Fake news, corruption, and stock markets in late 19th century France: The case of the Compagnie Universelle du Canal de Panamá

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In this paper, we aim to contribute to a long-standing debate in the literature regarding the impact of (fake) news on the long-term behavior of stock prices. We investigate how fake news, disseminated by four distinct French newspapers, may have influenced the stock of the *Compagnie* Universelle du Canal de Panama in 1888. This episode occurred while the company sought to issue securities (referred to as 'obligations à lots') to secure funding for its financially strained operations.

Historical accounts reveal a *pay-to-play* relationship between the *Compagnie* and editors and journalists from at least 11 journals and periodicals between 1880 and 1888. The primary objective was to attract maximum funds when the issuance occurred. Additionally, extensive payments were made between 23 April 1888, when the company's obligations à lots gained the backing of a technical commission, and 26 June 1888, when the issuance took place but was significantly undersubscribed. Consequently, we examine whether these payments achieved the intended effect of boosting the stock's price and attracting potential new investors. To address this question, we construct a new database that includes daily news coverage volume and sentiment regarding the *Compagnie*, sourced from four different French newspapers between 01 March 1888 and 26 June 1888. We also incorporate comprehensive daily coverage of 73 highly traded stocks across various sectors on the Paris Bourse, spanning from 01 March 1888 to 16 February 1889.

Methodologically, we employ two distinct asset pricing models: the Capital Asset Pricing Model (CAPM) and the Fama-French three-factor model. These models help us determine whether news coverage and tone can explain the excess returns of the *Compagnie*'s stock beyond the expected influences of market, size, and value factors. Furthermore, we investigate whether this effect differed between the period before the announcement of the issuance on 23 April 1888 and the days leading up to its disappointing outcome on 26 June 1888. Our analysis reveals compelling evidence of a negative and statistically significant effect for both news coverage and tone following the announcement on 23 April 1888. Surprisingly, the coefficient for news coverage is negative, suggesting that an increase in news coverage results in lower excess returns.

To make sense of this counterintuitive finding, we explore the possibility that investors were already aware that the company's issuance would underperform, leading to increased selling pressure when confronted with overly positive news. However, our analysis contradicts this notion, as the dividend yield decreases with positive news. This confirms that stock prices indeed rise with positive news, regardless of their accuracy, although they increase less than predicted by our pricing models. Consequently, we investigate the hypothesis that a subset of investors, aware of the impending news, purchased stocks in advance and profited from price increases following publication. Our findings suggest that investors followed the adage "buy with the rumor and sell with the news," as evidenced by positive and significant coefficients for both news coverage and tone five days before news publication.

The results presented in this paper shed light on the role and influence of the press in late 19th-century France. Notably, an extensive campaign of advertising and coverage for a particular asset or firm may have unexpected effects on investor behavior. In this case, economic reasoning would suggest that the newspapers' aggressive promotion of the Panama Company, despite facing corruption allegations three years later, should have spurred substantial investor participation in the 26 June 1888 issuance.