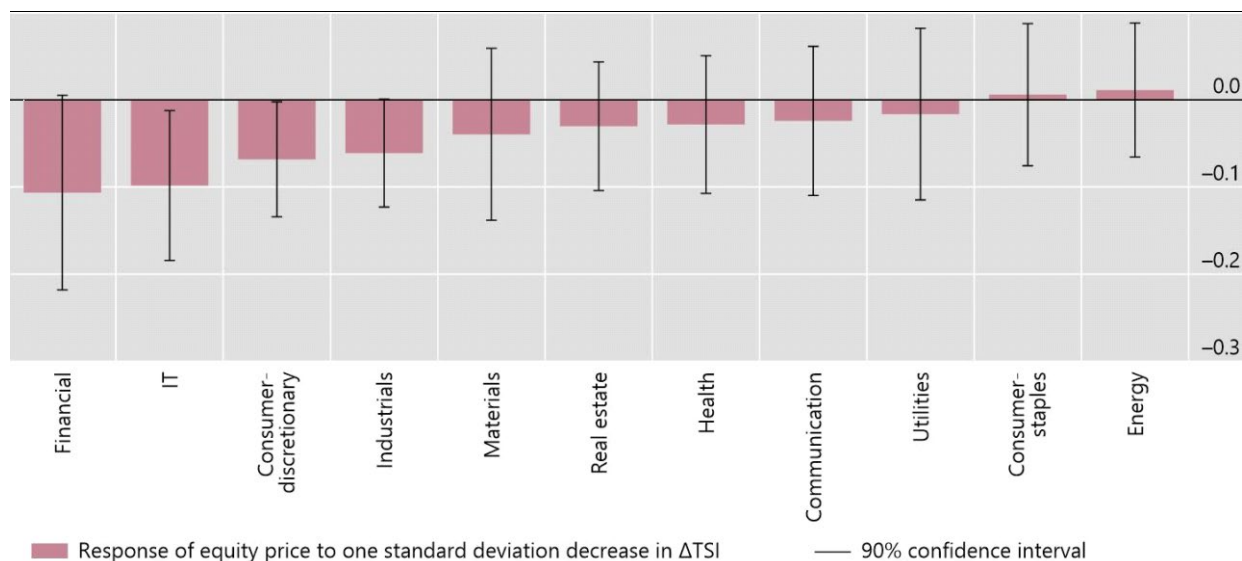
Graph 9



Source: Authors' calculations.

Impact of TSI deterioration on US equity markets

Graph 10

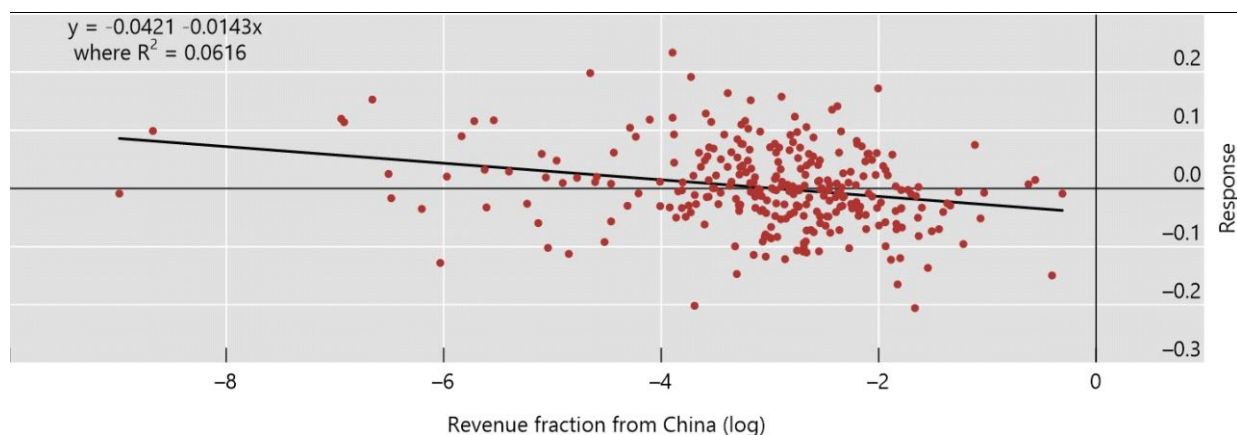


Note: Consumption discretionary are defined as businesses that tend to be the most sensitive to economic cycles, including hotels, restaurants, and other leisure facilities, media production and service, and consumer retailing and services in its services segment; the consumer staples sector is made up of companies whose businesses are less sensitive to economic cycles, including manufacturers and distributors of food, beverages and tobacco and producers of non-durable household goods and personal products.

Source: Authors' calculations.

Impact of TSI deterioration on firms in US with different revenue fraction from the China

Graph 11



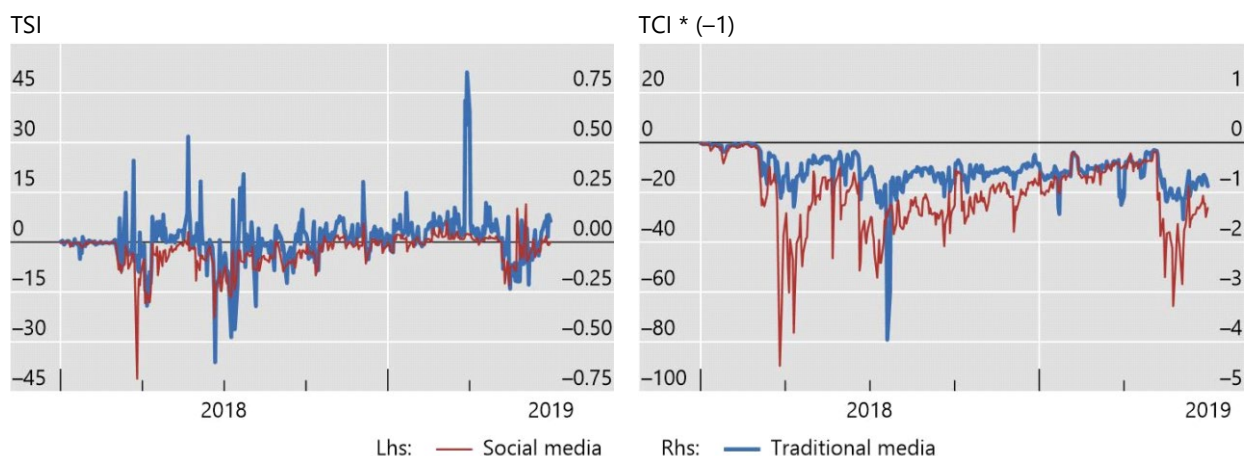
Note: Data for revenues from China are taken from Refinitiv. The response measured on the y-axis indicates the effect of a one standard deviation decrease in Δ TSI on equity prices. The regression coefficient to measure the impact of Δ TSI on equity prices is taken from Equation (5). The relationship is significant at 1% confidence level.

Source: Authors' calculation.

Trade sentiment index (TSI) and trade count index (TCI): social vs traditional media

In thousands

Graph 12

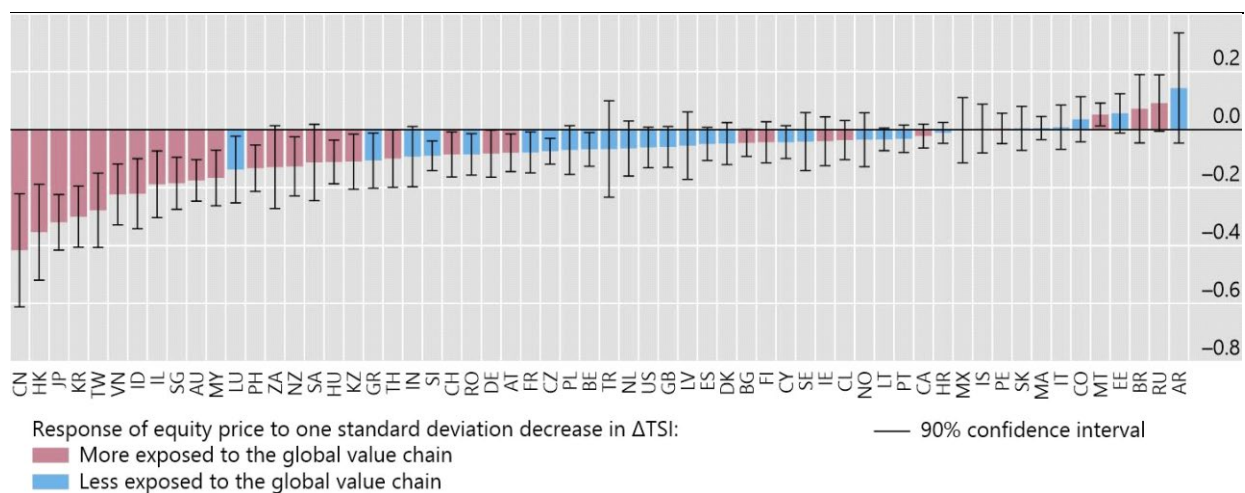


Note: TCI and TSI are defined in equation (1) and equations (3a,b) respectively. TSI social-media is constructed with information from Web, WeChat and Forum, while the TSI traditional media is obtained from newspapers (such as People’s Daily, China Daily, South China Morning Post, and Hong Kong Economic Times) and magazines (such as China Newsweek, iMoney, and Wealth Magazine).

.Source: Authors’ calculation.

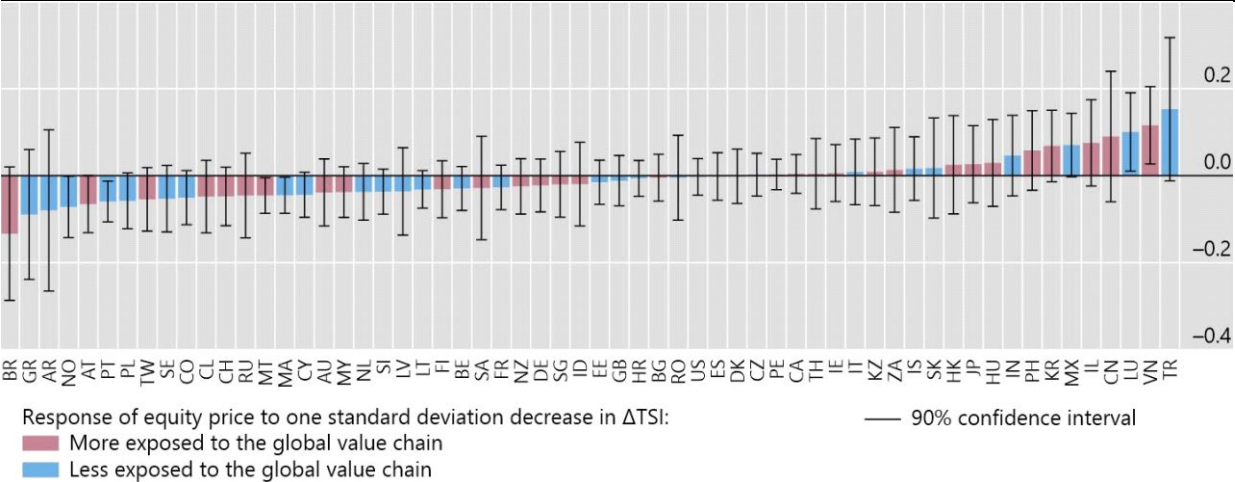
Impact of TSI social media deterioration on domestic equity markets

Graph 13



Note: CN is represented by Shanghai. Countries more exposed in China-US value chain defined as those with a global value chain indicator above the median. TSI social-media is constructed with information from Web, WeChat and Forum.

Source: Authors’ calculations.



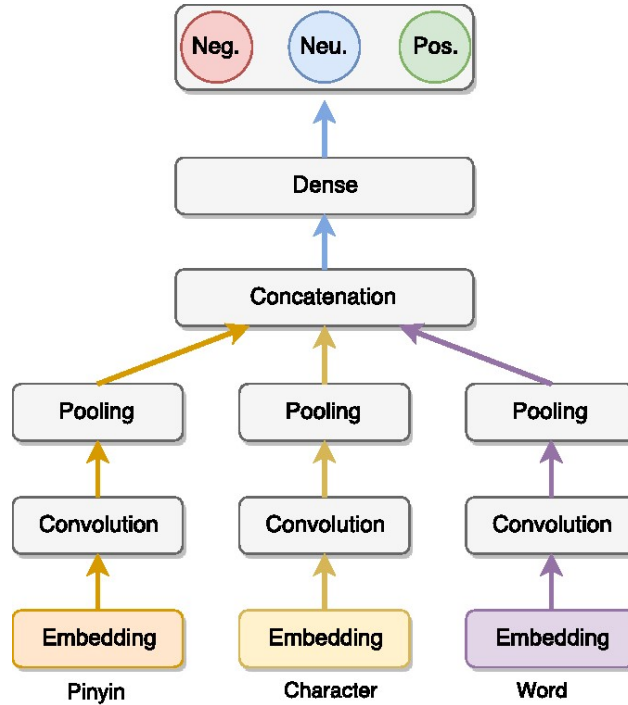
Note: CN is represented by Shanghai. Countries more exposed in China-US value chain defined as those with a global value chain indicator above the median. TSI traditional media is obtained from newspapers (such as People’s Daily, China Daily, South China Morning Post, and Hong Kong Economic Times) and magazines (such as China Newsweek, iMoney, and Wealth Magazine).

Source: Authors’ calculations.

Appendix A: MCCNN Sentiment Analysis Engine

Sentiment analysis aims to uncover the sentiment polarity expressed in a given text, so effective representation of a text is critical. To exploit the expression ability of Chinese as much as possible, the Multi-Channel Convolutional Neural Network (MCCNN) proposed by Liu et al (2018) leverages the multi-channel approach, where each channel corresponds to one particular representation of a Chinese text, namely word, character and pinyin.

Graph A1. A Multi-Channel Convolutional Neural Network (MCCNN) for Chinese sentiment analysis



As shown in Graph A1, there are three input forms (channels), in the MCCNN architecture. A given Chinese text T is first transformed into three sequences X_W , X_Z and X_P of different tokens:

$$X_W = [x_{w1}, \dots, x_{wi}, \dots, x_{wm}], \quad X_W \in \mathbb{R}^{e \times m} \quad (\text{A1})$$

$$X_Z = [x_{z1}, \dots, x_{zi}, \dots, x_{zn}], \quad X_Z \in \mathbb{R}^{e \times n} \quad (\text{A2})$$

$$X_P = [x_{p1}, \dots, x_{pi}, \dots, x_{pn}], \quad X_P \in \mathbb{R}^{e \times n} \quad (\text{A3})$$

where x_{wi} , x_{zi} and x_{pi} are the e -dimensional vectors representing the i -th Chinese word, the i -th Chinese character as well as the pinyin of

the i -th Chinese character in the text T , respectively. m and n denote, respectively, the numbers of Chinese words and Chinese characters in T . A set of convolution operations are then applied to the three representations of T , respectively.

Specifically, for a tokenized sequence X of the input text T , where

$$X = [x_1, \dots, x_l, \dots, x_l] \quad (\text{A4})$$

with $X \in \{X_W, X_Z, X_P\}$, l equals to m when X is X_W , otherwise l equals to n .

A matrix $K \in \mathbb{R}^{k \times se}$ are used as a set of filters to produce new features $C_{s,i}$ by

$$c_{s,i} = \max(0, K \cdot x_{i:i+s-1} + b), \quad c_{s,i} \in \mathbb{R}^k \quad (\text{A5})$$

where $x_{i:i+s-1} \in \mathbb{R}^{se}$ denotes the concatenation of the vectors of the tokens in a specific window size s . $b \in \mathbb{R}^k$ is a bias term and $\max(0, \cdot)$ represents the pointwise non-linear function (ReLU). For each possible window of tokens $\{x_{1:s}, \dots, x_{i:i+s-1}, \dots, x_{l-s+1:l}\}$, the filters K are applied to generate k feature maps

$$C_s = [c_{s,1}, \dots, c_{s,i}, \dots, c_{s,l-s+1}] \quad (\text{A6})$$

with $C_s \in \mathbb{R}^{k \times l-s+1}$. An overall-max-pooling operation is then applied to each row of C_s to extract the most important feature of each filter in K by

$$\hat{c}_s = \max(C_s), \quad \hat{c}_s \in \mathbb{R}^k \quad (\text{A7})$$

MCCNN applies (A5), (A6) and (A7) to X_W, X_Z and X_P using multiple filters K with various window sizes s to extract important features \hat{c} from different representations of the input text T

$$\hat{c} = \widehat{c_{s1,W}} \oplus \widehat{c_{s2,W}} \oplus \dots \oplus \widehat{c_{s1,Z}} \oplus \dots \oplus \widehat{c_{sd,P}}, \quad \hat{c} \in \mathbb{R}^{3kd} \quad (\text{A8})$$

where \oplus is the concatenation operator and d denotes the number of the different window sizes.

The feature vector \hat{c} is then passed to a full connected layer for combination and further refining to generate the final feature vector

$$r = \max(0, H_c \hat{c} + b_c), \quad r \in \mathbb{R}^h \quad (\text{A9})$$

where $H_c \in \mathbb{R}^{h \times 3kd}$ and $b_c \in \mathbb{R}^h$ are parameters of this layer.

Finally, to predict the sentiment polarity of the given text, T , a softmax layer is then applied to convert the feature vector into a probability distribution,

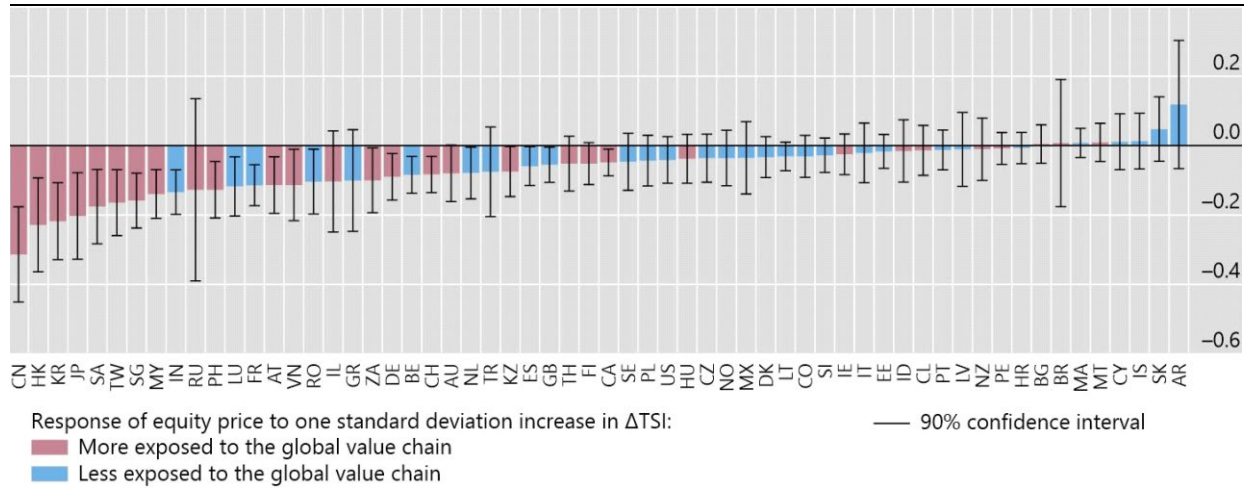
$$p(y | r) = \text{softmax}(H_o r + b_o), \quad p(y | r) \in \mathbb{R}^3 \quad (\text{A10})$$

where $H_o \in \mathbb{R}^{3 \times h}$ and $b_o \in \mathbb{R}^3$. $y \in \{\text{negative: } -1, \text{ neutral: } 0, \text{ positive: } +1\}$ is the predicted probability of each sentiment polarity. We choose the $\hat{y} = \arg_y \max p(y|r)$ as the output polarity of the given input T .

Appendix B. Additional robustness tests

Impact of TCI increase on domestic equity markets

Graph B1



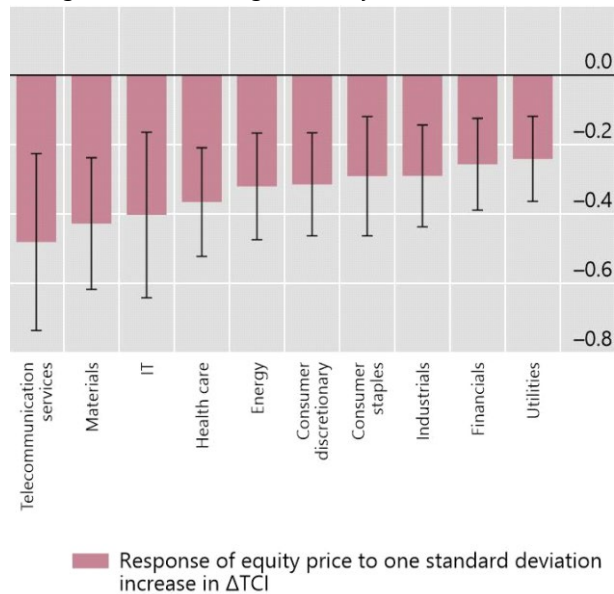
Note: CN is represented by Shanghai. Countries more exposed in the China-US value chain defined as those with a global value chain indicator above the median.

Source: Authors' calculations.

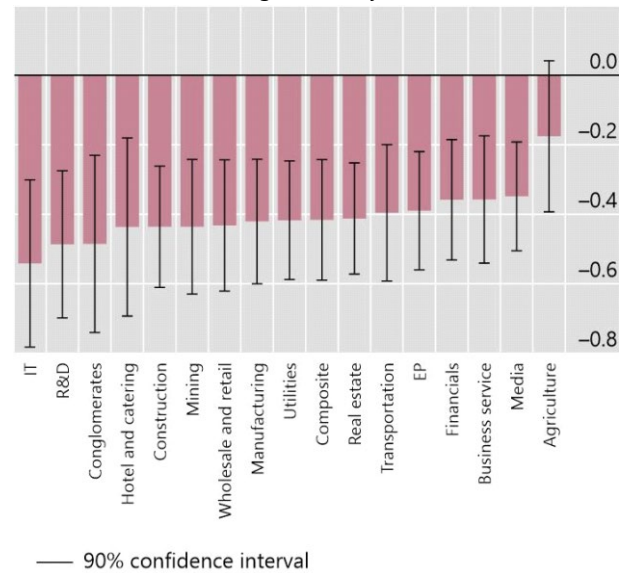
Impact of TCI increase on Chinese equity markets

Graph B2

Shanghai stock exchange index by sectors



Shenzhen stock exchange index by sectors



Source: Authors' calculation.

Regression results using TCI

Table B1

	All countries	Baseline regression (countries more exposed)	Controlling for the level of VIX instead of its change	Controlling for the policy rate	Testing non-linear effect in $\Delta(TSI)$	Testing asymmetric effect for positive TSI changes	Using return between t-2 and t
	(1)	(2)	(3)	(4)	(5)	(6)	(7)
$\Delta(TCI)$	-0.067 (0.057)	-0.095 (0.063)	-0.100 (0.063)	-0.090 (0.073)	-0.103 (0.069)	-0.136* (0.081)	-0.142* (0.079)
$\Delta\text{Log(Oil Price)}^1$	0.045 (0.032)	0.044 (0.031)	0.045 (0.031)	0.037 (0.032)	0.044 (0.031)	0.046 (0.031)	0.063 (0.046)
$\Delta\text{Log(Trade-weighted US dollar index)}^2$	-1.411*** (0.226)	-1.294*** (0.201)	-1.453*** (0.198)	-1.398*** (0.204)	-1.298*** (0.200)	-1.301*** (0.200)	-1.314*** (0.300)
$\Delta\text{log(VIX)} (\%)$	-0.020*** (0.007)	-0.019*** (0.007)		-0.022*** (0.006)	-0.019*** (0.007)	-0.019*** (0.007)	-0.013 (0.009)
VIX			-0.025** (0.013)				
Δ Policy rate (bp)				0.012 (0.017)			
1(TCI below 75 percentile)					0.033 (0.145)		
1(ΔTCI less than zero)						0.135 (0.134)	
Number of countries	60	30	30	16	30	30	30
R ²	26.7%	25.0%	22.4%	26.4%	25.2%	25.4%	12.9%
TCI R ² contribution	0.8%	1.2%	1.3%	1.1%	1.5%	1.6%	1.1%

Notes: Mean group estimator. Average coefficients across country specifications. The first column includes results for all 60 countries. Columns (2) to (7) include results only for countries more exposed in China-US value chain. These are defined as those with a global value chain indicator above the median. See Graph 5 for details and the list of countries ¹ Brent crude oil price. ² Trade-weighted US dollar index: broad, goods and services. Significance level: *p<0.1; ** p<0.05; *** p<0.01.

Impact of deterioration in TSI on equity markets and China-US value chain,
controlling for distance

Table B2

	(1)	(2)	(3)	(4)
Value-added China ¹	-0.178*** (0.029)		-0.120*** (0.026)	
Trade relationship with China ²		-0.005*** (0.001)		-0.004*** (0.001)
Geographical distance to China ³			0.012*** (0.003)	0.011*** (0.003)
Number of Countries	59	57	59	57
R ²	28.6%	19.6%	50.1%	42.3%

Significance level: *** p<0.01.

¹ Value added is measured as the value for added to China exports to final demands in the US (as provided by OECD) as a share of GDP. ² The intensity of trade relation with China is measured as import from China plus export to China as a share of GDP. The response measured on the y-axis indicates the effect of a one standard deviation decrease in Δ TSI on equity price, using the coefficient estimated in Equation (5). The relationships are significant at 1% significance level. ³ Geographical distance is measured as one thousand kilometres.

Source: Authors' calculations.

Disentangling the effects of TCI social media and TCI traditional media

Table B3

	All countries	Baseline regression (countries exposed in GVC)	Controlling for the level of VIX instead of its change	Controlling for the policy rate	Testing non-linear effect in TCI	Testing asymmetric effect for positive TCI changes	Using return between t-2 and t
	(1)	(2)	(3)	(4)	(5)	(6)	(7)
$\Delta(\text{TCI-social-media})$	-0.076 0.058	-0.110* 0.063	-0.119* 0.063	-0.103 0.072	-0.113* 0.068	-0.155* 0.080	-0.130* 0.079
$\Delta(\text{TCI-traditional-media})$	0.026 0.044	0.039 0.042	0.053 0.046	0.035 0.044	0.051 0.047	0.061 0.065	-0.035 0.061
$\Delta\text{Log}(\text{Oil Price})^1$	0.045 0.032	0.044 0.031	0.044 0.031	0.037 0.032	0.044 0.031	0.045 0.031	0.063 0.046
$\Delta\text{Log}(\text{Trade-weighted US dollar index})^2$	-1.418*** 0.228	-1.305*** 0.202	-1.465*** 0.199	-1.409*** 0.207	-1.307*** 0.201	-1.315*** 0.202	-1.306*** 0.301
$\Delta\text{log}(\text{VIX}) (\%)$	-0.020*** 0.007	-0.019*** 0.007		-0.022*** 0.006	-0.019*** 0.007	-0.019*** 0.007	-0.013 0.009
VIX			-0.025** 0.013				
Δ Policy rate (bp)				0.012 0.017			
1(TCI social larger than 25 percentile)					0.043 0.159		
1(TCI traditional larger than 25 percentile)					-0.071 0.131		
1(Δ TCI social larger than zero)						0.143 0.135	
1(Δ TCI traditional larger than zero)						-0.045 0.086	
Number of countries	60	30	30	16	30	30	30
R ²	26.93%	25.25%	22.77%	26.72%	25.76%	25.78%	13.11%
TCI social R ² contribution	0.85%	1.37%	1.51%	1.27%	1.53%	1.79%	0.92%
TCI traditional R ² contribution	0.22%	0.28%	0.38%	0.25%	0.55%	0.41%	0.19%

Notes: Mean group estimator. Average coefficients across country specifications. ¹ Brent crude oil price. ² Trade-weighted US dollar index: broad, goods and services. Significance level: *p<0.1; ** p<0.05; *** p<0.01.

TSI social-media is constructed with information from Web, WeChat and Forum, while the TSI traditional media is obtained from newspapers (such as People's Daily, China Daily, South China Morning Post, and Hong Kong Economic Times) and magazines (such as China Newsweek, iMoney, and Wealth Magazine). Baseline regression includes only countries more exposed in China-US value chain defined as those with a global value chain indicator above the median. See Graph 5 for the list of countries.