Using Technology to Interpret “Fedspeak”

Detalus recently sat down with Evan Schnidman, founder & CEO of Quiet Signal, to talk about how interpreting communications from the Federal Reserve has evolved and the role that technology is playing in this shift.

August 2016

As background, Quiet Signal is the parent company of two affiliated firms: LH Meyer and Prattle Analytics. LH Meyer is the research firm of former Federal Reserve Board Governor Larry Meyer, and Prattle provides quantitative data based on the sentiment of central bank communications.

Detalus: It seems that the Federal Reserve (“the Fed”) is actively trying to be more transparent. How do you think this is going?

Evan Schnidman: Over the last twenty years, Fed communication has undergone a fundamental transformation. In the 1990s we all watched Alan Greenspan’s briefcase believing that a fat briefcase meant he was reviewing data and rates were likely to change while a thin briefcase meant he was fine with the data and rates would stay the same. The Fed has since become dramatically more transparent, but with that transparency often comes confusion and wild market reaction.

The Fed’s transparency has taken the form of increased speeches, interviews, and press conferences. Investors are stuck deciphering complex “Fedspeak” from Fed representatives who are trained to obscure the message to avoid sending too clear of a signal. In essence, by becoming more transparent, the Fed has diminished the value of each communication, making it far more challenging to glean signal from noise.

> “For now, it looks like the Fed will continue to obfuscate and technology will play a growing role in deciphering that complex language.”

D: How are Fed communications and data analyzed differently than in the past?

ES: The market is now leveraging technology and sophisticated algorithms to analyze the impact of Fed communications. While not perfect, technology does correct for a few of the most pervasive human errors and biases. Human analysts are primed by the media and prior experience to key in on specific words or phrases while possibly ignoring or missing the rest of a communication. Technology provides the ability to analyze the whole communication, rather than just what a particular analyst emphasizes.

Essentially, central banks have spent two decades furnishing the public with more complex information than could reasonably be used to develop a clear signal. Only in the last couple of years have “Fed watchers” and technologists teamed up to make heads or tails of this language. The end result is strikingly more accurate than traditional, subjective analysis of likely policy moves and market response.

D: With broader acceptance of using technology for these purposes, what are some of the hot-button items around this subject in the market?

ES: Implementing technology to interpret Fed sentiment poses several questions for investors, namely how to leverage the resulting information into alpha. Although new, technological analysis of complex and veiled language already poses a significant opportunity for both short-term trading and long-term investment opportunities. Large hedge funds and family offices recently made headlines for converting more staff into quant positions, which is a trend likely to continue as investors find new ways to leverage technology to boost returns.

D: Do you believe there are any wholesale shifts coming in how Fed sentiment is interpreted?

ES: What if the Fed adopted a technology-based system for themselves? Instead of an algorithm scoring a complex speech on a “hawkish” or “dovish” scale, what if a policymaker simply walks out, announces a score, and steps away from the podium? It would be clearer and more efficient than our current system, but could also box policymakers into certain decisions. For now, it looks like the Fed will continue to obfuscate and technology will play a growing role in deciphering that complex language.

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