Institutional Trading around FOMC Meetings: Evidence of Fed Leaks

Nicola Mano
USI Lugano and Swiss Finance Institute

AFA 2022 - Poster Session
Motivation

▶ Big amount of circumstantial evidence of Fed leaks to financial institutions.
  ▶ Medley Global Advisors scandal in 2012.
  ▶ Several newspaper articles, newsletters and FOMC minutes mentioning leaks.
  ▶ Other direct and indirect evidence from the academic literature:
    ▶ Pre-FOMC announcement drift on the stock market (Lucca et al, 2015)
    ▶ Taxi rides between NY Fed and commercial banks (Finer, 2018)
    ▶ Stock Returns over the FOMC Cycle (Cieslak et al, 2019)
    ▶ Volume dynamics around FOMC dates (Zhu, 2021)

▶ Informal central bank communication is not necessarily bad, unless leaked information is actively exploited to front-run monetary policy decisions.
  ▶ I test this hypothesis on the stock market using data from Ancerno.
  ▶ 1999-2014: daily trades of US mutual funds, hedge funds, and pension funds.
  ▶ Stock sensitivity to interest rates surprises is based on CAPM $\beta$ and on the monetary policy exposure measure of (Ozdagli et al, 2020).
**Research question**

▶ *Do financial institutions exploit leaked information to execute profitable trades on the stock market before FOMC meeting dates?*

▶ Short answer is *Yes.*

▶ For a 25bp surprise rate increase, on the 3 days before the FOMC announcement, the trading imbalance is 11% higher for high-exposed stocks (stocks that are expected to perform well after a monetary tightening).

▶ The characteristics of the trades and of the institutions that front-run monetary surprises are consistent with an information-leakage story.

▶ The effect is stronger:

▶ Before *easing monetary surprises*, when market reaction is positive.

▶ For the *hedge funds* that are headquartered *close* to regional reserve banks.

▶ For the institutions represented in the FOMC by an *alternate* member.
Contribution

▶ These findings:
  ▶ Show that institutions receive and exploit Fed leaks.
  ▶ Contribute to an information-based explanation of the pre-FOMC drift.
  ▶ Provide an additional channel through which institutions make abnormal profits from their intra-quarter trades.

▶ Policy implications
  ▶ Concerns about unequal access to Fed information, with some investors gaining a persistent and unfair advantage.
  ▶ Hedge funds have reportedly made a practice of hiring former central bankers as their funds grow in size and scope¹.

The paper is available in SSRN.

I very much look forward to hearing your feedback!
Contact me at nicola.mano@usi.ch