

# NEWS EVENT TRADING

HOW TO PROFIT FROM  
TRADING CRUCIAL NEWS EVENTS

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## **Trading Secrets: How to Trade the News**

We've been taught we can't trade news flow.

In fact, many of us have also been taught that news is immediately priced in upon its release.

One analyst noted that trading the news is a trap for those who really aren't in tune with stock trends, he said. They don't realize that in many cases, news is baked into a stock by the time that it hits the press. He went on to tell his readers that when you think you are trading the news, you're trading yesterday's news. And if you react to news, you're setting yourself up to fail.

However, that's the idea of efficient market theory, which taught us that when news is released, it's immediately priced into stocks.

But that theory no longer carries any weight.

Many of us don't account for "information friction" and herd mentality.

### **Information Friction**

Let's say Apple (AAPL) releases hot news about a new iPhone one morning.

While some investors can react to that news immediately upon its release, thousands of other investors can't react to that same news until later in the day because they may be at work.

Once they do react, though, there's further reaction.

*"Nothing beats the stock market for sheer frequency of potentially interesting news items," said Robert Shiller in Irrational Exuberance. "News can foster an attention cascade among investors, he says, sending them into herd like behaviors. Following good news and rallies, we may often see positive feedback loops, where investors rush in thinking they missed a run, the media fuels the fire more, more investors move in, the media presses the issue harder."*

Then, there's the reaction to the reaction.

By that night, you might hear of the story on CNBC or see it the next morning in the *Wall Street Journal*. And way down the line, the story may make the weekly magazines like *Time*, *Newsweek*, *Business Week*, or *Forbes*, piquing further interest and activity in the stock.

All until the story fades and dies off.

**News flow can go from local to regional to national to global, depending on the story.**

But it's not picked up by the masses all at once, which creates that friction.

Press releases, television reports, radio, newspapers, e-mail, Twitter, Facebook, Google news, national press, global press. News runs from one investor to the next until the fade.

That means it's absolutely impossible for news to be priced in upon its immediate release.

And if you can spot news at the right time, you can successfully trade it.

### **Efficient market theory has also been disproved by the following studies:**

*"I examine returns to a subset of stocks after public news about them is released. I compare them to other stocks with similar monthly returns, but no identifiable public news. There is a major difference between return patterns for the two sets. I find evidence of post-news drift, which supports the idea that investors under-react to information [ . . . ] There is a large amount of evidence that stock prices are predictable." —Wesley S. Chan, M.I.T., Stock Price Reaction to New and No-News: Drift and Reversal after Headlines*

*"Arguably, the most important process affecting price movements is the news arrival process. For example, in Ross (1989) the volatility of stock price changes is directly related to the rate of flow of information to the market [ . . . ] On days no news arrives, trading is slow and price movements are small. When new information arrives that results in a change in expectations, trading becomes vigorous and the price moves in response to the impact of the news [ . . . ] In addition to price movements, news arrivals can affect the time between trades, number of transactions, and volume of trade." — John H. Maheu, University of Alberta, and Thomas H. McCurdy, University of Toronto, News Arrival, Jump Dynamics and Volatility Components for Individual Stock Returns*

*"Periods of good news are followed by periods of unusually high returns relative to natural benchmarks, with the reverse for bad news [ . . . ] Post-event drift is the tendency of individual stocks' performances following major corporate news events to persist for long periods in the same direction as the return over a short window—usually one to three days—encompassing the news announcement itself." —Andrew Jackson and Timothy Johnson, Unifying Underreaction Anomalies*

### **Herd Mentality Also Allows us to Trade News Flow**

More than 450 sheep jumped to their deaths in 2005.

One sheep jumped. Another one followed. All of a sudden, flocks of sheep began jumping off a cliff for no real reason. In all, 1,500 jumped. Hundreds of sheep perished, as they got caught up in herd mentality. Each followed and jumped simply because every other sheep was doing it.

And as uncommon as this may sound, it's not.

In fact, this very same thing happens each and every day among traders and investors.

We buy because everyone else does. We sell because everyone else does.

But we never question what we're really buying or selling, which can be quite costly. Instead, we take the leap simply because everyone else is doing it.

And if everyone else is doing it, it must be right. Right?

Well, not exactly...

In 2009, Kiplinger's ran an article by Robert Frick, titled, "Don't Trust the Crowd."

It noted:

*What's scary about the herd mentality is how insidiously it gets you to see things differently. In fact, a recent experiment showed that we may actually be hard-wired to believe what the crowd tells us. In the experiment, conducted at Emory University, participants were asked to look at an object (an assemblage of cubes) and then judge how it would look if it were rotated slightly. But there was a twist: Other participants--who in reality were actors hired for the experiment--were instructed to give wrong answers in an attempt to sway the opinions of their fellow participants."*

*"Sure enough, the real subjects, influenced by the actors, gave incorrect responses, despite what their own eyes told them. Brain scans found that participants didn't just decide to go along with the crowd. Instead, the crowd's opinion actually changed their perception of the problem. Participants "saw" the objects differently. The herd, it seems, alters our perception of reality."*

If, all of a sudden, the herd is rushing into a stock on great news, many of us follow. Or, if there's devastatingly bad news out, the herd has a historical tendency to react to that, as well.

But the question remains, can the average investor really profit from news without having proprietary research?

Absolutely.

We can trade the long and short side of opportunities using:

- Anticipatory momentum (snowball effect)
- Dissemination of news (depends on strength of news and herd reaction)
- Death of news (rubber band effect)

### **Anticipation of News Effect**

Stand at the top of a snowy hill with a small snowball.

Now, begin to roll it down the hill. As you do, it begins to become bigger and bigger. It begins to build momentum. The same thing happens with stocks.

If we can spot a potential story ahead of the herd, we can take a position and wait. We can get a jumpstart with our snowball. Then, as they begin to wake up to opportunity, our snowball gets bigger and bigger and picks up momentum.

Typically, we can do this with biotech stocks facing an FDA decision, Phase III trial data release, a PDUFA date, or even an advisory panel committee date. Typically, we'll find a biotech stock 2-3 months in advance to really milk the wave of expected anticipatory momentum.

Look at Axsome Therapeutics (AXSM), for example.

**In December 2018, ASXM popped up on our radar at \$3.05 a share.**

At the time, the stock was being ignored, even as it approached pivotal result dates for AXS-05 for treatment resistant depression, major depressive disorder, Alzheimer's disease agitation, and smoking cessation. According to the company's year-end 2018 clinical update, it announced positive results of an interim futility analysis for the Phase 2/3 ADVANCE-1 trial of AXS-05 in Alzheimer's disease (AD) agitation.



Yet, the stock wasn't budging – at least not yet.

Anticipating further good news with scheduled Phase II trial data being released on AXS-05 of major depressive disorder, we followed the stock at \$3.05 a share. The stock would run as high as \$26 a share just months later as positive trial news was released.

Or, look at anticipation of news with politics for example when President Trump was elected.

- On anticipation of infrastructure programs, stocks like Vulcan Materials (VMC) ran from \$112.50 to \$137.50. Jacobs Engineering (JEC) soared from \$50 to \$63.
- On anticipation of the wall, Cemex (CX) ran from \$7.60 to \$9.40. Martin Marietta Materials (MLM) ran from \$180 to \$245.

- On anticipation of increased military spending, General Dynamics (GD) ran from \$152.50 to \$192.50. United Technologies (UTX) ran from \$100 to \$114.
- Anticipation of financial deregulation sent bank stocks soaring. The XLF ETF for example roared higher on the anticipation of it happening.

## **How to Spot Anticipatory Opportunities**

Some of the best ways to spot these opportunities is by looking for FDA approval dates.

For example, if I know that three months from now, stock ABC is heading into an FDA approval decision, yet it hasn't budged, we can anticipate a potential move higher as the date approaches.

Or, we can even trade the upcoming release of essential information.

For example, in early September 2019, shares of Adverum Biotechnologies (ADVM) began to tick higher, as investors anticipated great news at an October 11, 2019 meeting.

Here's what we knew at the time.

We knew the company would present 24-week data from the first group of patients in its OPTIC phase 1 clinical trial of ADVM-022 intravitreal injection gene therapy in wet AMD at the Retina Subspecialty Day Program of the American Academy of Ophthalmology (AAO) 2019 Annual Meeting in San Francisco, CA on Friday, October 11, 2019.

We also knew the company was excited about potentially presenting great news.

“Wet AMD is an aggressive disease that often requires frequent anti-VEGF injections over the long-term in order to reduce vision loss,” said Aaron Osborne, MBBS, MRCOphth, chief medical officer of Adverum Biotechnologies. “ADVM-022 is administered utilizing a single, standard-of-care intravitreal injection, which we believe has the potential to significantly reduce treatment burden and improve real-world vision outcomes for patients with wet AMD. We look forward to presenting 24-week data from the first cohort of patients in the OPTIC trial at the upcoming AAO meeting.”

If we anticipate great news from the meeting, we could buy the stock in early September, and wait for the wave of buyers to come into the stock, as they wake up to the same potential.

It's all about spotting potentially big news before anyone else wakes up to it.

We can even use the upcoming 2020 presidential elections as an example.

With most elections, volatility begins to spike higher. History proves that. For example, ahead of presidential elections, we see big moves in the volatility index (VIX).

- Ahead of the 1992 election, the VIX exploded from 13 to 20
- Ahead of the 1996 election, the VIX popped from 14 to 22
- Ahead of the 2000 election, the VIX ran from 17 to 31
- Ahead of the 2004 election, the VIX ran from 12 to 14
- Ahead of the 2008 election, the VIX ran from 20 to 88
- Ahead of the 2012 election, the VIX ran from 15 to 22
- Ahead of the 2016 election, the VIX ran from 12 to 22

By anticipating that ahead of the 2020 election, we can trade volatility-based trades including the ProShares Ultra VIX Short-Term Futures ETF (UVXY), VelocityShares Daily 2x VIX Short-Term ETN (TVIX), and even the iPath S&P 500 VIX Short-Term Futures (VXX).

With anticipation, we're simply attempting to invest in publicly available news before the herd begins to wake up to the same opportunity.

### Dissemination of News -- Stone in Pond Effect

Investors may believe that news is priced into the stock upon its release.

However, it's just not true.

When you think of news, think of what happens when you toss a stone in a lake. The second the stone hits, it creates a ripple effect – strengthened by the size of the stone. The same thing happens with news, depending on how interesting and impactful the news may be.

If we're presented with sizable news, the story could ripple for days, if not weeks.

For example, news of the 2018 U.S. Farm Bill had quite a ripple effect because of its far-reaching impact on cannabis related stocks. Or when President Trump unveiled his 2017 tax plan, small-cap stocks and the Russell 2000 began to accelerate higher and higher.



It's simple proof that news is not — and never will be — immediately priced in upon release.

Once the news is tossed into public view, it'll ripple until that news begins to fade away – just like the effect of a stone tossed into the pond.

**One of my favorite examples of this is the Ebola story from 2014.**

In 2014, The World Health Organization declared the outbreak an international emergency, warning that it could spread further. And the US Centers for Disease Control and Prevention has said the spread of Ebola to the United States is “inevitable.”

We then saw a reaction to the reaction, catapulting a little-known Ebola stock, known as Arbutus Biopharma (ABUS). In fact, well-placed call options returned as much as 189% profits.



Potential outbreaks in Hong Kong, New York and Saudi Arabia led to obscene panic.

Related stocks like ABUS began to skyrocket even further. Fear reached epic levels. Then, as the number of Ebola cases popped up, so did the number of news stories, as did shares of related stocks, like ABUS, which ran from \$9 to \$26 in weeks.

However, look at what happened to ABUS once the Ebola story faded, so did the stock.

**Or, look at the price of gold since the trade war began to intensify in the summer of 2019.**

As news of the trade war intensified, and rippled, investors have been aggressively buying gold. As fear is disseminated, investors were very likely to continue that buying trend.



What we're looking for is impactful news with staying power with dissemination trading.

### How to Spot News Dissemination Opportunities

One of the best ways to spot dissemination stories is by finding stories with staying power. If there's a story circulating, creating sizable fear, look for stocks that could move higher or lower.

For example, as Hurricane Dorian made its way through the Atlantic, and fear began to circulate in the press about it, related stocks like Generac Holdings (GNRC) and Home Depot (HD), while also trading the short side of insurance companies like Everest Re (RE), which began to pull back on fears of potential, multi-billion-dollar damages.

Other catalysts investors can look for include:

- Insider buying
- Stock buybacks
- Stock splits or dividends
- Rumors or substantial news
- A big new product or major contract award
- A Big order from the U.S. government
- Commercialization of new technology.
- Press releases circulated to shareholders or those on mailing lists.
- Press releases sent to major news providers such as Yahoo, CNN, MSNBC, CNBC.
- Massive increases in volume and mentions in lists of best daily performers... and on and on.

### The Death of News: The Rubber Band Effect

Remember, news eventually dies. And as it does, we can profit from a stock reversal, too.

Let's refer back to the ABUS chart above.

Remember how it exploded on fears of Ebola spreading around the globe with consistent fear-based headlines? Look at what happened after the news died, so did ABUS.



**If you can spot news at the right time, you can make a fortune with stocks and options.**

After we've anticipated the effect of news, and after we've made money from the ripple effect of dissemination, we have to realize that news eventually fades and dies.

If a stock has skyrocketed on news, it often pulls back once it dies.

If a stock has plummeted on news, it often pivots and bounces once the news is priced in.

Look at Amazon.com, for example.

Donald Trump and Amazon.com have some seriously bad blood.

For example, in April 2018, Trump tweeted:

“Only fools, or worse, are saying that our money losing Post Office makes money with Amazon. THEY LOSE A FORTUNE, and this will be changed. Also, our fully tax paying retailers are closing stores all over the country...not a level playing field.”

Amazon shares fell from \$1,546 to \$1,371 on fears of potential taxes. The dissemination of the news sent the stock down. The death of news allowed it to recover.



## **So how can the average trader spot these excessive moves?**

If you pull a rubber band too far, what happens? Eventually, it'll snap back.

The same thing happens with stocks when they become too overbought or oversold.

And it's actually quite easy to spot.

Once big news is released, it can force a stock very high, or very low. Then, as the news begins to fade, so does the move in the stock. We can spot these opportunities by using key technical pivot points. These include the following technical indicators:

### **Bollinger Bands (2,20)**

The Bands are typically placed two standard deviations above and below a moving average. For example, a trader may choose to use an intermediate-term moving average of 20 with two standard deviations above and below that average.

The idea behind such bands is simple.

When a stock Touches or penetrates the lower band, the situation can be considered oversold. When a stock touches or penetrates the upper band, it can be considered overbought.

This is step one for letting us know a stock is overbought or oversold.

But we never want to rely on one indicator, so we confirm with others, such as RSI and W%R.

### **Relative Strength (RSI)**

We can use RSI to confirm other indicators above. When RSI moves to or above the 80-line, we have an overbought condition. When RSI moves to or below the 20-line, we have an oversold condition. It confirmed what Williams was telling us.

### **Williams % Range (W%R)**

When Williams moves to or above its -80, it's an indication the asset is oversold. When it moves to or above the -20-line, it's overbought.

For the pivot strategy to work, each of these indicators must now agree with the others.

### **Moving average convergence-divergence (MACD)**

MACD is calculated using the difference between a short-term and long-term trend and momentum behind a stock (typically 12-day and 26-day moving averages are used). With MACD, when the short-term line moves above the long-term line, we can make an argument for

higher moves in the stock. We can predict a lower move when the short-term line crosses under the long-term line. With MACD we're simply looking for unsustainable, big moves.

But here's the trick to telling when to buy or short a trade.

Each of the four indicators must align, and agree with one another. If each aligns in oversold or overbought, we have a good idea that the stock may be ready to pivot.

### Let's look at an example with Micron Technology (MU).

Look at what happens about 80% of the time when MU hits its lower Bollinger Band (2,20), coupled with RSI at its 30-line, and Williams' %R at its 80-line for example.

The stock pivots and bounces.



Or, look at what happens when MU hits its upper Band (2,20) with RSI at or above its 70-line with Williams' %R above its 20-line.

Again, the stock pivots and reverses.

Pull up your favorite stock chart. Look at a one- and two-year chart and you'll see that these indicators are great for spotting potential pivots.

Not only can these indicators mark tops and bottoms of stocks and ETFs, they can also mark tops and bottoms of major indices, like the Dow Jones Industrial Average (DJIA). Look at what happens when we apply those same technical indicators to the chart.



Up to 80% of the time, we can see where a stock, an ETF, or even an index may pivot.

Of course, folk will say any one can call pivots after the fact. But that's not what we're doing here – and pivots aren't quick, short-lived events. Spot them in time, and you can do very well.

## In Conclusion

To this day, many of us are still taught we can't trade the news.

One analyst noted that trading the news is a trap for those who really aren't in tune with stock trends, he said. They don't realize that in many cases, news is baked into a stock by the time that it hits the press. He went on to tell his readers that when you think you are trading the news, you're trading yesterday's news. And if you react to news, you're setting yourself up to fail.

However, it's just not true. News isn't baked in because of information friction.

Pull up your favorite stock. See if you can spot a key catalyst date that's nearing. Watch what happens as that catalyst date draws near. Or, watch what happens when great news is released

and disseminated to a larger audience. Then, watch what happens when that news begins to fade away, and technical indicators indicate the rally is nearing an end.

Do this with a few of your favorite stocks – and then tell me you CAN'T trade the news.