Watching the Beans (May 5, 2019)

One of the more refined and cerebral traders I knew at the Chicago Board of Trade decades ago was Lauren Daley, a trader who followed the corn and soybean markets. Most analysts and brokers depend on the U.S. Department of Agriculture, farmers and trade groups for information about the condition of the crops. But Lauren always studied the subject first hand. Every July or August, he would set off in his car and visit small towns in the corn and soybean belt, which meant extensive highway travel in Illinois, Iowa, and Indiana.

As most people know, weather is the central fundamental affecting the growth of any crop. Corn and soybeans are planted in the spring and harvested in the fall. Of paramount importance is the amount of rain and sunlight the belt is receiving. Ideal growing conditions are sunny weather and occasional rain, but sometimes a draught sets in and sometimes the fields are flooded. Lauren wanted to find out for himself how the crops were faring far from the exchange in downtown Chicago.

I was reminded of Lauren and his peregrinations through the Midwest by an article in the May issue of *The Atlantic Monthly*. In “Stock Picks from Space,” Frank Partnoy of the University of California at Berkeley describes the use of aerial intelligence to investigate, not crops, but the outlook for retailers. R.S. Metrics of New York City depends on satellites to count the number of cars in the parking lots of “representative” major retailers, including Home Depot, Lowe’s, and Walmart. McDonald’s has been surveilled as well. The assumption, of course, is that a filled parking lot portends good business and ample profits, knowledge that can be used to decide which stocks to buy.

And at least some research indicates that the method works. Two instructors at the business school at Berkeley checked six years’ worth of data at 67,000 stores. They concluded that if you bought shares when the lots seemed full, or nearly so, and sold when the numbers declined, you could appreciably improve your investment return. The stores they checked included Target, Whole Foods, Walmart, and others. (I am assuming that Partnoy is referring to “stand-alone” stores, and not the ones fitted into malls with a dozen others.)

The business of tracking parked cars started almost a decade ago, and other companies, such as Descartes Labs and Orbital Insight, have been drawn to the field. “When traders wanted to monitor the cars being produced at Tesla’s assembly plant in Fremont, Calif.,” writes Partnoy, “RS Metrics flew a plane overhead.” Not only stock analysts but also commodities traders have exploited the possibilities offered by planes, drones, and satellites. A train with nearly 300 cars of iron ore derailed in the Pilbara Desert in Australia last November. Normally, the disrupted supply of any commodity produces a spike in prices, for obvious reasons. But traders using aerial intelligence “saw the ore piled in a flat area where it could easily be reloaded.” The traders shorted the market, guessing that the rally was overdone and that prices would soon drop back to normal levels. According to Partnoy, “They were right--within a couple of weeks, the panic had subsided, and they [the traders] had made a fortune.”

The question he asks is whether companies that can afford to acquire this costly information have an impermissible advantage over the rest of us. “The information gap has widened considerably in recent years,” he claims. “Today, investment firms spend hundreds of millions of dollars a year on so-called alternative data—tracking consumer trends using everything from geolocation to online browsing activity.” And he quotes a business economist at Berkeley who believes that the advantage of access to this data “creates opportunities for sophisticated investors at the expense of small individual investors.”

I’m not sure that economist is right. To borrow a phrase popularized by John Kenneth Galbraith, there are “countervailing forces” that can reduce or nullify the advantage. And in some ways, what appears to be an unwarranted edge can emerge as a constructive market influence. As a rule in investing and trading, the more broadly a strategy is adopted, the less effective it becomes. The greater the number of companies acquiring this information--and especially as it becomes cheaper to obtain--the less value it offers. Traders lose their edge or advantage if too many others are doing the same thing. An analyst Partnoy interviews also notes, quite accurately, that improved market information is going to increase the likelihood that prices more accurately reflect underlying fundamentals.

One hedge-fund manager suggested that retail investors like you and me should simply buy into the low-cost index funds that were pioneered by Vanguard. Disregard the danger of individual stocks, the advice goes, on the grounds that if your don’t know what your edge is, you probably don’t have one. That assumes, of course, that we’re all trading stocks. But we can also open positions in companies and hold them for as long as possible, for years and perhaps even decades. Markets and stock prices are cyclical—there is almost always a good time to get in.