

# Resist Being a Pawn in the Fear Game

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Politicians and policymakers, advertising-funded media, securities traders, religion, and social media all are invested in perpetuating fear. Society is inundated by information that stokes fear for partisan furor, profits, and behavior control.

Politicians manufacture crisis situations to gain leverage over their opponents and to energize their voters and donors, whereas policymakers use rhetoric to supplement policy action in order to modify human behavior. The most current example of this on the political side is tying budgetary cuts to the raising of the Federal Government's statutory debt ceiling and on the policymaker side, the Federal Reserve's rhetoric over the last twelve months. That rhetoric has been markedly "hawkish," meaning the Federal Reserve's unanimous rhetoric was disproportionate "glass half full" when it came to the progress that was happening in terms of lowering the inflation rate. This rhetoric was purposeful and designed to restrain consumer spending and business investment in order to lower demand for goods and services.

Advertising-funded media sensationalize events and data in order to attract and retain the attention of viewers and readers.

Securities traders (brokerage firms and hedge funds) profit from volatility and nothing stimulates volatility more effectively than fear and uncertainty.

Many religions rely upon fear of eternal damnation to shape the behavior of their congregations.

Social Media companies profit from grabbing the attention of the public and it is widely understood that the most viral social media posts are those which stoke outrage and suspicion. “The social media business is modeled around the concept of the *attention economy*. In such an economy, human attention is deemed a scarce resource that can be harvested for profit. In a bid to do just that, social media algorithms are designed to promote content that engages people for as long as possible, encouraging them to spend more time online than they may have intended.” The Decision Lab, January 6, 2022, [Social Media and Moral Outrage](#) by Paridhi Kothari. Paridhi Kothari’s concluding remarks from this article were “Social media algorithms prioritize the spread of content that has proven to be popular—irrespective of what that content actually *is*—for the sake of monetizing this engagement. Successful content is often crafted to provoke moral outrage, for which humans have natural, group identity–based motivations to share.”

Individuals are being purposely triggered for profit and for manipulation. I raise this topic as a professional investor because I must look through the constant drumbeat of negativity to remain clear-minded to be an effective investor. I also must counsel my clients who many times are bombarded by data, information, and opinions that are designed to confuse and shape sentiment in ways that can be detrimental to prudent long-term decision-making.

On the political front, we are witnessing manufactured drama and fear with the current debt ceiling negotiations. Politicians raise money and energize voters by using hyperbole and fear. The leaders on both political sides of the debt ceiling standoff know very well that the debt ceiling must be raised. However, they also know that leading up to this inevitability they can grandstand and scapegoat for political and fund-raising advantage. We encourage investors to tune out this grandstanding and brinkmanship.

Each one of us makes up society and society is susceptible to manipulation by those driven by greed, power, and control. The most visible examples of this are the financial markets and politics. In this commentary, we focus on investments and the factors that are either opportunities or barriers to investing success.

If I were running a hedge fund and I actively traded securities on both the long side and short side, I would want high market volatility. I especially want volatility driven by macroeconomic and/or geopolitical concerns. I would want such volatility because my trading process is driven by algorithms programmed into powerful and very fast computers which can buy and sell securities instantaneously by monitoring all relevant sources of public information. If I were high profile enough, I could create my own self-serving headlines by sitting for an interview, writing an opinion column for a major newspaper, or even having private conversations with other high-profile individuals to shape their opinions toward my bias of fomenting fear and uncertainty.

I recently read a book written by Scott Patterson titled *The Quants*. The book chronicles the advent and proliferation of quantitative trading on Wall Street. For me, this book was both fascinating and infuriating. I have been professionally managing investment portfolios for 25 years and analyzing companies for over 30 years. I see the stock and bond markets as capital markets. To me, capital markets are designed to help companies raise capital to fund the growth and reinvestment needs of an operating company. I learned that the trading function within the capital markets is designed for price discovery or in today’s vernacular, crowdsourcing value opinions to arrive at a fair value for the enterprise itself. Quantitative trading got its start in the 1960s and early 1970s and it originated in the minds of a handful of mathematical-minded academics who adapted concepts that had their beginnings in attempting to tip the odds of winning in blackjack and roulette.

In *The Quants*, Patterson wrote about an early trading scheme that was developed by a new graduate from Columbia University (Garry Bamberger) who had a degree in computer science and worked at Morgan Stanley in the early 1980s. This new Morgan Stanley employee was assigned to a group that provided analytical and technical support for the bank’s block trading operation. Bamberger “wrote software for Morgan’s block trading desk, which shuffled blocks of ten thousand or more shares at a time for institutional clients such as mutual funds.” As this new employee observed the movement of various stocks as a result of these block trades, he “noticed that large block trades would often cause the price of the stock to move significantly.” He

also noticed that the price of similar stocks would not experience such moves as a result of these block trades. The author provided an example, “suppose GM typically traded at \$10 and Ford traded at \$5. A large buy order for GM could cause the price to rise temporarily to \$10.50. Ford, meanwhile, would stay at \$5. The “spread” between the two stocks had widened. By tracking the historical patterns and moving with cheetah quick speed, Bamberger realized he could take advantage of these temporary blips. He could short a stock that had moved upward in relation to its pair (Ford), profiting when the stocks returned to their original spread. He could also take a long (or short) position in the stock that hadn’t moved, which would protect him in case the other stock failed to shift back to its original price – if the historical spread remained the long position would eventually rise.” When I read this, I immediately thought that this type of trading scheme should be illegal as it was essentially a form of what is called front running. Front running is illegal because it relies upon non-public information on the composition and timing of institutional trading. Bamberger soon left Morgan Stanley after the firm brought in a seasoned trader to take over the trading function of Bamberger’s group because the group was now trading significant sums of money and Morgan Stanley was uncomfortable entrusting that much money to a computer programmer. As time passed both Bamberger and his replacement, who fully embraced the type of trading that Bamberger had pioneered at Morgan Stanley, had several career changes, and by the late 1980’s these two men could be credited with influencing the formation of several of today’s largest hedge funds, Citadel and DE Shaw. Both funds gain prominence and tens of billions of dollars using what became known as Statistical Arbitrage.

The book *The Quants* reinforced what I have always believed. Just because public securities are being bought and sold does not mean that all of that trading activity is “investing” as the common person would understand. A large and increasing share of daily activity in markets is coming from quantitatively driven programmatic transactions that do not base their buy/sell decisions on anything close to fundamental factors. Instead, security is defined instead by statistical factors such as price, volatility, and correlation. These quantitative strategies are profiting off the inherent “mechanical” inefficiencies of a market that 100’s of millions of people around the world rely upon as a long-term investment for the bulk of their accumulated wealth. This “gaming” of the markets has become so large that it has materially changed how markets react to new information. These changes in market behavior are almost impossible for the average investor to understand and as such some investors that I speak to have concluded that the markets are “rigged” and cannot be trusted.

I do not believe that the markets are “rigged”, and I also do not believe that the changes in the markets brought about the proliferation of quantitative trading will ultimately change long-term average market returns. However, from my experience, I do believe that what has changed is the way that markets arrive at these long-term returns. I believe that the path has been altered by the quants and I contend that we are long past the point of no return to the more fundamental market behavior of the past.

If you tune into your favorite financial media show or come across a discussion of the markets or the economy on your favorite social media platform, beware of “the sky is falling” types of discussion and tune out if you hear “How do you trade/play that.”

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