Early Trading and Tax Hints

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Market structure.

Institutional investors tend to trade near the close. Individual investors tend to trade near the open:

> Trades for individual investors tend to be executed in the morning, because they put in orders the previous evening through their online brokerage accounts or their financial advisers, often after they have been able to catch up on the news after work.

Guess who does worse?

> In the first half of the year, the difference between the bid and ask prices of shares in the S&P 500 was 0.84 percentage point in the first minute of trading, according to data from ITG, a brokerage. That gap shrinks to 0.08 percentage point after 15 minutes and to less than 0.03 percentage point in the final minutes of the trading day.

I suppose the explanation is that at the end of the day the market has been incorporating information into prices for hours, while at the beginning of the day it is racing to update prices to reflect overnight information. From a strict trade-selection perspective, you'd expect bid/ask spreads to be wider when there is more informed institutional trading (and more adverse selection), and tighter when there is more retail trading (which is mostly noise). Remember Dick Grasso's claimthat stock markets should be designed to benefit the "little old grandma in tennis shoes." If you believe that -- and I advise you not to -- then what should we do about this?

Deutsche Bank.

The news that Deutsche Bank "aims to cut roughly 23,000 jobs, or about one quarter of total staff," isn't *quite* as bad as it sounds, insofar as 15,000 of those jobs are at Deutsche Postbank, which Deutsche is planning to divest complete with its workforce, so it's only really considering 8,000 cuts. But that sounds pretty bad too. "The extra cuts would probably mostly affect administrative and technology jobs, although some client-facing positions may be eliminated," and I guess I'm a little surprised that Deutsche Bank's approach to banking in 2015 involves *less* technology? My crude assumption about modern banking was that the client-facing people were in trouble and the tech people were taking over.

Yahoo!?

We talked the other day about how Yahoo asked the Internal Revenue Service if its spinoff of its Alibaba shares would qualify for tax-free treatment, and the IRS pretended to have come down with a sudden case of laryngitis and pantomimed its inability to give any answer, yes or no. The IRS continued its gloriously passive-aggressive interaction with Yahoo yesterday when it released guidance sayingthat *some* spinoffs might not be tax-free, not that it was naming any names:

> "The Treasury Department and the Service are also concerned about transactions in which the distributing corporation or the controlled corporation owns a small amount of Qualifying Business Assets compared to its other assets," said the document.
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> "[They] have concluded that, under current law, distributions involving small Qualifying Businesses may have become less justifiable."

That seems real real real real bad for Yahoo's spinoff, whose small Qualifying Business is actually called Yahoo Small Business. "This changes everything," says a lawyer. I am increasingly fond of the brute-force solution to this problem, which is for Alibaba to buy Yahoo and then spin off Yahoo Small Business and whatever else is worth stripping off the pot of Alibaba shares.

Some enforcement successes.

So remember the Ukrainian hackers who (allegedly) stole tens of thousands of press releases and sold them to insider traders? Some of those alleged insider traders were charged criminally along with the hackers; others were just sued civilly by the Securities and Exchange Commission. Yesterday one of the latter -- Andriy Supranonok, along with his firm Jaspen Capital Partners -- agreed to pay the SEC $30 million to settle the case and, I guess, to unfreeze his bank accounts. The SEC says that Jaspen and Supranonok made about $25 million trading on inside information, so he's paying about a $5 million (20 percent) premium to settle. Insider trading law is weirdly arbitrary. Raj Rajaratnam supposedly made about $52 million insider trading and ended up paying back more than $156.6 million, a 200 percent premium, plus he was sent to prison for 11 years. Supranonok allegedly made about half that much, in an alleged insider trading ring that undermines confidence in the markets way more than Rajaratnam could have, and he's paying one-twentieth as much in penalties *and* not going to prison.

Meanwhile, Aleksandr Milrud made $1.9 million by spoofing the stock market with a legion of traders in South Korea who pressed hotkeys really fast. He has pled guilty to criminal spoofing -- making him the first convicted criminal spoofer -- and "faces up to 4-3/4 years in prison under federal sentencing guidelines." That is not a good sign for Nav Sarao, who allegedly made $40 million spoofing and is fighting his extradition, though as you can see, U.S. white-collar sentencing is not particularly linear or sensible.

Oh also "U.S. in Plea Talks With Man Allegedly Tied to JPMorgan Hack," but it's just a guy who operated an illegal bitcoin exchange; his actual ties -- even his alleged actual ties -- to the actual hackers seem pretty murky. And "Credit Suisse Said Nearing $80 Million Dark Pool Settlement."

And a failure.

We talked a while back about Gregory Bolan and Joseph Ruggieri. Bolan was a research analyst at Wells Fargo, and Ruggieri was a trader there, and Bolan sometimes told Ruggieri about his upcoming analyst reports, and Ruggieri sometimes traded on them. That is a no-no, and neither Bolan nor Ruggieri works at Wells Fargo any more, but is it *insider trading?* Illegal insider trading requires not just a tip of confidential information, but also some personal benefit provided to the tipper. Here, the personal benefit to Bolan for tipping Ruggieri was a little nebulous: When Bolan left his job "after being questioned by Wells Fargo compliance personnel," "Ruggieri gave Bolan the keys to his apartment so that he could use it when interviewing for positions in New York," which is hardly a benefit at all, compared to just keeping his job. So it was a tough case. But because Ruggieri worked in the securities industry, the SEC brought its civil insider trading case against him in its in-house courts, which seem to be a bit biased in the agency's favor.

And yesterday the in-house SEC judge, Jason Patil, dismissed the case! "Patil ruled that while the SEC had established Ruggieri traded on the tips four times, it failed to show that the analyst, Gregory Bolan, received any benefit in exchange for the information." One lesson here is that, at least in in-house SEC courts, the rule of U.S. v. Newman -- that the tipper needs to have received some personal benefit -- will apply to civil as well as criminal insider trading cases. Another lesson is that sometimes the SEC loses in its own courts.

Elsewhere in insider trading, "Insiders Beat Market Before Event Disclosure: Study." The study is by Alma Cohen of Harvard and Rob Jackson and Joshua Mitts of Columbia; here's the abstract. A sample:

> When a significant event occurs at a publicly traded company, federal law requires the firm to disclose this information to investors in a securities filing known as a Form 8-K. But the firm need not disclose immediately; instead, SEC rules give companies four business days after the event occurs within which to file an 8-K.

> These rules thus create a period during which market-moving information is known by those inside the firm but not most public-company investors — a period we call the "8-K trading gap." In this Article, we study how corporate insiders trade their company's stock during the 8-K trading gap.
>
> We develop a unique dataset of 15,419 Form 8-Ks with trades by insiders during this gap. We identify systematic abnormal returns of 42 basis points on average, per trade, from trades by insiders during the 8-K gap. When insiders engage in an unusual transaction during the gap — open-market purchases of their own company's stock — they earn even larger abnormal returns of 163 basis points.

And Tom Hayes.

The Wall Street Journal's Tom Hayes saga marches on; here's part 2, "The Gambler," on his decision to fight the charges against him, andpart 3, "The U-Turn," is out today. Meanwhile Hayes is "seeking to appeal both his conviction and sentence," and while I don't especially know the odds of that working out, 14 years really does seem like a long time to spend in prison for sending chat messages.

Elsewhere, "Fired Currency Traders Won't Leave Quietly," but are instead accusing their bosses and their banks' cultures of condoning FX manipulation. Bloomberg Businessweek's Tom Hayes saga notes that, when he was fired, Hayes told his boss: "Well, that's sort of ironic that you're firing me, given that you were involved in it up to your eyeballs." And you see where he ended up. Be careful with the whistleblowing, FX traders!

And enforcement elsewhere.

Here's how it goes in China:

> The equity swaps and other trading strategies Citic Securities promoted now appear to trouble regulators who are struggling to get a grip on the stock market decline and probing the industry for signs of what they term "abnormal" trading.
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> Within hours of convening a meeting of shareholders and his board on Aug. 25, Mr. Wang learned at least eight of his senior executives were being questioned by police investigators about what had gone wrong in Chinese markets.

And in India, a stock analyst at Veritas Investment Research was arrested for issuing a negative report on Indiabulls Group and taken "on a five-day trip to two Indian cities, accompanied by an Indiabulls lawyer." Apparently negative reports are frowned upon:

> Some of the issues highlighted in Veritas's criticisms were "plainly obvious," said Saurabh Mukherjea, head of institutional equities at the Mumbai-based Ambit

> Group, in an interview. “The problem is that Veritas went out with guns blazing,” which isn’t done in India, he said, because you could “end up in a police station late at night and never see the light of day.”

People are worried about stock buybacks.

What is the probability that, if Jeb Bush is elected president, he will revise the tax code to eliminate the deductibility of interest on corporate debt? I assert that it is zero. But here is Andrew Ross Sorkin on Bush's tax plan, which does in fact call for an end to interest deductibility. (Here is Bloomberg View's Paula Dwyer on the effects of this plan on the bond market.) Sorkin points out that this would be bad for the private-equity and real-estate executives who give Bush money, but my own view is that they should not be too worried about it, because the odds of it happening are zero. I think of presidential candidate tax plans as being purely for entertainment purposes (particularly the bits of Republican plans calling for higher taxes), and I assume that Henry Kravis et al. are duly entertained.

Oh right buybacks. Here's Sorkin:

> Mr. Bush’s plan could also make big public companies a lot less inclined to borrow money to pursue stock buyback and dividend programs. That would also significantly hamper the tactics of activist hedge fund investors, whose favorite move is to pressure companies to load up on debt to buy back stock.
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> If you believe share buybacks do little more than help chief executives increase their own compensation, or think private equity executives get paid too much, Mr. Bush’s plan has great appeal.

Now that the two dynastic presidential candidates have both come out against stock buybacks, I feel better than ever that the "people are worried about stock buybacks" tag will be a keeper.

People are worried about bond market liquidity.

This one, on the other hand, is on the way out. Congrats everyone on beating the scourge of illiquidity.