Traders Pay for an Early Peek at Key Data

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On the morning of March 15, stocks stumbled on news that a key reading of consumer confidence was unexpectedly low.

One group of investors already knew that. They got the University of Michigan's consumer report two seconds before everyone else.

New York offices of Thomson Reuters, distributor of some key indexes.

BLOOMBERG NEWS

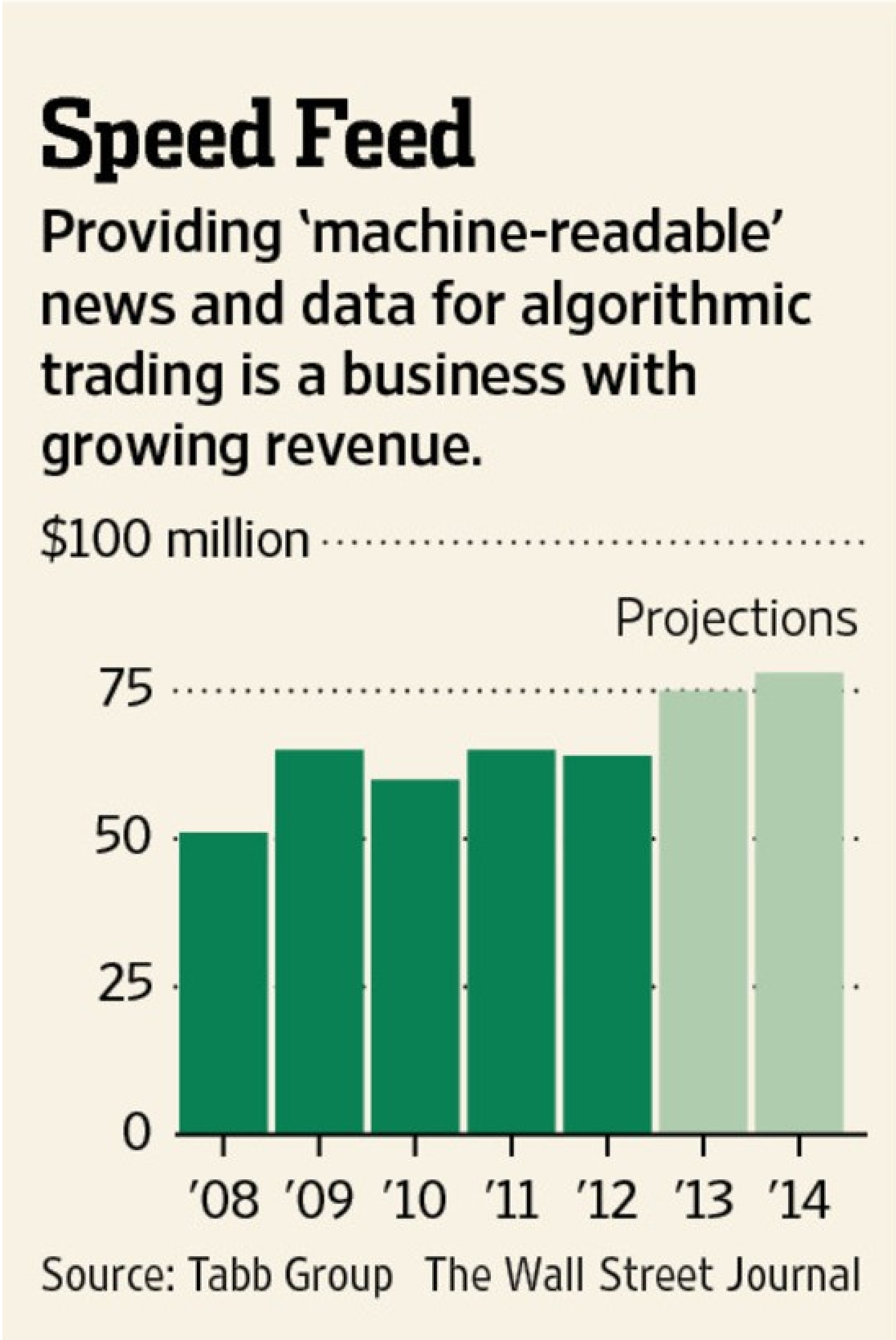
Infinium Capital Management, a high-speed trading firm in Chicago, used the information to launch a wave of trading in futures contracts, in just one example of the activity that followed. In a single second, according to a Wall Street Journal analysis, traders from various firms bet nearly seven million shares that equity markets would decline—which was exactly what happened when news of the survey became widely known.

Economic reports from public universities, trade groups and other nongovernmental organizations can move markets as surely as official data from the U.S. government. But unlike government reports, where pains are taken to make certain no one gets them ahead of time, few rules control release of nongovernmental economic reports. Unknown to many investors, selling early access is routine.

This is a "blind spot" in U.S. law, said Richard Painter, a former Republican White House ethics lawyer. Groups, he said, should "not be allowed to selectively disclose market-moving data to people who pay more money—that is not right."

But it is legal, and so is trading on the advance peeks. Even as securities rules bar companies from selective data disclosure, and as authorities vigorously pursue insider trading in all its forms, no law prevents investors from trading on nonpublic information they have legally purchased from other private entities. Trading would be illegal only if the information was passed through a breach of trust, said securities lawyers.

"If someone gives you permission to use the information, then there is no problem," said Steve Crimmins, a former Securities and Exchange Commission enforcement official now at law firm K&L Gates LLP.



Besides the Michigan consumer-sentiment survey, reports released early to paying customers include a Chicago-based barometer of business activity and a widely followed manufacturing index from the Institute for Supply Management—which said Wednesday it is re-evaluating how it releases its data.

Other organizations, including trade associations and private research firms, sell data that move industry-specific stocks and futures markets on everything from agriculture to truck sales. Among investment firms that have subscribed to such reports are SAC Capital Advisors L.P., Tudor Investment Corp., and Wellington Capital Management, according to people familiar with the matter. The firms declined to comment.

"It's not an exclusive club," said Infinium's chief operating officer, Gregory Eickbush. He said his firm needs to have an advance look at the consumer-sentiment survey to keep from getting "flattened" by other futures traders.

Mr. Eickbush said Infinium attributes around 10% of its annual revenue, or close to $18 million in recent years, to using high-speed news and economic-data feeds, in a strategy he called "event jumping."

Inside Game

How major players profit by gaining a trading edge on Wall Street, in Washington and in corporate America.

Trading on such reports, called the "news-feed trade," is emblematic of an era in financial markets dominated by hair-trigger trading measured in fractions of seconds.

At its speediest, this means trading by algorithms based on what is known as "machine-readable news." Paul Rowady of research firm Tabb Group, who studies the economics of trading, estimates the delivery of machine-readable news will generate $75 million in revenue for financial-news providers this year, up almost 50% in five years.

Sharad Kumar, a veteran of several high-speed trading firms, said the availability of early access to nongovernmental data creates an arms race in which firms pay for it to avoid being at a "huge disadvantage." At the same time, its cost can be "a barrier to entry" for smaller traders, he said.

The early look at the consumer-sentiment findings comes from Thomson Reuters Corp. TRI -0.45% The company will pay the University of Michigan $1.1 million this year for rights to distribute the findings, according to the university. Next year, it will pay $1.2 million.

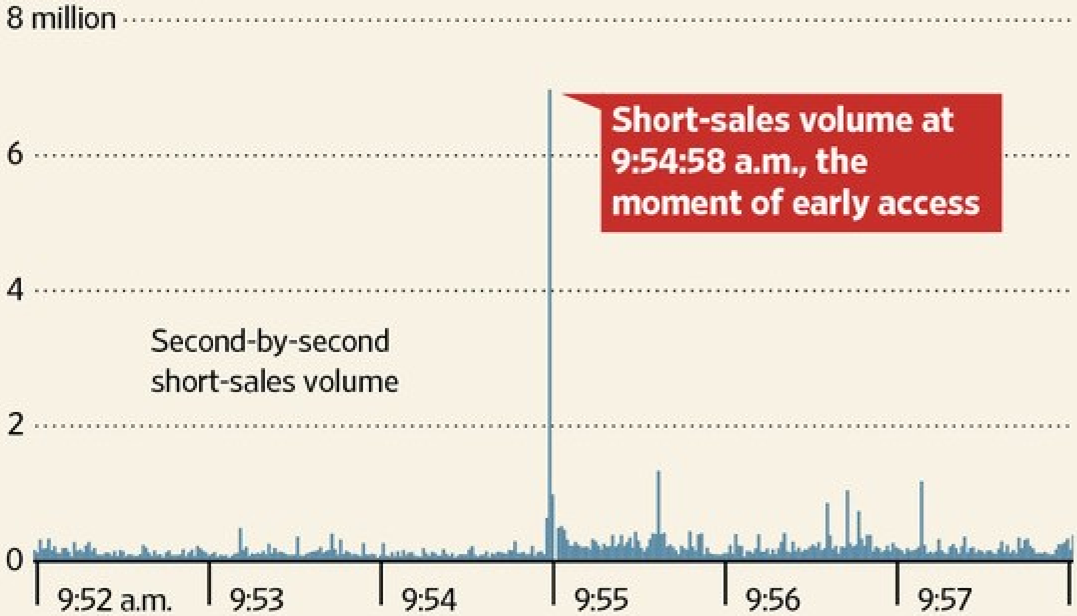
In turn, Thomson Reuters's marketing materials say the firm offers paying clients an "exclusive 2-second advanced feed of results...designed specifically for algorithmic trading."

Clients who pay a subscription fee to Thomson Reuters, which for some is $5,000 a month plus a $1,025 monthly connection charge, get the high-speed feed at 9:54:58 a.m. Eastern time.

Those who pay for Thomson Reuters's regular news services get the report two seconds later. At that point, it swiftly becomes widely available through other news providers as well, including Wall Street Journal publisher Dow Jones, a News Corp. unit that is a Thomson Reuters competitor.

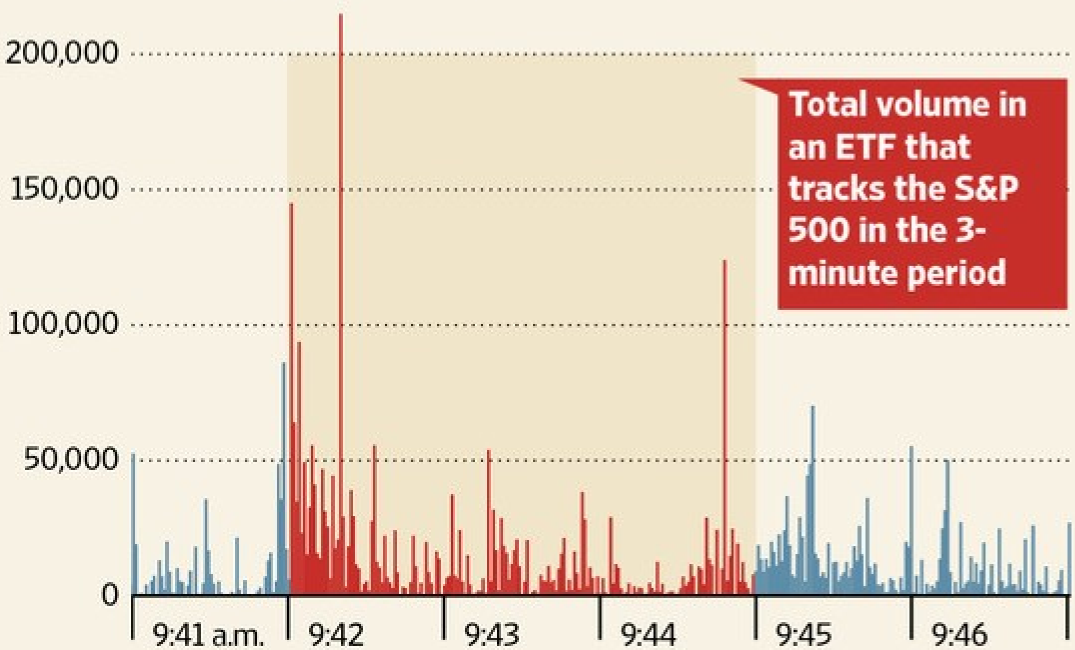
A Jump on the Market

High-speed traders who got a two-second-early peek at a disappointing March 15 University of Michigan consumer-sentiment survey sold short nearly 7 million shares on equities markets in one second—correctly betting stocks would fall after wider release of the data.



Source: WSJ analysis of data from stock exchanges

For a price, Deutsche Börse lets traders see the market-moving result of the monthly Chicago Business Barometer three minutes before the general public. On April 30, volume in the SPDR S&P 500 ETF surged during the three minutes those traders had exclusive access.



Source: Telvent DTN

The Wall Street Journal

Five minutes later, at 10 a.m., the university posts the numbers on its website.

Richard Curtin, an economist who runs the university's survey, said he knows the deal gives an advantage to select investors.

"Hardly anyone would pay for it if they didn't see a profit motive," Mr. Curtin said. Later, he added: "This research is totally funded by private sources for the benefit of scientific analysis, to assess public policy, and to advance business interests. Without a source of revenue, the project would cease to exist and the benefits would disappear."

Thomson Reuters said in a statement: "Thomson Reuters is a leading provider of data and analytics to many categories of participants in financial markets such as investors, asset managers, traders, and high frequency traders. Thomson Reuters, like many information providers, looks to produce and secure exclusive content to help its customers make better informed trading and investment decisions. Thomson Reuters is open and transparent about how data is released but always looks for ways to improve this transparency further. Anyone wishing to invest or trade on this data can subscribe to the service that best meets their data needs."

Matthew Winkler, editor in chief of Reuters rival Bloomberg News, criticized the University of Michigan's arrangement with Reuters in a letter to the university's president and provost in April 2012.

"As an institution that receives public funding, the university has a legal and ethical obligation to be accountable to the public. If such organizations as Bloomberg News, Reuters, Dow Jones and others do not have equal access to information, neither does the public," Mr. Winkler wrote, in a communication reviewed by the Journal. He said Reuters's subscribers had "an unfair advantage."

Suellyn Scarnecchia, then the university's general counsel, responded to Bloomberg that university officials "have always been comfortable that our relationships and structures were in full compliance with all applicable laws."

Six years earlier—before Reuters acquired distribution rights—Bloomberg itself bid for them, promising it would create a level playing field.

After its offer wasn't accepted, a Bloomberg executive editor emailed the university complaining that in the deal the school planned to make with Reuters, "you will be guaranteeing that every other news organization—to say nothing of every investor who doesn't subscribe to Reuters—will be disadvantaged. No wonder Reuters is willing to pay you so much more than Bloomberg: While we were offering money to help the University create a system that is fair to everyone, they are paying you to guarantee an unfair one!"

A university economist told Bloomberg at that time that those were difficult issues the university was grappling with.

Journal publisher Dow Jones doesn't exclusively distribute indicators created by nongovernment entities but does send some exclusive content reported by its news staff to premium subscribers before it is published on general newswires or on its website. Most Journal articles are available only to subscribers.

The Chicago Business Barometer is a monthly index of economic activity based on a survey of companies in that area. German financial exchange Deutsche Börse AG DBOEF 0.35% bought the right to produce and distribute the Barometer two years ago, and sells early access to it starting at about $2,600 a year.

Customers receive "this market-moving data 3 minutes before public release," according to the website of a Deutsche Börse affiliate. Paying customers can get the early release by email, conference call or a machine-readable feed.

Subscriptions are "open to everyone and all customers receive the report simultaneously, regardless of delivery method," a spokeswoman for Deutsche Börse said.

On April 30, the Barometer showed its lowest reading in 3 ½ years. Those who bought early access found this out at 9:42 a.m. Eastern time.

Jump Trading LLC, a high-speed trading firm in Chicago, used the head start to make negative bets on securities that tend to move with the report, according to people familiar with its operations. Jump declined to comment.

This was part of a flurry of trading at 9:42. In one minute, the SPDR S&P 500, an exchange-traded fund that tracks the stock market, traded 1.4 million shares, triple the number traded in the previous minute.

Its share price was 24 cents lower by 9:45, the time when anyone who wasn't paying Deutsche Börse for an early look got the news.

In contrast to "the fast money" that uses the early report, "the dumber money" comes along three minutes later with the Barometer's general release, said Caleb Eplett, a former trader at Chopper Trading LLC, another Chicago high-speed firm. "Anybody who's anybody is going to have that number when it [first] comes out," he said. Chopper said that it trades on Deutsche Börse's high-speed access but declined to discuss specific transactions.

Jim Overdahl, an economist and an adviser to a traders' group at the Futures Industry Association, to which Jump, Chopper and Infinium all belong, said: "Professional traders subscribing to services that provide the fastest possible access to news hardly differs from your paying extra for online access to a favorite newspaper instead of waiting for the paper to plop on your doorstep the next morning. For some people, it's worth the premium to get access to news in real time."

Besides the Chicago Business Barometer, Chopper said it trades on an early release of the monthly manufacturing index from the Institute for Supply Management, or ISM.

That index—beefed up during the Great Depression when President Hoover was frustrated by a lack of data—is regarded by many as the single most important economic report coming from the private sector.

Last summer, the ISM began offering access to survey results through Thomson Reuters's high-speed feed. Customers who want it pay Thomson Reuters a fee of about $2,000 a month, plus the $1,025 monthly for a high-speed connection if they don't already have it.

The manufacturing data are scheduled to be released to the public at precisely 10 a.m. by Thomson Reuters's high-speed feed and also via news release from the ISM.

In fact, the ISM news release routinely goes out five to 10 seconds late, giving that much of an edge to customers of Thomson Reuters's high-speed news feed, according to records from the release and people familiar with it.

Thomson Reuters's sales team has used the lag as a selling point for the high-speed feed, according to an emailed sales pitch to a prospective client viewed by the Journal.

On Feb. 1, the ISM manufacturing number was good, exceeding expectations. This rippled through stock, options, futures and currency markets.

In the single second after the clock struck 10—with the ISM news release not yet in the hands of subscribers—volume in the SPDR S&P 500 exchange-traded fund soared to 719,000 shares, from about 27,000 in the prior second.

The Journal analysis shows most of the trades were bets on the fund to rise. It did rise. Within five minutes, these bets collectively rose in value by almost $100,000.

The ISM's chief executive, Thomas W. Derry, said he wasn't aware of a delay in the 10 a.m. broad release of the data. He said the ISM "strongly believes that this data is released on equal terms to everyone."

Later, Mr. Derry said the ISM is "evaluating whether it makes sense to continue" its arrangement with Thomson Reuters.

The University of Michigan's consumer-sentiment survey, produced since 1946, is considered by some economists to be the best predictor of future U.S. household spending.

On March 15, its mid-month update landed with a thud. Economists polled by Dow Jones Newswires expected the index to come in at 78, which would have been up slightly from the prior month. Instead, it fell steeply to 71.8.

During the two-second window that Thomson Reuters gave to some clients, traders made short-sale bets against 1,624 separate securities. More than 85% of those securities saw their prices fall within five minutes, according to the Journal's analysis. The price action increased the value of these short positions, if still held, by hundreds of thousands of dollars.

The hectic trading during the two-second window before public release of the surprisingly negative report included these examples:

• Trading that morning in the Consumer Discretionary Select Sector SPDR, an ETF tracking stocks that do well when consumers feel flush, averaged 177 shares a second. But during the first second when Thomson Reuters fed the disappointing result to certain clients, 59,839 shares traded. Stock-exchange data show most trades were negative bets. Benefiting them, the share price fell as much as 21 cents in the next five minutes.

• Volume in the SPDR S&P 500 fund also skyrocketed in that key second, to nearly 310,000 shares from just 1,000 total in the previous two seconds. Two-thirds of the bets were negative. These were rewarded when the ETF's share price dipped by as much as 27 cents over the next five minutes.

• On the Chicago Mercantile Exchange, Thomson Reuters's release coincided with a spike of trading in futures contracts based on the S&P 500 index, according to data collected by market-research firm Nanex LLC. Volume in that single second totaled 4,196 contracts, which was a level that had been exceeded by only 50 other individual seconds since the beginning of 2012.

At the ISM, Mr. Derry, in noting that his group is re-evaluating how it releases its manufacturing index, said: "We are in the business of distributing important economic data, not in the business of providing privileged access to a certain class of investors."

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