

# Global Trade and Stock Market Predictability

Munchen Luo

January 2022

## **Abstract**

We show empirically that a one standard deviation increase in customer countries realized return is associated with a 0.2 standard deviation increase in supplier country return, and the effect is stronger when trade flows are larger.

# 1 Introduction

This paper contributes to the literature on information diffusion and propagation of the economic shocks via trade network. Network of trade links can transmit relevant economic information (Acemoglu, Carvalho, Ozdaglar, and Tahbaz-Salehi (2012)). Menzly and Ozbas (2010) also show that information gradually diffuses along the supply chain. This notion can be applied in an international market sense.

Specifically, we investigate whether cross-country trade linkages allow for fundamental information diffusion. Lagged returns of customer countries can predict the future returns of the focal countries, beyond the predictive power of lagged focal country's return. A one standard deviation increase in customer countries realized return is associated with a 0.2 standard deviation increase in supplier country return.

Our paper is related to studies showing how economic information travels through production networks. Gofman, Segal, and Wu (2020) show that upstream firms have higher returns. Ahern (2013) shows

that central industries command a higher premium.

## **2 Conclusion**

Our results support the idea that information slowly upstream diffuses via global trade.

---

## References

- Acemoglu, D., Carvalho, V. M., Ozdaglar, A., Tahbaz-Salehi, A., 2012. The network origins of aggregate fluctuations. *Econometrica* 80, 1977–2016.
- Ahern, K. R., 2013. Network centrality and the cross section of stock returns. Working paper.
- Cohen, L., Frazzini, A., 2008. Economic links and predictable returns. *Journal of Finance* 63, 1977–2011.
- Gofman, M., Segal, G., Wu, Y., 2020. Production networks and stock returns: The role of vertical creative destruction. *The Review of Financial Studies*, forthcoming
- Menzly, L., Ozbas, O., 2010. Market segmentation and cross-predictability of returns. *The Journal of Finance* 65, 1555–1580.