

MV Capital Management Weekly Market Flash

The Price of Certainty

December 20, 2013

There was an interesting article in the *Wall Street Journal* this week, which perhaps slipped under the radar amidst all the frenzied taper talk. That piece was about a company called Genscape. There is a connection between that article and the big story of the week. Success in the capital markets comes from information: what you know, and when you know it. Increasingly the tools are available – for those willing and able to pay – to know things before they happen.

Insider Trading Done Legally

Kentucky-based Genscape uses cutting edge surveillance technology to piece together nonpublic data about things like oil supply, electric power production and retail traffic. It then sells this data to investment and trading companies that pay dearly for the privilege of knowing something important before anyone else does. The annual bill for intel on the oil supply alone can run a Genscape client to over \$500,000. Technically there is nothing illegal about what Genscape does, nor are the investor clients in clear violation of any SEC-defined insider trading rules. The practical effect, though, is that someone who is able to shell out half a million a year will have very accurate figures about oil supply trends two days before the U.S. Energy Information Agency releases that same information to the public. Two days, of course, is a lifetime in the capital markets spacetime continuum.

Frozen Orange Juice, Anyone?

Of course, traders have looked for unfair advantages over their rivals since the dawn of time and markets. In the classic 1982 film “Trading Places,” the nefarious Duke brothers hatch a plan to corner the market in frozen orange juice, only to find themselves outplayed by Eddie Murphy and Dan Aykroyd, who manage to get their hands on the orange juice crop data first and send the Dukes to the poor house. We could laugh at that, because it was such a ridiculous and far-fetched scheme. But with today’s ultra-sophisticated surveillance technology, you don’t need Clarence Beeks, the bumbling gumshoe who procured the crop report, to get that inner edge. You need Genscape, and, for a price, you can have it.

A Genscape for the Fed?

In a market hardwired to react to Fed events, one can only imagine how many propeller-heads are toiling away at their predictive analytical models, trying to write that Holy Grail of algorithms that would accurately predict what will come out of those monthly Board of Governors meetings. Sound impossible? Not really. The surveillance includes infrared technology, antenna stations, videotapes, satellite imagery, and quantitative methods that crunch the data and arrive at the answers to questions as varied as how much a retail chain made in Black Friday weekend sales (before the retail chain itself even knows), or how much coal is being shipped to electrical grids in the Midwest. It is far from inconceivable that a perfectly legal, insider report on the outcome of a Fed deliberation could be in the hands of Goldman Sachs and JP Morgan traders on the Monday before the Fed’s Wednesday post-meeting conference.

There Will Still Be Uncertainty

However much they seek certainty, though, the profiteers from insider information will always have to contend with uncertainty. Consider what happened this week. For the last two weeks, all the talk has been of how badly markets may react to a December taper. Then the taper comes, and markets enjoy their biggest rally in weeks. If you knew the taper was coming, would you also be able to predict that exact outcome? As sophisticated as they are, predictive analytical models will still dwell in the realm of probability, not certainty.

Masood Vojdani
President & CEO

Katrina Lamb, CFA
Head of Investment Strategy & Research

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