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Traders May Have Gained Early Word on Fed Policy, Study Finds

By Matthew Boesler May 13, 2014

Some investors between 1997 and 2013 may have gotten early word of changes to Federal Reserve policy and profited by trading before the Fed publicly announced the policy shifts, according to Singapore-based researchers.

Trading records show abnormally large price movements and imbalances in buy and sell orders that are “statistically significant and in the direction of the subsequent policy surprise,” according to a paper by Gennaro Bernile, Jianfeng Hu and Yuehua Tang at Singapore Management University.

The moves occurred before and during the time that reporters were given the Federal Open Market Committee statement in so-called media lockups.

On days the FOMC policy decision deviated from market expectations, “back-of-the-envelope calculations indicate that the aggregate dollar profits” from early access to the statement ranged between $14 million and $256 million, the authors said in the study titled, “Can information be locked up? Informed trading before macro-news announcements.”

The Fed, starting with the release of its FOMC statement on Oct. 30, tightened regulation of the lockup.

The stricter rules were adopted “to better protect the information against premature release,” Joe Pavel, a Fed spokesman, said today. “We review our processes and controls on an ongoing basis and make adjustments as necessary to address any issues.”

Under new procedures, journalists from media organizations, including Bloomberg News, gather in a room at Fed headquarters in Washington. They are forbidden to carry phones into the lockup, and lines connecting their computers to the Internet are blocked.

Lines Opened

Journalists are given the FOMC statement 20 minutes before its release to the public, giving them time to prepare stories. When the 20 minutes elapse, lines of communications are opened and journalists allowed to transmit their stories.

Under prior rules, the Fed released the statement in the press room of the U.S. Treasury Department about 10 minutes before the release time. While journalists promised to respect the embargo, computer lines weren’t blocked.

The central bank’s process for releasing the statement came under scrutiny after trading in financial instruments linked to gold in New York and Chicago occurred quickly after the release of the Fed’s policy statement on Sept. 18. Trading in gold futures and exchange-traded funds linked to gold intensified within a millisecond of the 2 p.m. eastern time FOMC release that day, according to Nanex LLC, a firm that analyzes high-frequency trading.

The Singapore study, by contrast, focused on the period before the embargo expired.

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‘Robust Evidence’

“We find robust evidence of informed trading, as measured by the abnormal price run-up and order imbalance of equity index futures and exchange-traded funds, during the lockup periods ahead of FOMC announcements,” the authors wrote.

The authors studied the E-mini S&P 500 futures contract, E-mini Nasdaq 100 futures, the SPDR S&P 500 ETF, and the PowerShares QQQ ETF tracking the Nasdaq 100 index.

The researchers found that statistically significant order imbalances that correctly predicted the post-release market reaction tended to arise in the E-mini S&P 500 futures market between 10 minutes and 20 minutes before the scheduled release of the statement.

In the 10 minutes prior to the release of the statement, E-minis rose on average by 0.2 percentage point more on days when the announced policy decision was a surprise, compared with days when the decision was in line with the market consensus, the authors said.

The researchers found no evidence of trading abnormalities during media lockups ahead of the Bureau of Labor Statistics’ release of the monthly employment and inflation reports, or the Bureau of Economic Analysis’ release of the gross domestic product report. They tracked trading around FOMC policy statements released between Sept. 9, 1997 and June 30, 2013.

Bernile, 39, received a Ph.D. in finance from the University of Rochester in 2006. He taught at the University of Miami from 2006 to 2013, except for August 2008 to February 2010, during the financial crisis, when he was a visiting scholar at the Securities and Exchange Commission in Washington. Last year he moved to Singapore Management University.

A paper Bernile co-wrote on the backdating of stock options was published in 2009 in the Journal of Accounting and Economics.