

## STRATEGIES

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### **Stock Tips From Spam Aren't Just Silly. They're Costly.**

By MARK HULBERT

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MANY investors apparently trust spam e-mail -- at least those messages that say a fortune is to be made in a speculative stock. All too often, credulous people buy the shares, only to see them plummet in value.

That is the conclusion of a new study, "Spam Works: Evidence From Stock Touts and Corresponding Market Activity," by Laura L. Frieder, an assistant professor of finance at Purdue, and Jonathan L. Zittrain, professor of Internet governance and regulation at Oxford.

Professor Zittrain is also a visiting professor of law at Harvard Law School, where he was a founder of its Berkman Center for Internet and Society. The study has been circulating for several weeks in academic circles; a copy is at <http://papers.ssrn.com/sol3/papers.cfm?abstract-id=920553> .

The professors focused on spam that urges the immediate purchase of a company's stock. Such unsolicited e-mail is quite cheap to send, the professors noted, and not just because of the low cost of obtaining e-mail address lists. In recent years, they said, "relationships between spammers and virus authors have caused millions of virus-infected personal computers to be harnessed as 'zombies' to send spam, further lowering its cost."

As a result, one person can send the same junk e-mail message to thousands, if not millions, of addresses in a relatively short time. Based on industry data, the professors estimate that as many as 100 million stock-touting junk messages are sent around the world in an average week, accounting for as much as 10 percent of all Internet e-mail traffic.

In almost all cases, the professors found, the stocks promoted in these messages do not trade on major exchanges. Instead, they tend to be illiquid and are found in the off-market, over-the-counter trading arena known as the Pink Sheets. Typically, such stocks are not followed regularly by an investment adviser or Wall Street research department. Their illiquidity, and the absence of regular scrutiny, make the stocks relatively easy to manipulate, the professors said.

To compile a database of stock-touting spam, the researchers combed through the 26,000 junk messages that Professor Zittrain received in his own e-mail box from January 2004 to July 2005. They also surveyed 1.8 million specimens of spam received during that time by the Internet newsgroup called Nanas (for net.admin.network.abuse.sightings), which alerts administrators of e-mail networks to spam outbreaks. While Nanas has many contributors around the world, the professors concede that there "is no way to assure that Nanas's archive is a representative cross-section" of all spam.

All told, some 300 stocks were recommended in the studied messages, each of which contained a time-stamp indicating when it was sent. Because not all of the messages hyping a particular stock were delivered at precisely the same time, or even on the same day, the professors focused on the day when the greatest number of messages touting a certain stock were received. On that day, they found, the stock was 13 times more likely to be the most actively traded Pink Sheet issue than it was on days when they had no evidence that junk e-mail was sent urging its purchase.

The increased liquidity created by this higher volume is crucial to the success of the spammers' pump-and-dump strategy, according to the professors. If not for that greater liquidity, in fact, the spammers would find that their sell orders would depress prices so much that they would realize little if any profit.

Sure enough, the professors found a distinct price pattern in the touted stocks. It pointed unambiguously to spammers buying stock before the days when they sent their messages and selling as those messages were received.

On average, a touted stock gained 4.6 percent more than comparable issues on the trading day just before the spam's peak volume day. On the peak volume day itself -- when the professors believe that the spammers sell the bulk of their shares -- the stock's price stayed more or less even. But one trading day later, the return was 5.9 percent lower than that of comparable issues.

The professors concluded that unscrupulous traders were able to turn a tidy profit by buying shares before sending their spam and then selling as investors started acting on the spam's advice. In contrast, investors who bought shares realized a sizable loss.

In an interview, Professor Frieder said she was initially skeptical that investors were actually following the advice in stock-touting junk e-mail. After all, few people ever say they welcome spam; most seem eager to zap it from their computers. But her skepticism faded after analyzing the data. "I am aware of no other plausible explanation for the patterns we found," she said.

She said that the authors based their conclusions entirely on an analysis of aggregate data, not on a study of particular cases, so they had no proof that any individuals in particular were directing such schemes.

IN any event, Professor Zittrain said in an interview, the Securities and Exchange Commission has rarely tried to prevent stock-touting spam messages, many of which contain fine print disclosing that the spammer will be selling the very stock being recommended for purchase.

Of course, the most immediate lesson for investors is this: ignore unsolicited e-mail messages. But there is also a broader lesson, relevant even for those who ignore spam. It has do with the desire, even eagerness, to believe that there is a stock out there that could make a lot of money, and with how that desire affects people's judgment. As Professor Zittrain put it, "greed all too easily colors our objectivity," and it's true for all types of investors.

Chart: "Buying the Hype"

A new study finds that stocks touted in spam e-mail messages typically rise as those messages are received, but then fall.

Graph tracks cumulative return of stock beginning five days before the peak volume of spam touting it and the average of several hundred stocks from Jan. '04 to July '05.

(Source by Laura L. Frieder, Jonathan L. Zittrain)

Mark Hulbert is editor of The Hulbert Financial Digest, a service of MarketWatch. E-mail: [strategy@nytimes.com](mailto:strategy@nytimes.com).

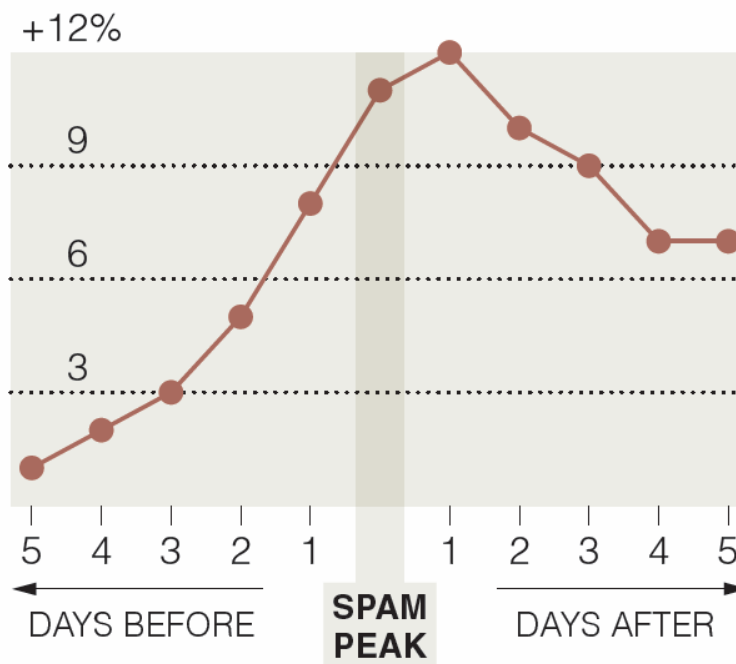
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## Believing in the Hype

A new study finds that stocks touted in “spam” emails typically rise immediately after those emails are sent and then fall.

**Cumulative return since six days prior to “spam” email touting stock hits peak volume**

*Average of several hundred stocks between Jan. '04 and July '05*



**Trading days relative to “spam” email touting stock**

Source: Laura L. Frieder, Jonathon L. Zittrain

The New York Times