How To Trade The News -- Top Ten Rules

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Markets have long sought to generate alpha from policy developments. Investors understand that geopolitical policy and regulatory policy generates real and lasting impacts on the growth prospects for individual companies and for the economy . Those who access relevant information faster …and know how to analyze it….will reap significant investment gains.

The principle may be simple, but the execution is complicated. Policymakers make information public in a wide range of ways. The language of policy can be complicated, technical, and convoluted. Capital markets have long pressed for more technologically advanced ways to access reliable information and analysis regarding policy developments.

In the last 150 years, capital markets have been early adopters of advanced communications and computing technology. The telegraph gave way to the ticker tape, the Bloomberg terminal, the Blackberry and Google Alerts. Program trading gave way to algorithmic trading. With information and trade execution flowing at the speed of light along fiber optic cables,, intermediaries raced to co-locate their servers closer to exchange servers in order to reduce the distance the light had to travel and, thus, decrease execution risks from latency.

Today's 24/7 media cycle, turbo-charged by social media and algorithmic high frequency trading, accelerates execution cycles and generates information overload which complicates strategy formation as well as execution strategies.

> Throughout all these technological changes, the process for identifying alpha generation and risks from the news cycle has not changed fundamentally. It's all about faster and better access to information.

At a fundamental level, the race to acquire more and better information is not so much about the quantum of information as it is about understanding what the information means. The basic steps are the same across time: (i) **absorb** the inputs, (ii) assess their **impact** and then (iii) identify **execution strategies**. Armies of analysts, pundits, and former policymakers have been deployed to help make sense of the news cycle with varying degrees of accuracy.

Until now. Advanced technology (and our own patented process) makes it possible to automate the first few steps of the analytical process. We can now disaggregate the various components of policy risk, measure them, and generate time series that facilitate risk management. The tools exist for the first time to treat policy risk as an asset class and as a distinct risk component.

The key to measuring and managing policy risks is to realize that the public policy process is neither random nor unpredictable in most cases. Policy formation follows a path dependent trajectory through time. It only seems random because (i) the path may not be linear and (ii) the reaction function in headlines highlights drama.

Advanced technology like our patented process provides investors with powerful tools for reliable alpha generation based on concrete facts. These tools replace the chaotic race to chase headlines and Tweets. They provide a more rational and reliable foundation for strategic portfolio management .

When Interactive Brokers asked for a blog series on "how to trade the news," we welcomed the opportunity.

Starting in March 2019, BCMstrategy, Inc. has been contributing columns nearly weekly to the Traders' Insight blog at Interactive Brokers. Our goal is simple. We seek to help investors identify inflection points in the news cycle faster and better using advanced technology.

This book consolidates in one place the first ten blog posts. They represent the "top ten" rules for how to trade the news.

We hope that these rules will help investors make investment decisions based on concrete facts. We also hope that these tools decrease traders' exposure to "fake news" by providing them with the tools to turn down the noise of the news cycle and see real, concrete policy moves within the context of the news cycle.

Rule 1: Be Objective

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This is harder to implement than it sounds. But being objective is a crucial condition of success when designing and executing market strategies related to policy developments.

An investment thesis requires conviction and evidence. It includes often embedded assumptions regarding the regulatory, economic, and political context in which execution will occur. Markets demand directional conviction. Consequently, traders can fall in love with the investment thesis. This blinds the trader to contrary evidence, which is why risk limits exist. The same is true in risk management. From trade approvals to periodic scenario analysis and stress testing, risk managers test portfolios and positions against expected adverse developments.

Why Being Objective Is Hard

When dealing with the policy cycle, the risk of blindness increases exponentially for three reasons.

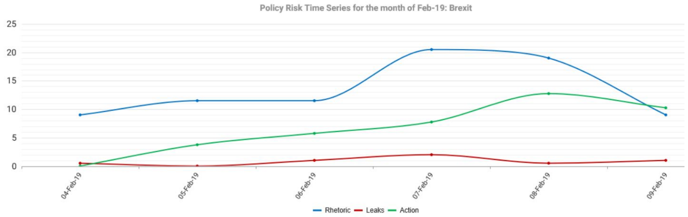
1. **Emotions (Denial and Disbelief)**: If one disagrees normatively or ideologically with the policy choice, much time is wasted by fighting the outcome conceptually. Time is money. The more time you spend disagreeing with the policy choice is time you could have spent adjusting your portfolio.
2. **Surprise**: **When caught by surprise, it is natural and understandable that one might be defensive. The reality is that inflection points are missed because the policy monitoring process was flawed**
3. **The Lemming Effect**: It is true that early adopters typically reap the largest alpha . But it is also true that there is safety in numbers. Risk committees that approve a position or portfolio strategy can resist approaches contrary to prevailing wisdom. A trading strategy consistent with what "everyone" believes to be true generates less personal risk of adverse consequences for the trader or the risk committee if "everyone" turns out to be wrong.

Why Being Objective Is Important

The job of a money manager is either capital preservation or alpha generation, not policy formation. When traders or risk managers focus on whether a policy trajectory is normatively "good" or "bad," they miss a valuable opportunity to spot and profit from inflection points that challenge their world view.

Case Study -- Brexit

Prevailing opinion holds that exiting the European Union will adversely impact on the UK economy. This perspective drives denial and disbelief regarding Brexit policy trajectories. Consequently, many missed the February 2019 inflection point that appeared in the chart below.



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In policymaking, leaders typically talk far more than they act. This is for a range of reasons, the most important of which is that policymakers negotiate with each other through their public words. When action outpaces rhetoric, a clear inflection point has been reached.

The components generating the graph accessed at the time of the events, indicated clearly that policymakers on both sides of the English Channel were putting into place rules that would go into effect automatically when a no-deal Brexit was expected to go into effect. At the time, the no-deal Brexit date was expected on March 31, 2019.

Why did this inflection point not generate more attention? Part of the answer lies in human behavior. So many analysts were (and remain) so convinced that Brexit is a bad idea, that their reactions to the news cycle sought validation for their view rather than assessing objectively the concrete facts. They were in denial. In addition, analysts familiar with the EU negotiations with various troubled EuroArea sovereigns (e.g., Spain, Greece, Ireland) were accustomed to behavior patterns that saw the EU receiving most of what it sought from those sovereigns. To them, the main issue was that the UK Parliament had rejected the Withdrawal Agreement more than once. No EU parliament to date had successfully challenged the EU.

Most analysts lost the ability to be objective during this period. This led them to overlook the strategic hardening of position by European leaders in early February 2019. In fairness, as discussed in Rule 3, they were also distracted by

How to Implement Rule 1

Adjust to policy developments just like you would adjust to momentum in the Dow or the VIX, guided by objective facts and data. Leave the normative judgements and disagreements regarding the developments for another time and place. Focus first on adjusting the portfolio positions in relation to the policy developments .

Clarify Assumptions. How much is your position exposed to policy risk? Many traders assume incorrectly that the policy framework is constant. If they consider policy risk at all when formulating a position or portfolio strategy, they will often assume that the policy framework will not change across the expected holding period for the position. Clarify these assumptions by asking Does a long-dated position overlap with a pending rule change in the industry?

Clarify whether and to what extent your portfolio positions are exposed to policy risk by asking questions that directly address the link between policy risk and market risk. Does a long-dated position overlap with a pending rule change in the industry? Does a holding period or an expiration date straddle a summit meeting?

Distinguish between policy (what elected and appointed officials are saying and doing) and politics (public sentiment, polling data, vote counts).

Grassroots voter sentiment, polling data and sentiment analysis are notoriously fickle. The correlation between advocacy and policy outcomes is neither high nor immediate in most cases. Policymaker actions and words provide more reliable indicators of policy trajectories.

Accept that the "laws" of economics are not enforceable in court.

Policymakers prioritize values (e.g., free markets, income redistribution, economic sovereignty, climate sustainability). Reasonable people will disagree on whether specific policy choices are consistent with the canons of economics. This is why democratic societies hold elections...to identify the value priorities that will guide decision-making over a period of time.

If the evidence for an anticipated policy shift is someone else's opinion, know that you are looking at a lemming and dig deeper. If the evidence supporting a position relies on a policymaker's statement or actions, know that you are looking at cold, hard facts and are on the right track.

Your job as an investor is not to judge the wisdom of a policy. Your job is to determine how the current policy trajectory will impact your portfolio positions. Your job is to maximize returns by investing in companies and sectors that can benefit from specific, observable trends. Policy choices create winners and losers, whether you agree with the choices or not. Being objective means accepting that in the near-run policies that contravene the laws of economics will have an impact that require adjusting investment theses and market positioning.

Prioritize facts over opinion. Whenever a trader or a risk managers says "I cannot believe theyi did -- or will do -- this," push back. Is the anticipated outcome illegal or otherwise proscribed by treaty, law or regulation? If not, then the outcome is possible.

If an outcome is possible, it is critical to determine whether it is also then (i) likely and (ii) sufficiently material to impact the economics of your positions or portfolio.

Markets have an old, valuable maxim: "don't fight the tape; the market is always right."

The point is that as a trader you don't want to get caught on the wrong side of momentum. It does not really matter if the fundamentals or the technicals are pointing in a different direction. If the market is heading somewhere, as an individual investor you cannot change the direction of travel so you either have to follow the trend (e.g., invest in an index fund) or get out of the way (hedge or divest).

The efficient market hypothesis basically posits that all those other traders together cannot possibly be wrong. Someone knows better and if you don't see why the market is heading in a particular direction then you need at a minimum to get out of the way to avoid getting crushed.

Anyone who has spent a fair amount of time on Capitol Hill and within the policy process in Brussels, Basel, Washington, London, or any other center of policymaking knows that the same dynamic applies to the policy process. The policy trajectory builds momentum the closer one gets to a final decision. Policymakers learn that leadership consists in part of generating sufficient momentum in a particular direction to ensure that critics and opponents either get out of the way or turn into followers.

The challenge for market participants is that policy momentum looks and sounds different from market momentum.

Rule 2: The Trend Is Your Friend

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Policy momentum moves more slowly than market momentum. And unlike the value-neutral numerical values that express market momentum, policy momentum is wrapped in values and unstructured data (words).

If you are an advocate, a voter, or an impact investor, then you will want to pile in to support the direction you believe to be the normatively correct outcome by creating a positive feedback loop for companies that take virtuous or preferred actions. But for everyone else, it is important to realize that you are a bystander in the policy process. You are not able to influence the outcome with your individual investment.

If you want to influence the outcome, become involved in the policy process. Write a comment letter when a consultation opens. Write an op-ed. Hire a lobbyist. Hire a pollster. Vote.

But don't confuse these activities with investment policy.

Investment policy (except for impact investors) isn't about *changing* and outcome or even supporting a *good* outcome. Investment policy is about making sure that you can generate alpha and/or hedge for downside risk even when you think that a policy trend is negative.

You Don't Have To Like It

This is where Rule 1 (Be Objective) comes in handy. You don't have to like the trend in order to identify it and invest accordingly. You just need to be able to identify the trend in order to trade effectively.

Case Study: Cryptocurrency Regulation

Consider the evolving cryptocurrency policy landscape. Many investors, issuers, and ICO issuers believe deeply that regulation of the blockchain/crypto universe is either unnecessary or inappropriate. You can believe this all day long, but if you are invested in the sector in any way you have a professional obligation to be aware when and how regulatory policy will impact the economics of your position.

In point of fact, momentum towards direct regulation of the crypto space has been building for two years. Momentum accelerated in the first half of 2019.

- ***August 2017***: The Basel Committee drops a major conceptual document regarding FinTech regulation while most people were on summer vacation. We spotted it HERE in August 2017.
- ***January 2019***: The UK's Financial Conduct Authority released a consultative paper proposing a regulatory framework for Initial Coin Offerings (ICOs) that would effectively keep some forms of cryptocurrency outside the perimeter of regulation. We analyzed that proposal HERE in January 2019, noting that the UK is now the outlier since other major jurisdictions (Singapore, Hong Kong, United States, Japan, Abu Dhabi and Qatar are taking a different approach.
- ***February 2019***: Financial Stability Board policymakers released a trio of documents over a ten day period that, taken together, point towards increased regulatory attention to, and regulation of, the crypto space. We put the puzzle pieces together HERE and HERE.
- ***March 11 - 13, 2019***: We identified HERE key policy issues for the cryptocurrency space associated with the new JPM Coin. By Wednesday morning (March 13), the Basel Committee on Banking Supervision had issued a statement making clear that any regulated bank either with exposures to the sector or with related services that operate in the sector is expected to have in place a range of risk mitigation policies and procedures including: due diligence, disclosure and notification to its regulators.
- ***May 28, 2019***: We noticed immediately HERE when regulators (in this case, the International Organization of Securities Commissions) proposed to expand the regulatory perimeter to cryptocurrency trading platforms.

Consider the penultimate sentence of the Basel Committee press release on March 13: "The Committee will in due course clarify the prudential treatment of such exposures to appropriately reflect the high degree of risk of crypto-assets." In other words: bank regulators globally are exploring what kind of regulatory capital requirements should apply to bank exposures in this sector. IOSCO made a similar statement with respect to the application of regulatory capital requirements to cryptocurrency trading platforms in May.

You don't have to like this trend to realize that the Wild West days of low cost, low regulation crypto-issuance are over. Knowing that the trend exists is the first step towards crafting a serious strategy for hedging or delivering alpha.

What is true regarding digital assets is true for every regulated sector on the planet. We could craft a similar timeline for any number of trade and tariff policy decisions which have been driving headline risk for the last 18 months.

You don't have to support increased tariffs on steel or, the UK, increasing the proportion of EU imports to eligible for zero tariffs (from 80% today to 87% in a post-Brexit world) as reported by Reuters here to know that specific sectors (e.g., industrial manufacturing, soybean farmers in the United States, the auto sector) will be uniquely impacted by the policy shift.

Whether the trend is towards increased regulation or deregulation, the outcome is the same: the cost basis for delivering a product or service shifts with every change in regulatory policy. You do not need to agree with the shift in policy in order to position yourself strategically in relation to the shift. You just need to be able to maximize the advantage from the momentum, particularly if you owe a fiduciary obligation to your clients.

How To Deal With Momentum Shifts

Dealing with momentum shifts in the policy process is fundamentally no different than dealing with momentum shifts in the capital markets through a mark-to-market discipline. Follow the same basic process:

- Reevaluate the position in light of new facts.
- Conduct scenario analysis for different policy outcomes.
- Identify potential hedging strategies to cover downside risks from a shift in policy.

If you are not yet invested when momentum to change policy begins to emerge:

- Start crafting investment theses that will position you and your clients to maximize first mover advantages.
- Identify the sectors most likely impacted positively and negatively from the anticipated policy shift.
- Assess the likelihood of a specific policy outcome becoming a reality within a specific time horizon (more on this in later chapters), and invest/hedge accordingly.

FX markets and sovereign bond markets are usually the asset classes most directly impacted by macroeconomic and geopolitical policy shifts. However, all asset classes are impacted by policy risk. More importantly, a much broader range of policies impact a large number of companies and asset classes through developments that operate below the level of front page news. These policies also can deliver a material impact on individual economic sectors and companies.

Investors are exposed to policy risk at all times. The level of exposure can vary based on multiple factors, particularly the time horizon anticipated for the investment and the vulnerability of the company or sector to shifts in policy.

Advanced technology makes it possible for investors to assess the risk of exposure to public policy risk and to develop a strategy to address those risks and related opportunities without engaging high -priced consultants and pundits. Tracking momentum makes it possible to identify momentum when it begins to build, which enables early identification of likely outcomes long before the headlines are written. Taking the time to undertake this analysis when the momentum begins to building helps insulate the investor from headline risk later when a decision is announced.

See Rule 3 in the next chapter for how best to identify when momentum is building.

If you are following Rule 1 (Be Objective) and Rule 2 (The Trend is Your Friend) and if you have a mechanism for following the news cycle, you might think that being strategic is easy. Sadly, this is not the case.

Being strategic can be very difficult in a world of information overload and a 24/7 news cycle turbo-charged by social media. You need to implement processes to combat information overload in order to leave space for strategic planning.

The strategic challenge expands exponentially for algorithmic traders that rely on automated execution. Process automation may decrease latency associated with headline risk reaction functions, but automation also accelerates the velocity of market reaction to headlines regardless of whether those headlines are accurate.

Information Overload Undermines Strategy Formation

Trading the news often seems like a Cold War arms race. Investors vie for access to more and better information to support their investment and execution strategies. Simultaneously, the flow of information from official sector sources increases daily.

Rule 3: Be Strategic

On the supply side, policymakers generate a nearly infinite flow of information around the clock. New developments are posted on websites while you sleep. Massive volumes of documents and statements are dumped into the news cycle around key inflection points like summits and hearings. Reporters seek out leaks and hints about decisions, creating potential future exposure to shifts in the policy profile. Everyone has an opinion, from bloggers and former government officials to newsletter writers that populate your inbox regularly.

Demand for access to information from capital market participants prompts significant investments in technology that can decrease the latency of information transmission. High frequency traders and algorithmic traders track headlines and Twitter feeds so they can execute trades on a nanosecond basis. Their goal is to be the first and the fastest to react to policy shifts. Risk managers and portfolio strategists require the most updated information in order to generate more accurate, realistic scenario analysis that facilitates smarter risk assessments.

More rapid access to information powered by advanced technology creates its own challenges, however.

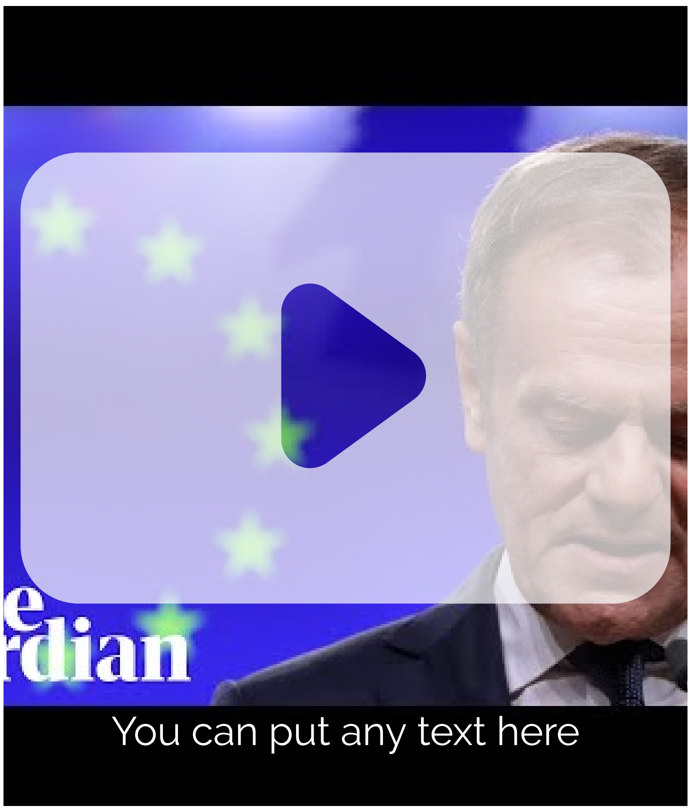
The Telephone Game: By tracking the news cycle intensively, advanced technology powered by Natural Language Processing can help spot inflection points faster. This leaves space for professionals to focus on strategic issues used to program the next set of execution instructions. The irony, however, is that the noise of the news cycle creates distraction. It is easy to slip into the teenage game of telephone as traders and media outlets ask "did you hear about" the latest statement, outrage, or disaster.

Addiction: Significant, non-stop access to information about policy also generates the temptation to convince people (including, of course, risk managers that must approve a trade or a trading strategy and related risk limits) that you know what you are talking about. You can tell when someone has become addicted to the news cycle because they know every arcane detail of a situation.

Misleading Headlines: Headlines can be misleading. They can overstate a situation. They can focus on gossip while burying the substantive detail that makes a difference . Most importantly, while everyone in the market chases the headline, alpha can be generated from the detail.

Case Study: Bexit (Feb. 2019)

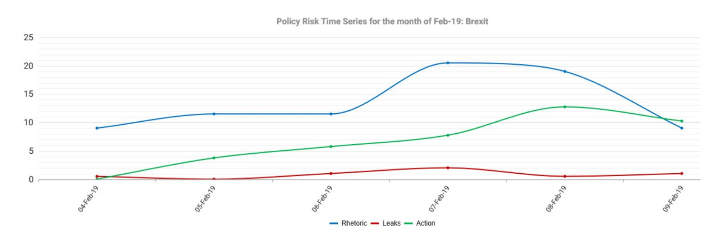
Do you remember the EU reaction to the UK Parliament's rejection of the negotiated Withdrawal Agreement? Do you remember the statement they issued? Of course not. Most people only remember this press conference and the "special place in hell" comment:



The next 36 hours in the media cycle were dominated by this colorful comment. Blogs were written. Countless hours were spent in broadcast media talking about (and chuckling over) the comment. Countless more hours were spent by trading professionals repeating the quote and the story, many with the apparent intention of portraying themselves as an insider close to the action when in reality the talking point had been plastered all over the global news cycle.

Brexit supporters responded, thus extending the news cycle and the argument over this statement which has zero impact on the actual substantive issues.

Throughout the week, various policymakers in London *and throughout Europe* began putting into place policies designed to minimize the disruption on the first working day of April in the event of a No Deal Brexit.



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As the chart above illustrates (created by our patented technology), by the end of the week, action had out-paced rhetoric. More importantly, the distribution of the action was broadly dispersed across a range of policymakers in Europe (EU Parliament, European Securities Market Authority) and the UK. Even more importantly, all these policy actions shared a common purpose: implement a No Deal Brexit. For more detail, please see the full analysis on our website in this blogpost.

The 24/7 news cycle and all the chatter distracted attention from the inflection point that occurred that week. No Deal Brexit became the dominant policy trajectory that week and has remained so to this day.

The media cycle and the ensuing gossip stream distracted from the substantive hard line position taken by the EU. President Tusk's statement made the following point clearly and succinctly: "the EU27 is not making any new offer."

This set in motion the creation of two irreconcilable positions: a majority in the UK Parliament disapproving the Withdrawal Agreement and seeking a renegotiation at the same time that the EU was articulating a strong position against any renegotiation. The outcome from this deadlock was dramatic, although the media did not report on it.

How To Remain Strategic Amid A Chaotic News Cycle

If you are exposed to policy or geopolitical risk, it is crucial to avoid getting distracted by the noise of the news cycle. Remember that policymakers for decades have been skilled at the art of generating news headlines to focus public discussion on the topics they prefer to discuss while technical policy operates quietly in the background with less attention.

The marketplace of ideas has become more crowded with the advent of social media. But the basic mechanisms used by policymakers, advocates, and saboteurs has been in pace for decades. The communications modes may have changed, but the dynamic remains the same: policymakers, advocates, and activists vie to dominate the theme of the news cycle.

> The first step along the road to freedom from the tyranny of the news cycle is to realize that ALL participants in the policy process are also prime movers of the spin cycle.

The good news is that two simple steps can help insulate you from the influence game so that you can focus on the alpha generation priority important to capital markets.

1. **Stay Focused and Disciplined**: If your position is focused on a specific issue, avoid spending time on ancillary irrelevant developments. Yes, the "special place in Hell" talking point was salacious. But was it really relevant to the policy trajectory regarding cargo inspection standards at Calais or equivalence decisions regarding clearinghouses? No. ***Focus only on developments that directly impact your position***

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2. **Use Technology Wisely--**
Capitalize on Enhanced Cognition:
Seek out technology solutions that deliver the ability to focus on concrete policy activities rather than just regurgitate aggregate search results from the media cycle. Advanced Natural Language Processing (NLP) makes it possible to delegate reading to a computer which can process much larger quantities of information faster than any human. Wise use of this technology to support trading-related research delivers "enhanced cognition" by which human beings can connect the dots faster and better than a computer.

We know that artificial intelligence and machine learning is all the rage right now. But the reality is that AI is in its infancy, literally. AI systems cannot yet generate the kind of connections between related concepts as well as humans. A human using NLP-based solutions can still out-perform the current generation of AI systems.

It is an open question whether and to what extent AI systems will be able to replace human analysis. More sophisticated training data and greater understanding of AI algorithms will continue to push forward the frontier of innovation.

In the near-term and for the foreseeable future, advanced technology can deliver significant productivity gains to human analysts by automating the first few steps of the analytics process. Investment analysts using enhanced cognition platforms today will be able to increase alpha generation regarding investments exposed to policy risks.

These are not easy steps to implement. The ability to trade the news responsibly requires being able to distinguish between the chatter and real activity. Failure to implement these rules exposes you and any client funds you manage to policy risks.

Rule 4: Understanding The Role Of Economic Data

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You have your investment thesis. You are committed to being objective (Rule 1) and strategic (Rule 3). You are disciplined about understanding that The Trend is Your Friend (Rule 2). You have a mechanism for tracking news developments.

Then a blockbuster economic data point is released which generates substantial market volatility. What do you do? Hope for the best? Take the ostrich strategy and pretend the data don't exist? Rationalize that you are only trading the news so the data is irrelevant?

The right answer is: none of the above.

Economic data releases are always relevant and important. The key is to understanding the relationship between specific data points and specific news-driven trading exposures. Data releases and the news cycle have an obvious symbiotic relationship. Data releases generate news cycles as well as trading opportunities. You cannot ignore the data.

You need a strategy for how to read data *in the context of the news cycle*. Welcome to Rule 4.

Why Economic Data Matters

Economic data obviously sends important directional signals regarding the economy. It also directly and immediately impacts asset classes particularly important to macro traders (FX , sovereign bonds, corporate bonds).

The market reaction function to data releases can spill over into other asset classes when the data release demonstrates unexpected outcomes (positive or negative). The reaction function thus generates the incorrect perception that economic data drives policy risk.

Reality is more complicated.

When trading the news cycle with an eye on geopolitics and policy risk, economic data can create distractions. Economists and pundits will pounce on data releases to declare that policymakers “must” take a particular action in light of the released data. **However, the correlation between policymaking and economic data releases is far from direct in most non-crisis situations**.

The key to implementing Rule 4 successfully is to remember to **treat headline risk as an asset class**. Portfolio structure and investment theses in other asset classes require meticulous preparation to identify potential pressure points from market data in order to structure stop-loss orders and other trading thresholds. The news cycle is no different.

Economic data accelerates or constrains policymaker choices. But only specific data releases will impact specific policies. So being strategic and thinking it through at the beginning will minimize downside risk from headlines regarding irrelevant data points.

Minimize headline risk with respect to economic data releases by taking three simple steps, patterned on the process for tracking economic data generally.

Identify in advance which specific economic data points will have a material impact on your position.

For example, a strategy focused on trade policy news will be directly impacted by trade deficit/surplus data releases but not necessarily by inflation data.

Automate the tracking process . Identify release dates from all relevant sovereigns. This is a fairly straightforward calendaring function since most jurisdictions publish economic data releases well in advance. RSS feeds and enhanced cognition platforms make tracking the release process easy, eliminating the risk of being surprised by the timing of a data release. Automated ingestion of data releases into spreadsheets immediately upon release of the data turbo-charges the data acquisition process, effectively turning the data release and analysis function into an IoT activity. The magic occurs not in being the first to acquire the data but in being the first to *understand* what the data means. See Step 3 below.

Identify specific values for economic data points which will create adverse downside risk for your chosen time horizon/holding period.

Automate the alerting function by requiring your spreadsheet to notify you when specific or anticipated threshold values appear in the released economic data. For example, if you know that trade negotiations between two countries are politically sensitive to specific deficit or surplus levels at the bilateral level, then set up an alerting function to trigger when those levels have been breached.

Update/refresh your policy expectations and data alerts following data releases.

This step mirrors directly the approach regarding traditional investment analysis. If you reassess your economic and other financial projections based on the release of GDP or inflation data, then the same data release should prompt a reassessment of whether a particular policy trajectory has become more or less likely.

Ignore all other data releases when making decisions about the position.

If inflation data is not relevant to a policy decision (e.g., privacy regulation), then that data point will not impact the trajectory for that policy. Know your risk drivers in policy with the same level of depth and attention to detail as you would for any other asset class.

Rule 4 does have limits, however. No level of automation will without first thinking through the implications of the underlying data.

If you are treating the news cycle as an asset class, it is crucial to understand the nooks and crannies of that policy asset class in the same level of detail as any other asset class.

Traders may not have access to the same resources, but they can implement a range of process automation functions that facilitate decision-making. For example, set an automatic alert to trigger when data releases indicate a reversal of direction. In the trade policy context, if a bilateral trade deficit is expected to grow, a rudimentary alerting function could be triggered if instead a surplus develops.

Economic data releases drive news cycles, creating the news even when they deliver directional indicators regarding real growth prospects. Any effort to trade the news cycle must incorporate a strategy regarding economic data releases in order to minimize adverse impact on a position from headline risk driven by data releases. Approaching the news cycle as if it were an asset class helps define which specific economic data releases will be important to a trading strategy.

The complexity of the economic data tracking and signaling process will be determined by the resources available to any given trader. The key is to implement a disciplined, consistent process for assessing the impact of data releases when preparing to trade the news. Even the simplest process will deliver enhancements in risk profiles (and possibly alpha), especially if the rest of the market has not yet implemented Rule 4.

Rule 5: Be Relentless

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Rule 4 (the role of economic data) highlights the importance of having a "mechanism for tracking news developments." Rule 5 tells you how to execute on this recommendation. Because trading the news requires being utterly and completely relentless in capturing new developments consistently, efficiently, and effectively.

"Relentless" Defined

Merriam-Webster's definition for "relentless" provides the relevant starting point:

> "showing or promising no abatement of severity, intensity, strength, or pace."
>
> — Merriam-Webster

The news cycle in general and public policy news in particular can change in a heartbeat. Strategically significant developments can be dropped quietly on a government website or released to the media late on a Friday afternoon. Developments halfway around the world can trigger a policy reaction function that accelerates a decision from a regulator that impacts your investment as soon as people notice.

The reaction function to news can occur on a nanosecond basis for high profile issues that generate headlines tracked by high frequency traders. But the reaction function can also be attenuated. So much happens in public policy that never makes it to the news cycle either because it is too technical or because the developments are overshadowed by more dramatic developments elsewhere.

The smart money knows the importance of tracking relentlessly key policymakers and action-forcing events (like summits and hearings) as well as more itinerant policy announcement events.

Financial markets have long rewarded those with the fastest and best access to relevant information. The tickertape and telegraph were the Twitter of their day, delivering the fastest and most direct access to information available at the time.

The 24/7 news cycle, turbo-charged by social media, accelerates and fine-tunes the information acquisition process while smartphones place information access literally in the palm of your hand.

Technology Is Essential

Technology is essential to being relentless in the pursuit of information if you are planning to trade the news. It has always been essential, and it always will be.

The question, however, is *what kind* of technology do you need? The question is as challenging for a day trader as it is for a macro strategist at a major firm with multiple screens and terminals. Technology makes it easy to access information, but the trick is in understanding *which* information is relevant.

The answer comes from dusting off Rule 3 (Be Strategic). Having identified which elements of the news and public policy cycle are relevant to your position, use that strategic to guide your choice of technology tools to help you monitor developments that will impact the position.

The good news is that we are well past the days that require people to stare at the newswires or cable news broadcasts. The even better news is that sophisticated language processing technology (Natural Language Processing or NLP) now makes it possible to track developments electronically with a level of precision not available even five years ago. You can fine-tune precisely which words or phrases you want to track.

As noted recently in our company's Disruption & Data Blog, "NLP and related analytical technologies deliver ***enhanced cognition***, making it possible for human beings to see and analyze trends in policy language faster and better because they create a buffer between the emotional reaction to policy language and the information content of policy language."

In other words, not only is technology essential for acquiring information quickly, it is also essential for acquiring policy-related information efficiently in a way that facilitates analysis and alpha generation.

More Is Not Always Better

Many investors can feel like kids in candy store with so much access to information. And that's before we start talking about premium news services like Bloomberg and Thomson Reuters or premium data vendors or newsletters or consultants.

The danger is that one drowns in the details of information delivered through an electronic information firehose. Financial markets have always had their fair share of analysts and strategists that slip into obsession when tracking developments related to their position.

Every one of us knows when a colleague or a friend has become obsessive because they are able to quote obscure data or developments with great excitement. No detail is too small or obscure. Technology amplifies the ability to become obsessive over information flows relevant to a position.

Just remember that more is not always better, particularly when it comes to public policy data.

> It is easy to lose sight of the fact that much of the information regarding public policy within media reporting is....*opinion*.

Do you really need to read every single op-ed and every single blog post on a particular issue? No. In fact, all that opinion can create a smokescreen that distracts or obscures from important actions taken by policymakers.

It may seem hard to believe, but often the most strategically significant public policy developments occur quietly in the technical details not in fiery op-eds. So take a deep breath and step away from the echo chamber. Focus on identifying strategically significant components that will impact your position and only then start shopping for your technology toolkit.

Being relentless in acquiring information is essential when seeking to trade the news. If you are serious about trading the news, there is no substitute for investing in the best automated tracking tools you can afford. Just be smart about how you invest in these tools and be strategic in how you use them. Finely targeted and sophisticated tracking platforms can generate far more value-added in the hands of a strategic, focused investor than unlimited access to the news flow from multiple screens.

Rules 1-5 focus on how the policy process mimics markets and how investment strategists must adopt the same rigor to analyzing policy developments that become public as they do to tracking market, company and economic developments. Rule 6 highlights how public policy and the news cycle around public policy are different and what you can do about it.

Rule 6: Be Flexible

Rule 6: Be Flexible

The most important thing to understand about public policy risk is that it is not binary. This will initially sound counter-intuitive. The news cycle encourages outside observers to view public policy as generating binary event risk.

Examples include:

--Did legislators vote for or against a law?

--Did voters vote for or against a particular referendum ballot item or a specific candidate?

--Did leaders at a summit meeting agree to take a specific action?

The temptation is great to treat these inflection points as triggers for investment decisions. Algorithmic and high frequency traders build entire automated execution strategies around headlines for this reason.

The underlying, implicit assumption is that these policy events (which we at BCMstrategy, Inc. consider to be data points) are no different from economic data. A particular job growth number or CPI number or quarterly earnings report will hold specific and automatic second-order impacts on economic growth and a company's bottom line at least for the next quarter or until the next data release…which occur at predetermined intervals.

Public Policy Risk is NOT Binary

Public policy risk is not that simple. It operates on a continuum. Decisions can be taken off-cycle, as the Brexit situation has illustrated multiple times during 2019 alone.

More importantly, public policy is more like software development. It is never really finished. A "final" vote or decision merely re-sets the deck for the next round of advocacy and policy planning as the winners seek to maximize momentum to ensure their decisions cannot be reversed and the losers start planning for how to regain lost ground.

Successfully trading the news requires a strategic perspective that sees past the immediate headline to the next few steps in the process in order to determine how solid the outcome might be. Treating a new development as a binary event often can result in trades that leave (or eliminate) the alpha potential.

Being nimble can be difficult, particularly in the face of overwhelming media attention to a specific inflection point. This is why high frequency traders automate the execution process. Unlike humans, a computer does not need to get past its emotional reaction to a development in order to act. It just sees the inflection point and takes the action programmed into its system. As we noted HERE recently, solutions that facilitate the translation of unstructured verbal data into structured numerical data deliver efficiency and analytical gains precisely because they provide an objective, unbiased mechanism for interacting with the news cycle that forces people to engage analytically rather than emotionally.

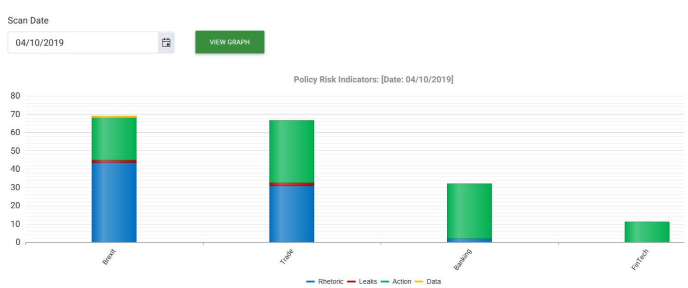
Inflection Points Are Predictable

Policy decisions may not occur on a set calendar like data releases and regulatory filings and annual meetings, but they can be identified in advance by applying a 360 degree view of the policy cycle.

Consider the full range of official sector activity globally in the 24 hours before April 10, 2019:

Brexit	European leaders were preparing for another summit where possible extensions to the Brexit deadlines would be discussed..
G20/IMF/ FSB	Finance ministers, regulators, and central bank governors were preparing for their annual spring meetings.
Trade	Following the WTO's ruling in favor of the United States regarding Airbus subsidies, transatlantic leaders were preparing for a fresh set of trade policy discussions.

The momentum picture looked like this at the beginning of April 10 in the United States:



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That's right – global trade policy was nearly as active as Brexit policy in aggregate. But the amount of concrete action regarding trade policy was far larger than for Brexit, even with all the pre-summit negotiations underway in London and in Europe.

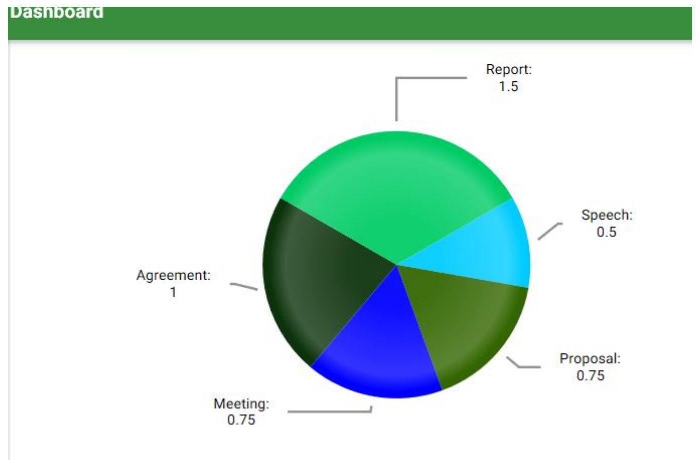
Being flexible requires understanding when the noise of the news cycle obscures strategically significant developments and being ready to act on it.

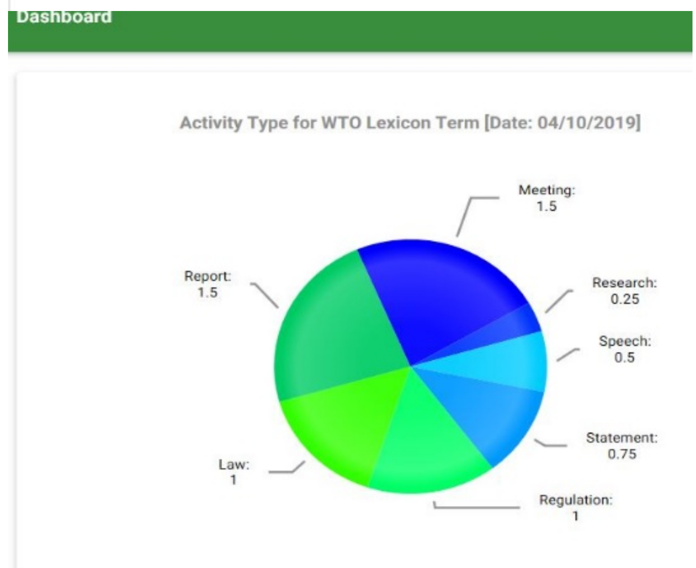
> Being flexible means every day being open to the possibility that a prevailing policy trajectory should shift and reacting nimbly to that shift when it materializes.

Being relentless (Rule 5) in tracking developments and being objective (Rule 1) in analyzing those developments makes it possible to spot policy shifts early enough to take action.

Why Being Flexible is NOT About Tracking and Executing on Headlines

Consider next the composition of activity regarding trade policy on April 9, 2019. Policymakers in the United States (the first pie chart) and the WTO (the second pie chart) were active on a much broader range of issues than just trade war tariffs and subsidies.





Buried deep in the weeds of the United States trade policy arena, far away from the media spotlight, U.S. trade policy was accelerating its shift to focusing on non-tariff barriers. As noted HERE and HERE, advanced economies dominated by services increasingly seek to focus on non-tariff barriers in the form of regulatory policy and standards in order to expand the free flow of services across economies.

The specific action was extremely technical and quite strategically significant. But because it occurred outside the ambit of the WTO/Brexit media feeding frenzy, it was largely overlooked.

The Details: Pursuant to a bilateral trade promotion agreement with the United States, Peru reversed a December 2018 decision (to which the United States objected) regarding the agency that oversees forests and timber concessions. In December, Peru had moved to incorporate the agency into the government in order to exert more political control over the entity. USTR objections pursuant to the bilateral agreement. The agreement required that the relevant regulatory body in Peru remain independent. Unnoticed by the media in April, USTR announced the Peruvian government had reversed course and the forestry regulator would remain independent.

While everyone else was chasing the Brexit and WTO headlines, two very specific sectors (timber, environmental issues) in a specific country (Peru) solidified policy trajectories AND signaled publicly that the main driver of timber policy in Peru was a bilateral trade promotion agreement with the United States. This is how alpha can be generated from a disciplined process for tracking policy developments comprehensively. Research into which US companies and which Peruvian companies stand the most to gain from this decision will generate trading strategies in the timber and environmental sectors that no one is tracking based on cold hard data.

Being flexible means not only having a superior process for spotting the inflection point but also the willingness and ability to act based on the implied opportunity beyond (and sometimes despite) the headlines. Being flexible thus requires a 360 degree view of the policy process and understanding that policy often is made outside the glare of the media limelight and using tools that will provide more than just an aggregation of headlines that repeat the same information.

> Policy is often made publicly, but away from the glare of the media limelight.

Rule 7: Understanding Leaks

Few things in the news cycle generate more interest than a leak. It's easy to understand why. A leak makes public information that otherwise would be confidential. Once it is out in the wild, it is fair game as the foundation for trade execution because the information is now "publicly available."

But generating alpha from leaks is far from straightforward. The policy process does not follow a linear path in general. Leaks only make policy trajectories more jagged. Why? Because making information available to the general public via the media creates a window for a reaction function and a policy pivot.

The Spectrum of Leak Activity

Let's start by understanding the landscape of leak activity. When we use the word "leak," most people jump to the conclusion that it refers to the unauthorized (and illegal) release of classified national security information to the media or a website, usually by a disgruntled lower level employee. Despite the media feeding frenzy over such inappropriate disclosures, this is actually a very small part of the leaking process.

Leaks occur for many other reasons regarding non-classified but still valuable information. Policymakers themselves share information with the media; sometimes they authorize staff to share the information. When used in the manner described below, they are an element of statecraft that permits policy to move forward.

Strategic Communications: The policy process requires multiple public officials to agree regarding the next rule, law, communique, or public posture. But because the media and other observers follow policymakers so closely, the mere fact that two or more policymakers meet with each other can generate speculation about a deal under negotiation long before the policymakers are ready. In some instances (e.g., U.S. financial regulators), the law prohibits policymakers from meeting together privately.

A well-placed leak provides a mechanism for policymakers to talk to each other during negotiations without actually meeting. If the leaks also articulate a "red line," they help minimize the risk of surprise at a meeting when – or if -- one finally occurs. The policy process moves forward through the reaction function as reporters circle back to other relevant players to ask their opinion on the leaked information.

Trial Balloons: Sometimes, leaks provide a way for policymakers to assess public reaction or other policymaker reactions to an idea. Because a leak is not attributed to a specific individual, the policymaker has maximum flexibility to take a different decision if the leak generates a firestorm of opposition. Elected politicians are particularly skilled at the artful use of leaks to help determine the direction of public sentiment; some use strategic leaks to generate momentum in the direction they would prefer.

Reaction Function: Sometimes, a situation is developing so quickly that "no comment" in response to a reporter's question would only add fuel to a very public fire. Rather than feed the fire, a spokesperson might be authorized to share some information with a reporter to ensure that the media depiction of a situation is at least not misleading.

Self-Aggrandizement: It is human nature to want respect and seek to be seen as a mover and shaker. This is particularly true of people involved in the policy process. Leaks can occur merely because the individual wants the reporter to believe that he or she is "in the room where it happens" and really knows what is going on.

Minimize Surprises/Market Volatility: Policymakers, like market participants, loathe surprises and volatility. A leak regarding the main elements of major reports or decisions can help cushion the market blow and minimize related volatility.

The Spin Cycle: Policymakers can -- and do-- seek to influence the perception of their actions by providing reporters with access to privileged information designed either to head off public outcry or build support for their position.

The motivation to share a leak with the media thus varies considerably across situations and individuals.

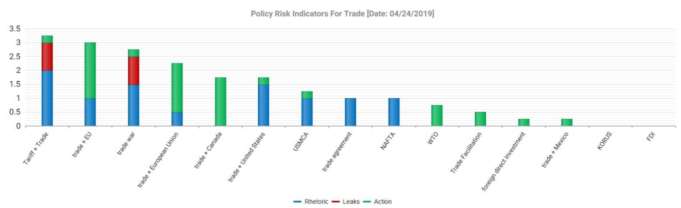
Yet all leaks are alike in one crucial respect. Leaks, by definition, do NOT represent a final official decision. This is not well understood by markets generally. Many market participants mistakenly believe that leaked information holds a high predictive value of policy outcomes. Instead, leaks only generate increased volatility regarding an outcome. They rarely determine the outcome.

Risky Business

Leaks leave room for decision-makers to change their minds. They can disavow the information. They can discredit the information. They can shift a negotiating stance. They can refuse to take a meeting. Leaks can change the *trajectory* of policy but they rarely trigger a concrete outcome immediately.

Leaking activity tends to peak before major meetings and decisions as more policymakers start communicating with each other and the public through leaks. Those leaks often contradict each other. At best, they provide perspective on the scope of the policy discussion. But they are not dispositive of the outcome. Automated processes that track headlines or leaks in order to fuel high -frequency or other trading will thus generate additional volatility, increasing the misperception that the policy process is random.

Consider the leaks in the April 24 policy risk measurements for trade :



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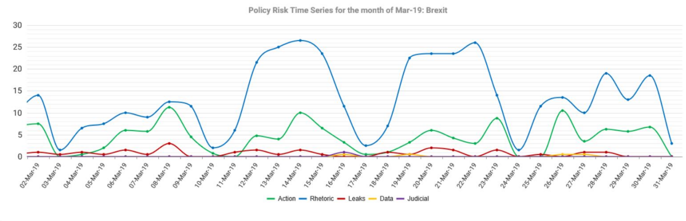
Do leaks regarding tariffs and trade wars signal that trade tensions are intensifying? Not really. For example, the trade war reference occurred in an FT story regarding a chip manufacturer rather than providing new information from the official sector. Context matters regarding leaks.

Or consider the relationship between leaks, action and rhetoric regarding Brexit in the month leading up to the end-March deadline for the UK and the EU to reach a deal:



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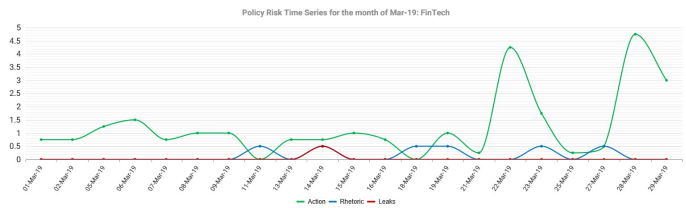
The leaks operated at a substantially lower level of volume compared with action. As anticipated, leak activity (the red line) peaked just before significant meetings and summits, but in this case far higher and more concrete actions (the green line) were being taken. As we noted in February, concrete technical actions by policymakers on both sides of the Atlantic were a far more reliable indicator of a no-deal outcome than any leak and they had the benefit of being real decisions.

Moreover, not all policy processes are driven by leaks. Compare activity levels during March 2019 for Brexit (above) and for FinTech policy (on the next page).



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An alpha generation strategy premised on leaks would generate little to no actionable data for FinTech policy issues globally. Not only is the aggregate level of activity low (despite the hype regarding cryptocurrencies), but there was only one leak from the official sector for the entire month. In the FinTech sector, actions truly speak louder than words, including leaked words.

Managing The Risk – The Technology Trifecta

Context matters greatly. In order to generate alpha responsibly and reliably from the news cycle, it is crucial to place leaks into their proper context.

Sophisticated technology to monitor, track, and analyze leaks is a necessary but not sufficient component of a serious alpha generation strategy with respect to the news cycle. Identifying that a leak occurred without identifying the context and content of the leak is a recipe for making mistakes when executing trading strategies.

When in doubt, refer to the cheat sheet on the right.

Rule 8: The Importance of Nowcasting

Rule 8: The Importance Of Nowcasting

When capital markets interact with the news cycle and public policy, the focus usually is on the ultimate outcome. Rule 9 illustrates why this long-term focus is misplaced, even for macro and bond market investors.

Capital market participants must mark their portfolios to market daily and adjust their exposure to risk accordingly. Adjustments can take the form of new or additional hedging activities as well as asset disposition.

If your goal is to generate alpha from the news cycle, then there is no substitute for adjusting exposure to policy risk on at least a daily basis. As noted throughout this book, reacting to headlines is at best a suboptimal way to manage exposure to policy risk. Strategic investors instead must adopt a nowcasting approach to assessing policy risk in order to get ahead of the news cycle using publicly available information.

Nowcasting – A High Level Overview

Nowcasting is the process of generating short-range forecasted outcomes using current data.

It originated in meteorology in the 1860s to anticipate weather-related events for navigation purposes. More recently, it has been used in the healthcare and economics contexts as described in this article. The Federal Reserve uses nowcasting to anticipate GDP growth, as described in this 2014 Federal Reserve Bank of Atlanta working paper.

Because nowcasting relies on the most current data in a series (e.g., the latest quarter data release), it focuses like a laser on the real-time inflection point implied by the data. In other words: it is not drawing conclusions or making projections based on past historical data. It instead assesses whether the current trajectory is consistent with, or departing from, the previous trajectory in order to assess whether an inflection point may be materializing.

Nowcasting is particularly relevant for policy risk analysis because new developments have the capacity to make historical information obsolete within a matter of seconds. The rapid rate of change in the policy environment leads many to conclude incorrectly that policy outcomes cannot be forecasted accurately. This is especially true during periods of rapid structural shifts. Nowcasting provides flexible mechanisms to facilitate analysis in fluid situations.

The problem, however, is in a mismatch of time horizons and data sets. Generating alpha from the news cycle requires a *daily* discipline of determining whether the developments of the day continue to support the investment thesis (and the cost of holding a position amid market volatility).

Generating alpha does not require knowing today the specific outcome at the end of the year. It merely requires knowing whether the policy process *today* is trending towards one outcome or the other. It also requires understanding when the noise of the news cycle is generating false signals. See Rules 1, 2, and 4 for how to read the news cycle. It requires learning and implementing the core skills common to all " superforecasters."

How to Use Nowcasting for Policy Risk Analysis

Every day, policymakers generate data that can be used to assess risk relative to a position exposed to public policy risk. They generate this data with every speech, statement, proposal, leak, and quote. In other words: they generate the data needed to conduct nowcasting with respect to the public policy process.

Generating alpha from the news cycle and managing related investment risks merely requires investors to adjust their time horizons to match the daily data release cycle. It requires the discipline of reassessing every day whether (or not) policymakers are proceeding towards a specific outcome. It also requires flexibility (Rule 6), relentlessness (Rule 5) and objectivity (Rule 1) to adjust portfolio positions in the event that policymakers are proceeding towards an outcome that you personally or the market do not favor.

Is your long-term view that policymakers "must" take a specific action because that action would be responsible/morally appropriate/necessary? Generating alpha requires instead a daily assessment of whether or not policymakers are pursuing that path.

Consider the bond investors in Greece a few years ago. Daily market volatility associated with GGBs and the EuroArea bond market in general demonstrated daily moves a multiple standard deviations during peak moments of negotiations. Investors that listened carefully and relentlessly to what policymakers were actually saying and doing took a range of tactical measures throughout the period in order to generate substantial alpha using only publicly available information.

Challenges of Using Nowcasting for Policy Risk Analysis

Implementing nowcasting for public policy risk is harder than it sounds. Executing well a nowcasting process on a daily basis requires three different sets of tools:

Relevant Information: The investor must be able to find relevant information for policy risk analysis beyond the headlines. This usually requires specialized knowledge from individuals that once were policymakers themselves. Significant expansions in transparency by governments worldwide paired with internet-based communications mechanisms means that far more information is available publicly from the official sector than at any point in the past.

Automated Media Monitoring: Policymaking now occurs in a 24/7 media cycle turbo-charged by social media. The number of media outlets covering government policy activity has grown exponentially in the last decade. The only way to cover effectively and comprehensively all public statements made by policymakers is to mobilize advanced technology to automate the media monitoring process.

Natural Language Processing: Sophisticated technology based on Natural Language Processing is needed to capture and analyze the language policymakers are using. This is NOT sentiment analysis. A policymaker can use negative language and express negative emotions regarding a particular policy even as he or she proceeds to endorse that policy. Sentiment analysis will only capture the emotion in the language. Instead, a value-neutral approach is needed, which assesses the action from the language. This is the frontier of Natural Language Processing, where BCMstrategy, Inc.'s patented technology operates.

Why does it work? Because policymaking is a community activity that requires consensus. The business of a policymaker is to garner sufficient support for specific language that articulates that consensus. How do they find the acceptable language? By articulating language publicly through speeches, materials, and interviews with the media. These words comprise the data set needed to implement a nowcasting approach to policy trend projection, as discussed in detail in this blogpost.

When we filed for our patent in 2011, we were excited to find an automated way to measure the volume and analyze the direction of public policy from the words articulated by officials. Now that the platform has been built, we see on a daily basis the value of taking a nowcasting approach to assessing public policy risk. It enabled us to anticipate that the UK would reach the end of March with "no-deal" Brexit as a reality. It enabled us to anticipate using transparent, objective data that the EU and the United States would begin building a more constructive trade policy relationship despite incendiary public rhetoric. And it enabled us to identify significant macrotrends regarding cryptocurrencies and their close (if not potentially competing) cousins in the central bank digital currency arena.

Rule 9: The Role of Alternative Data

Rule 9: The Role Of Alternative Data

Investors need data the way people need oxygen. Capital markets have consistently been on the frontier of technological innovation precisely for the purpose of acquiring more and better information faster. Before we had Twitter, there was the ticker tape, the wire services, and then the Bloomberg terminal and the Blackberry.

Capital markets may measure success through the financial gains acquired through alpha generation but the business of investing is only incidentally about money. Successful intermediation is about being able to manage, understand, and capitalize on information flows better than the competition. Investment funds are mobilized only *after* an investor has acquired sufficient information to justify the move.

Data provides concrete, objective information for the foundation of any investment thesis and portfolio strategy across a broad spectrum. Third party data includes: firm-specific micro data (quarterly results, sales revenues, ROI, etc.); sectoral data (industry sales trends, marketing statistics, market trading data); and macroeconomic data (GDP, interest rates, trade flows, stock market trading data including indices).

This array of data points has one thing in common. Within the technology universe, these data points are considered "structured" data.

Structured Data 101

At the highest level, "structured" data consists of any data that resides in a fixed field within a record or file. This includes data contained in relational databases and spreadsheets. It covers all integers traditionally used by market analysts to determine whether a specific investment is appropriate for a given investment objective (usually, delivering alpha or executing on a hedging strategy). It covers all integers used by economists and published by governments. It also covers words that have been incorporated into a spreadsheet.

The point is that structured data only exists in the context of an organizing framework. It provides the fodder for data science, which seeks to identify patterns such as correlations and covariances within the data. Increasingly, this analysis can be automated using machine learning and artificial intelligence utilities. Whether a person or a machine analyzes the data, in order to generate insights the data must appear in a structured format.

Alternative Data

Data and the science of analyzing data are all the rage right now given the proliferation of new data thrown off by smart devices and internet usage. Capital markets again appear on the frontier here, purchasing access to new kinds of data from new kinds of vendors. As noted in this blogpost, the universe of alternative data used in finance may be vast but it is not necessarily revolutionary.

Location Data	Long used to assess creditworthiness (often with controversy and legal restrictions).
Lifestyle Habits	Long used by insurance companies to set premium pricing for health, life, and auto insurance.
Weather Data	Long used to set property insurance premium pricing.

Alternative data from smart devices accelerate and deepen the level of detailed information available for analysis. Sophisticated IT processing makes it possible to combine these data points in new ways and to generate deeper analysis of existing data in order to generate better insights – and better decisions – in order to deploy investment funds effectively.

Two frontiers exist in the alternative data space: unstructured data and entirely new kinds of data. "Unstructured" data consists of content that cannot easily be crammed into a spreadsheet cell such as images, audio, email, and PDF files. In 2013, a Gartner blog defined the term as components that are "human-generated and people-oriented content that does not fit neatly into database tables." They then boldly (and probably prematurely) declared that processes to convert this content into structured data had made information overload premature.

It is certainly true that rapid advances in translating unstructured data into a machine-readable format have been accelerating for the last decade. Our own patent for converting words into numbers illustrates the point nicely. But the conversion process has created entirely new kinds of data for which no historical precedent exists. These developments are incredibly exciting for those of us on the frontier. But they also create challenges for investment professionals experimenting with how best to use this data.

Managing the Risks

Using alternative data to support investment decisions generates different kinds of risks. Incorporating habit tracker data for insurance premium setting is less risky at the conceptual level than using entirely new kinds of data which have never been used before in the investing process. Convincing your risk committee or your individual investors to rely on this information when committing capital to an investment thesis can present challenges.

For example, the alternative data may not have a sufficient track record. In addition, a firm choosing to rely on alternative data will want to be able to continue relying on that data for an extended period of time (particularly for long-dated, multi-year positions). The data vendor may not have been in business long enough to generate confidence by an investment committee that they will be able to provide a steady stream of high quality data to support a multi-year relationship.

These are legitimate concerns. But the concerns also create barriers to innovation. Staying on the sidelines creates the possibility that an investor will forego substantial alpha-generation opportunities that accrue to early adopters. The data revolution is not going away any time soon. Those who understand how to maximize the utility of newly available information streams will reap significant rewards through smarter, better investment decisions.

Investment professionals interested in relying on alternative data therefore must implement a range of risk management policies to guide experimentation with new data streams. We suggest those risk management policies consist of the following elements:

Training Wheels: When accepting a new data stream for which no historical patterns exist, operate your modeling processes in parallel (one with the new data, one without) for a period of time before committing real capital. The time period for parallel runs will differ based on the firm, its risk management and compliance culture, and of course the results. Some data streams may generate reliable results in six weeks; others could take six months.

Nowcasting: Don't get too hung up on historical data. Particularly in periods of significant structural shift, historical data has limited utility when forecasting new outcomes in generally. This is especially true regarding public policy. Consider whether any give historical analysis might (or might not be) relevant to your specific investment thesis and/or data source. Rely on Rule 8 and align your testing time horizon to shorter term outcomes. If the new data delivers credible results in the near-term over a period of 6-12 months, then investment in more formal backtesting may be warranted.

Operational Risk/Vendor Management: A robust regulatory framework already governs how financial firms interact with third party vendors. In the United States, policymakers like the Office of the Comptroller of the Currency have defined specific parameters for mitigating vendor-related operational risks. Among other things, a sliding scale exists. The amount of due diligence required of a regulated financial firm is proportionate to the level of reliance on the third party vendor.

So at the beginning, when using the training wheels approach, the level of reliance on alternative data will not be high. In addition, the OCC enumerates a range of components which can be used to assess the financial viability of the start-up and, thus, its suitability for engagement by a regulated bank. The components include: access to funding, funding sources, net cash flow and expected growth.

Seed Stage or Targeted Investment: If the relevant regulatory framework permits, some investors may consider underwriting specific product development or formal backtesting programs to validate the information value of the proposed data stream. Deploying the firm's capital to develop a promising technology before making that technology and data available when allocating investment capital from third party clients can generate subsequent gains when robust data streams have been developed which limiting client risk exposure.

Responsible use of alternative data – particularly the new frontier data for which no historical precedent exists – can deliver dramatic improvements for investment professionals. However, using alternative data requires an additional investment of time in order to understand well the contours of the data set and its relationship with the investment process. . It also requires implementing appropriate risk management safeguards.

Have you ever heard the phrase: “They are all talk and no action”? Nowhere is this more apt than in policymaking. The problem is that most people mistakenly believe that every word in the media from a policymaker is action. Your challenge as an investor is to distinguish between rhetoric and concrete action.

This is particularly a challenge in a distributed social media age when policymakers can connect directly with constituents and stakeholders without media intermediation.

Rule 10: Distinguish Between Action and Rhetoric

Rule 10: Distinguish Between Action and Rhetoric

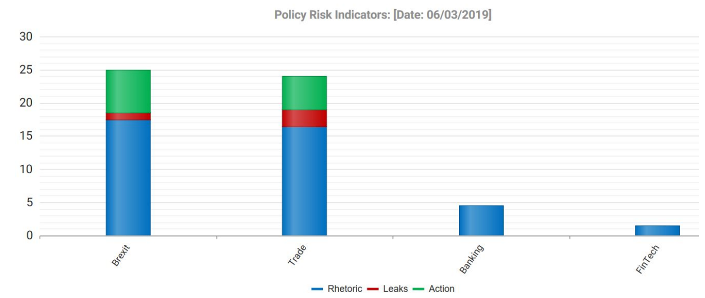
"Actions speak louder than words." This is true.....but you need to find the action in order to hear it.

Action in policymaking can be found in many places beyond media, both published and social. The activity policymakers choose to highlight in social media and published media represents their priority. But it does not represent the totality of their action. Similarly, journalists serve a filtering function, reporting on the developments they believe are important.

The filtering function provided by journalists who cover individual beats is important. When implementing Rule 10, the idea is NOT to discount or minimize the importance of media coverage for specific issues. The idea is to place that coverage in context.

Context: More Talk Than Action

Consider the momentum measurements on our patented risk measurement process for June 3, 2019, particularly with respect to trade and Brexit policy issues.



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There was far more talk than action regarding these two policy issues compared with banking and FinTech on that day. Interestingly, policymakers were talking marginally more about Brexit than about trade policy despite the fact that on the previous day the Chinese government released a significant white paper that aggressively pushed back on U.S. trade policy negotiating tactics.

A closer look at the results (not shown above)shows that the ONLY reaction function to the Chinese white paper that day was rhetorical. Policymakers reacted to the Chinese white paper with words and quotes to the media.....but they did not take additional retaliatory action.

> Words without action are just letting off steam or floating a trial balloon to sess the reaction function.

Context: More Action Than Media Attention

In many respects, public notice of action with limited or no media attention is a trader's nirvana....so long as the trader knows where to find the information. When policymakers act but no media reports on the action, then investors using out-moded mechanisms for monitoring public policy risk never "hear" it. They are too busy being distracted by a random word or phrase on social media that has zero legal weight.

Being able to see quickly and regularly the actions taken by policymakers beyond the glare of the media spotlight delivers significant informational advantages to investors seeking a strategic advantage. When algorithmic traders program their execution engines in relation to headlines, they use technology to deliver this informational advantage by accelerating the execution cycle.

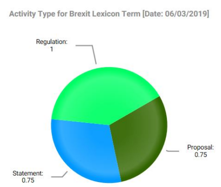
The problem is that by targeting headlines from wire services and other major media outlets they are missing much of what policymakers say and do. In addition, by priming the execution cycle to respond instantly to the policymaking cycle, they intensify policy dynamics and create the need for policymakers to respond again.

This is not entirely the media's fault. Governments generate far more concrete facts than any human can reasonably absorb in any 24 hour period. Even the most dedicated journalist or investor cannot possibly read and understand everything that policymakers say and do during a policy cycle. But you CAN use advanced technology to automate the intake and initial analytical functions so that you can quickly distinguish between situations when policymakers are just talking their book and when they are taking strategic action.

One benefit of assessing rhetoric *in the context of action* is that it permits investors to do what clients want them to do: take a strategic view that de-couples the investment reaction function from the policymaking reaction function.

If you can see the delta between rhetoric and action, you can identify faster and better when the words used by policymakers in the media represent strategic inflection points that require you to take action in the markets....and when those words are just letting off steam.

Consider the action vs. rhetoric results from the June 3 momentum measurement regarding Brexit.



	Activity Type	External URL
	Proposal	http://europa.eu/rapid/press-release_MEX-19-2812_en.htm
	Regulation	https://www.esma.europa.eu/press-news/esma-news/esma-publishes-supervisory-briefing-pre-trade-transparency-requirements-in
	Statement	https://www.esma.europa.eu/sites/default/files/library/esma70-154-1204_revised_public_statement_trading_obligation_shares.pdf

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The results show that European (not British) policymakers were taking strategic, concrete action to prepare for and minimize the impact of a no-deal Brexit in two crucial areas: transport at the port of Calais and financial services. Specifically:

Eurotunnel Customs Procedures: EU Commissioner Moscovici was in Calais to assess new customs procedures being implemented to prepare for Brexit. A press conference was planned with local officials . The move was designed to underscore to the UK that the EU was ready, willing, and able to implement customs and border controls immediately upon a no-deal Brexit scenario becoming a reality.

Share Trading Rules: The European Securities Markets Authority (ESMA) amended a technical regulation regarding the International Securities Identification Numbers (ISINs) that appear on share certificates. Since the order booking process requires that ISINs be entered in order to effect a securities transaction, any changes to the regulatory framework governing the ISINs could generate problems for the order execution process..

ISINs begin with a country code set of integers. Currently, all securities originating in the UK carry an EU country code designation. ESMA publishes lists of ISINs that they determine have met EU regulatory requirements and thus are eligible for trading in the European Union. In theory, Brexit will require all those securities to be issued new ISINs which carry a UK country code instead.

The Brexit situation thus raises a range of technical regulatory challenges. Existing ESMA lists will be out of date or irrelevant if the UK immediately redenominates ISINs with UK country code designations. Going forward, ESMA will have no regulatory authority over UK-based securities, which will compromise ESMA's ability to publish a comprehensive list of ISINs that meet EU regulatory requirements

In early June, ESMA announced it would no longer publish lists of ISINs that meet EU regulatory requirements. This action in early June accomplished a few goals simultaneously. First, it created a gap in which market participants can continue to use old ISINs without worrying whether they are authorized by ESMA. Second, it created pressure on the UK either to (i) grandfather existing securities (and thus permit ISINs with EU designations to trade on UK exchanges without a UK designation) or (ii) issue specific rules providing clarity to market participants and ESMA about its plan to transition to UK designations in ISINs. Finally, and possibly more importantly, the move publicly pressured UK policymakers to act, effectively foisting onto the UK any blame for post-Brexit market disruptions.

Commodity Derivatives Trading:
Simultaneously with its ISIN policy action, ESMA also separately released regulatory guidance regarding pre-trade transparency for commodity derivatives trading. ESMA has made clear that it expects EU firms to verify that trading venues comply with EU regulations or have obtained an official waiver from EU regulations by the end of 2019.

Although Brexit is never mentioned in the document itself, the guidance holds resonance for post-Brexit capital markets. It signals to EU firms that they will face heighted compliance risks by continuing to trade in London.

Currently, UK regulatory requirements are consistent with EU requirements since the UK has been part of the EU policy process for decades. However, separation from the EU institutions creates two issues. First, immediately upon exit, the UK becomes a "third country" relative to the EU and, thus, will require an equivalence determination or a waiver form policymakers in Brussels in order to support continued engagement by EU firms in its capital markets. Second, if UK regulatory requirements change over time, then EU commodity derivatives traders may face difficulties certifying compliance to EU authorities if waivers have not been granted.

These developments are technical but strategically significant. They signal that EU officials beginning the week of June 3 continuing to play hardball regarding Brexit policy at a point in time when the UK continues to drift without a new Prime Minister. Preoccupied by the leadership vacuum in England, the media has not reported these developments.

Investors focused on the delta between rhetoric and action and armed with sophisticated processes to find action as well as rhetoric were thus well-prepared for headlines that could have been generated in the next 24 hours by Commissioner Moscovici's press conference in Calais. Investors using this system were also well prepared for potential policy volatility regarding both share trading and commodity derivatives trading as the next Brexit inflection points approach throughout the summer.

Why It Works

Those of us that have operated within the policy formation process understand a profound and simple point.

> Today's policy actions generate tomorrow's headlines.

The smart money therefore follows like a laser and prioritizes the action taken by policymakers. The smart money that follows this approach is also able to spot faster and better when the media has missed a technical but strategically significant policy shift. This is the alpha generation moment.

Investors seeking to generate alpha from the news cycle must take a much more targeted approach to assessing the information value of the news cycle. Accurate and comprehensive assessments that compare the current news cycle and official sector action equip investors to make better strategic decisions faster. It also frees investors from reaction functions triggered by headlines, facilitating more strategic portfolio allocation decisions.

The Early Adopter Program

Automated, interactive access to daily global measurements of policy risk in four areas initially (trade, Brexit, FinTech regulation, and banking regulation) using our patented and proprietary technology. Early access to platform extensions as they become available.

Learn more

Publications

For companies that require advanced, data-driven predictive analytics regarding public policy but do not require daily interactive data access. Initial coverage: FinTech RegTrends (monthly); USMCA ratification (weekly), cryptocurrency & payments regulation (weekly).

Learn more

Additional insights regarding the frontier of data and public policy intelligence can be found on the company's blog: Disruption and Data.

How To Trade The News