Predictability of Bank Stock Returns:

Evidence from the Endurance Index of Bank Investor Sentiment

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Abstract

Applying the binomial probability distribution-based investor sentiment endurance model developed by He (2012) to the banking sector, this paper creates an endurance index of bank investor sentiment. The index reflects the probability of the high or low stock price being the closing price for the NASDAQ Bank Index. Results of this study reveal a considerable forecasting ability of the index. Both monthly and quarterly forecasts of bank stock returns demonstrate high accuracy. For example, the overall accuracy for the six-quarter rolling forecasts reaches 71.25%. The true forecasting model and accuracy ratio applied in this study provide investors and analysts of bank stocks, as well as banking professionals, with effective analytical tools.