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Web Exclusive

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BUSINESS

Twitter Invades the Stock Market

SOCIAL MEDIA is the latest tool for analyzing trends in real time.

SOMEBODY WILL LIKELY TWEET THIS story, commenting on it for better or worse. That single tweet, a drop of water, will flow into a gushing fire hose of tweets — something like 400 million worldwide each day on every possible subject.

In Chicago, four sharp guys at a little startup company will filter those tweets, each and every one, looking for the drops of water that carry just the right words — *buy* is nice, but so is *dump* — from the right folks. Morgan Stanley is excellent; Paris Hilton, not so much.

The men will place the selected tweets in carefully calibrated historic context. Is the Twitter chatter for, say, Home Depot heavier than usual, especially compared to other home-supply stores? How much heavier?

They will measure how deep and wide the chatter is. Is the surge in Home Depot tweets coming from many quality sources or a relative few? They will measure whether the Twitter chatter is positive or negative — again compared to a precisely developed baseline — and by how much. Is the chatter for Home Depot, for example, full of talk about “going long at 50” and “adding to my position” or “dump at the open” and “swoons amid criticism?” In all, they will aggregate and size up selected Twitter chatter on all U.S. stocks in four essential ways and assign scores. And to what end?

To beat the markets, of course.

Social Market Analytics (SMA), run by the four Chicago guys from a loft space full of rock-band equipment but no desks, is a pioneer in the emerging field of analyzing social-media content to give traders a leg up in the capital markets. Trading is the art and science of absorbing relevant information — the sacking of a CEO, the price of oil in the Middle East, a company’s latest earnings report — and acting



on it faster than anyone else. SMA slices and dices billions of tweets, which increasingly are the stream of consciousness of the business world, to give traders an information advantage.

Does this stuff work?

Though the very idea of sifting through social media for an edge on Wall Street is but a few years old, some experts predict it one day will be more useful to traders than traditional economic indicators, such as quarterly federal jobs reports. Social-media data is more current, has a broader base and looks forward, not back.

Eighty-seven percent of Fortune 100 companies use social media. Twitter is the most popular, and companies are not just tapping out missives like, “Check out this video of cute kitty riding a bike.” They’re conducting serious business, as reflected in federal regulators’ decision last April to let companies release key information, such as quarterly earnings reports, on social media such as Twitter.

For its part, SMA offers a wealth of evidence that this stuff does indeed work, but its most convincing selling point might simply be that the New York Stock Exchange in February signed on as a distributor. SMA now is available to all New York Stock Exchange (NYSE) clients who want to subscribe to the service.

When it comes to squeezing “actionable intelligence” — that trader’s edge — from social media, SMA is an “eLewis and iClark” that “stands out,” Tom Watson, vice president of the global-market data group for NYSE Technologies, says in a phone conversation.

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BUSINESS

The idea of trading on Wall Street based on Twitter “sentiment” can be traced back at least to a landmark, though deeply flawed, study published in the October 2010 issue of the *Journal of Computational Science*. The study’s authors claimed that by using Twitter, they could predict the daily changes in the closing values of the Dow Jones industrial average with 87.6 percent accuracy. Since then, Watson says, the challenge has been to refine the process so that Twitter becomes an ever-more-trustworthy crystal ball.

“How do you filter out the nonsense?” Watson asks in a blog post. “There certainly are scammers and spammers and sarcasm on Twitter. And there certainly are people intent on doing the wrong thing. But that stuff is, unfortunately, human nature and has existed on Wall Street for over a century. It has been a part of business since people started selling things to each other — think snake-oil salesmen.”



Social Market Analytics President and CEO Joe Gits

Sizing up Twitter sentiment so tellingly that traders would see it as a valuable predictive tool was the holy grail for the four founders of SMA in May 2011, when they began brainstorming. They were sure it was the next big thing.

“We were all developers for trading systems, and we were looking for new projects to work on together, but we didn’t even have a place to meet,” says Joe Gits, president and CEO of SMA. That problem was solved when Jeff Blaschak, another of SMA’s founders, was offered free use of space by his brother-in-law in an office building in Chicago’s Loop. But the formalities of desks, offices and boardrooms have never really mattered much to them. With an MBA and three Ph.D.s among the four of them, they straddle the heady world of academia and the make-a-killing world of the capital markets and appear most comfortable in the deceptively casual culture of startups. They use Skype and email from their suburban homes and treat any coffee shop with Wi-Fi as an office.

The more democratic a workspace is — no walls, no offices, no obvious physical hierarchy — the more creativity is encouraged, Gits says. SMA’s current space, in a hip neighborhood west of the Loop, features a long bar stocked with good beer and a few small,

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round tables suitable for a cocktail lounge, but no boardroom or dreaded workstations.

“The idea is that anybody can jump into anything – got a good idea? Let’s hear it,” Gits says. “How many decisions are made over a water cooler? If I see something, I can just call over to Jeff or somebody and say, ‘Hey, why did we score this tweet?’”

Impressive degrees and big ambitions are one thing. Results are quite another. As the partners emailed and used Skype between weekly meetings in those early months, offering this idea or that suggestion, they were by no means sure they had anything at all. “But then Jeff ran the first four months of data, and I said, ‘Whoa!’” Gits recalls. “I knew we had a winner.”

Blaschak was beating the market. Better yet for SMA, its best data continues to beat the market. From December 2011 through June 2013, any Wall Street trader who had bought or sold on the basis of SMA’s “high positive” scores for stocks – those that were at least two standard deviations above the normal Twitter “sentiment” – would have outperformed the Standard & Poor’s 500 index by 21 percent.

Here’s a real-world example of how that can play out:

Around 8:15 a.m. EDT on Aug. 6, 2012, Richard Schulze, the founder and chairman emeritus of the retail chain Best Buy, submitted a written offer to Best Buy’s board of directors to buy at a premium price all the shares in the company that he did not already own.

At 8:30 a.m., SMA detected a huge jump in Twitter chatter about Best Buy and scored that sentiment as “high positive” – SMA’s strongest indicator that something big and good was happening with Best Buy and traders might want to act fast.

Not until 8:44 a.m. did the major financial-news services break the news. In the trading world, 14 minutes can be an eternity.

For all of that, cautious traders are only now beginning to stick a toe in the water of social-media analysis. None have been quick to forget how a single fake tweet on April 23, 2013 – “Obama is injured” – rocked the markets. They understandably are proceeding with caution.

Typical of the early birds is Tom Pruter of the small Chicago-based trading firm Drysdale Holdings, an SMA client. “We put some money behind SMA’s findings with some success” but backed off when the

market grew choppy, Pruter says. “Now we’re really going to do a deep dive into it.”

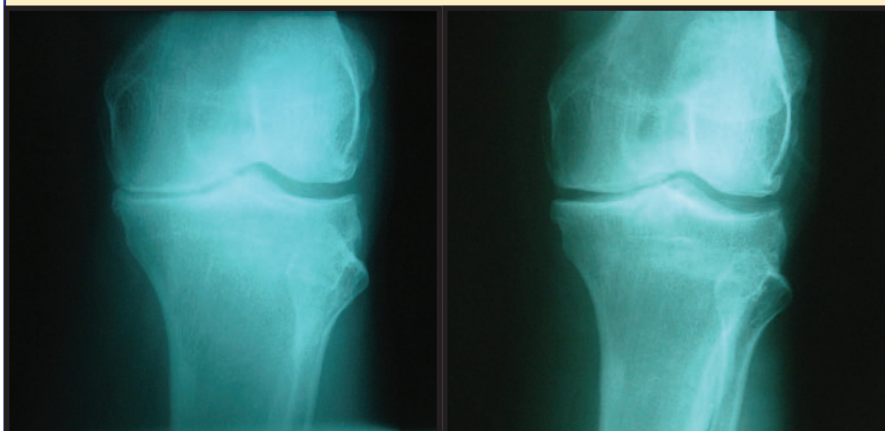
Again, somebody is going to tweet this story. But that tweet, alas, is unlikely to carry much weight at SMA, where they prefer the chatter of the Wall Street crowd. They eavesdrop every day on some 400,000 traders, hedge-fund managers and the like.

That’s fine. But would a tweet of this story at least matter more than a Paris Hilton tweet?

“Maybe,” Blaschak replies. “A little.”

TOM McNAMEE is the editorial-page editor of the *Chicago Sun-Times* and the author of several books with Windy City themes. He wrote about eating flaming saganaki in Chicago’s Greektown in *American Way*’s June 15, 2013, issue.

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