THE TRAPPINGS OF ALPHA CAPTURE ARCHITECTURE

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It is never a good feeling when you see that a source you are writing about for an upcoming issue is mentioned in a regulatory release. All of a sudden you are in scramble mode and contemplate whether you are going to have to pull or alter a story at the last minute.

That occurred this month when we discovered that Estimize subsidiary Forcerank LLC had settled a case with the Securities and Exchange Commission (SEC) regarding a mobile game app contest.

After speaking with Estimize CEO Leigh Drogen, I understood that the issue was not with the Forcerank data set (basically its product), but a contest to encourage people to participate in the rankings; though it did cost them $50,000 (see "**Forcerank 2.0**," page 27). The SEC found that the contest where Forcerank would charge a small amount to participants and reward those whose predictions were most accurate constituted a security-based swap offering.

It was a bit concerning because the reason Estimize launched its Forcerank subsidiary was due to a New York Attorney General's investigation into the practice of hedge funds soliciting sell-side analyst rankings that effectively shut down the practice. Because the participants in the Estimize crowdsourcing model are not sell side analysts, they can provide these rankings to hedge funds hungry for the data (see "**The view from the crowd**," page 28).

It reminded me of a conversation I had with the folks at the North American Derivatives Exchange (Nadex) a couple years ago. Seems that the final Dodd-Frank rules regarding Derivatives Clearing Organizations (DCOs) required Nadex to meet heavy compliance requirements. The problem is that the Nadex binary option products are fully collateralized, meaning traders can only risk up to the amount of money they have in their accounts. So the provisions that they were required to follow were completely unnecessary. Nadex eventually received exemptive relief, but it required quite a bit of legal work to do this and lawyers aren't cheap. The regulators should have known enough about the Nadex model in the first place so as not to have required them to spend resources to clear this up.

Sanford Bragg called the Forcerank action "a bizarre application of the 2,300 page Dodd-Frank Act," in an industry blog. He went on to note that the SEC has been using a convoluted interpretation of swaps as a pretext to shut down fantasy stock websites. Several years ago when TradeSports launched a binary market in what appeared to be an attempt to run around gambling laws, the Commodity Futures Trading Commission for several years simply ignored it, figuring it was a matter for state gaming laws. Seems financial regulators should have higher priorities.

The hedge funds that initiated ranking models weren't necessarily trying to get non-public information from sell-side analysts, but to invent a creative way to pull value out of analyst information (see "**Forcerank: An idea that can't be stopped**," page 18). The typical buy/sell/hold rating systems offers little value, and by forcing analysts to rank a handful of stocks in a particular sector, these firms acquired valuable actionable data. So valuable that they were willing to pay up to $12 million a year for it and for them to reach out to Estimize to ask if they could replicate this data through its crowdsourcing tools. They have done this.

This issue also takes a sharp look the U.S. Treasury market (see "**Picking the top of the long bond**," page 32). It seems every year we talk to analysts regarding the bond market this question always comes up: When will the bull market in Treasuries end? The answer, of course, is we don't know.

Interactive Broker's Andrew Wilkinson makes the point that the 35-year bull market has survived numerous tightening cycles that have been more significant than the current one — if you can call one 25-basis point increase with the anticipation of one more this December, and perhaps two in 2017, a tightening cycle.

The Fed Funds rate peaked out at 20% in 1981 prior to the beginning of the current bull market, so even if bonds have topped, we don't expect a huge reversal any time soon. Looking at the movement in the Fed funds back in the early 1980s — rates moved several full points (not basis points) — and the hand wringing over a simple quarter-point move seems silly. ∆

Daniel P. Collins

Daniel P. Collins
Editor-in-Chief, Modern Trader
@moderntradered

Send your comments, criticisms and suggestions to openoutcry@moderntrader.com