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Jumping on the Bandwagon Brings Rewards

Day traders made bigger profits when they moved with the herd

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By Rachel Ehrenberg, *Science News*

When minds think alike great things can happen, even if the minds themselves are not so great. Stock day traders who act in sync—no matter the stock, or whether they are buying or selling—make more money at the end of the day than their out-of-sync peers, reports an analysis to appear in the *Proceedings of the National Academy of Sciences*.

The research adds to a growing body of evidence that a collective wisdom can emerge from the myopic views of individuals. Understanding how and when could lead to ways of tapping that wisdom, enabling trading firms to make more money. Mining collective wisdom could also lead to new approaches for combating terrorism or fighting flu outbreaks, says study leader Brian Uzzi of Northwestern University in Evanston, Ill.

Uzzi and his Northwestern colleagues analyzed a year and a half of trades—more than a million transactions—made by 66 day traders at a single firm. Parsing the trading behavior down to a scale of seconds revealed sweet spots of synchronization—seconds to minutes when many traders were engaged in frenetic activity. On average the traders made money on 55 percent of their trades, but those who were in sync with their peers profited 60 percent of the time.

“I love the counterintuitive nature of the finding,” says complex-networks expert Albert-László Barabási of Northeastern University in Boston. “The dogma is that the successful investors are the Buffets—those who swim against the current. Yet this study shows that when it comes to day trading, going with the wave has real benefits.”

A peculiar aspect of the emergent intelligence is its lack of intentional coordination. There wasn’t a preestablished crowd for traders to glom onto, nor a leader to follow. The assessment suggests instead that instant messaging among traders helped couple their behavior. Instant messaging volume went up and down with trading volume, and the flow of instant messaging became less random as traders got more in sync, the researchers found.

Each trader uses whatever information is available—whether about housing market changes or Steve Jobs’ health—to figure out the best time to buy and sell for a particular specialty. “No single one can figure out the market,” says Uzzi. Yet somehow when many traders reach a decision to act at the same time, “It’s really super-special,” says Uzzi. “And by super-special, I mean really lucrative.”

It’s unlikely that an individual trader could take advantage of the phenomenon, given that the golden bandwagon emerges suddenly, as if from a mist. But someone with a global view of what’s happening might be able to jump on, or urge others to do so, says Uzzi. It may prove fruitful for government agencies, for example, to harness the collective wisdom of intelligence officers trying to figure out when to act on information about terrorist activity, or to keep an eye on specialists as they monitor for an infectious disease outbreak.

Of course synchronicity can also be neutral, or worse. And distinguishing which is which is much easier after the fact. “Sometimes synchronicity doesn’t lead down the path of collective wisdom,” says Uzzi, “but down the blind alley of mob madness.”

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