

High frequency trading

Business



In the age of technology, everything is changing. Policies, regulations, and the way of doing business is constantly changing and evolving. In particular, a large change came about in 1999 when the SEC (U. S. Securities and Exchange Commission) authorized electronic exchanges (Wikipedia).

This had a huge impact on the Stock Market and gave way to something known as High Frequency Trading. In simple terms, High Frequency Trading is when people use powerful computers to transact a large number of orders at very fast speeds (Investopedia). These traders exploit loopholes and delays in trade orders to gain an unfair advantage. From this advantage, High Frequency Traders are able to usurp large amounts of profits at the cost of others. Because of this, measures need to be taken in order to restrict and regulate High Frequency Trading. High Frequency Traders move in and out of short-term positions at high volumes.

The traders aim to capture sometimes a fraction of a cent of profit on every trade (Wikipedia). Multiply that by millions of transactions per day and you can see where some of the profits from High Frequency Trading come from (Investopedia). With the emergences of High Frequency Traders and their advanced algorithms, they greatly change the market dynamic (Young). In addition to rendering human traders practically obsolete, High Frequency Trading is blamed for making stock exchanges less transparent and markets more volatile (Phillips). As stated in Flash Boys, the “ market was rigged” by high-frequency traders.

With the appearance of this new method of trading, many people have begun to join in on the exploitation of loopholes and market inefficiencies.

They use their greater speed to front run the competitions and take advantage of varying delays in orders. Front running is an immoral / illegal practice in which brokers (In this case the High Frequency Traders) receive information before others do. Consequentially, High Frequency Traders make millions of dollars at the cost of those who invest their savings with professional money managers. At times, it results in volatility and market impact costs, which hurt long-term institutional investors and the people they represent (Young).

Rightly or wrongly, High Frequency Trading has disrupted the process of trading stocks that determines the value of public companies (Philips). Therefore, High Frequency Trading benefits a very few at the expense of the many (Young). High frequency trading has operated almost completely out of the public eye until the Flash Crash in May 2010. During this crash, the Dow Jones Industrial Average dropped to drastic lows, and then recovered the majority of it within minutes. Ever since then, people have begun to look deeper into High Frequency Trading, which many believe to be the cause of the crash.

Furthermore, with books being published like Flash Boys, the world of High Frequency Trading has come even further into the limelight. When looking back to the early 2000's, HFT only accounted for roughly 10% of the market share. Now, High Frequency Trading accounts for roughly 50% of all trades in the United States (Wikipedia). This revelation along with growing concern has peaked the interest of many governing entities. These include the SEC, CFCTC, US Department of Justice, FBI, and New York's Attorney General's Office (Mallon).

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They have all begun to conduct investigations into the interworking's of High Frequency Trading and are attempting to determine what should be done. Although not illegal, High Frequency Trading operates in a gray area. People everywhere are evaluating the merits and morals of High Frequency Trading. In a recent Liquidnet survey of more than 100 traders from around the world, more than half (57%) of respondents said they believe High Frequency Trading should be a top concern for regulators (Young). This concern for High Frequency Trading is not unwarranted and is spreading throughout the world as High Frequency Trading grows. High frequency trading is not confined to Europe and North America anymore, it has been found in Japan, Korea, and many of the Chinese Markets (Hartley).

In line with these concerns, a host of global proposals have been put forward to combat High Frequency Trading. For example, Italy is one of the few countries to have raised a tax specifically upon High Frequency Trading (Wikipedia), however many other regions are beginning to consider such actions. Currently the rules put forth by the SEC allow for High Frequency Trading to operate due to certain loopholes and vague regulations. These loopholes are actively being evaluated and reviewed. Through these possible revisions, the SEC hopes to reconcile these issues. The problem is, High Frequency Trading operates in such a complex way that regulators must scrupulously gather data and conduct analyses.

It is this complexity that Lewis argues, allows high-speed traders to disguise what he claims to be a scheme to front-run other investors (Lewis). Through much of Lewis's work in Flash Boys, whether a fair representation or not, there is now far more awareness on both sides of the Atlantic about the <https://assignbuster.com/high-frequency-trading/>

world of HFT. In order to solve the issue of High Frequency Trading, greater knowledge of their trade must be acquired and regulations must be put in place. For this to occur, people like Michael Lewis must continue to share their insights into the complex inner workings of High Frequency Trading. Without people taking the risk and attempting to combat these financial giants, they will continue to cheat millions if not billions of dollars out of our economy.

By the dispersal of information it will become easier and easier for regulating entities to discern a solution. From these solutions, hopefully, the financial market will be restored to an even playing field. While the issue of High Frequency trading will not be solved legally for some time, individuals are attempting to create their own solution. Many of the individuals from Flash Boys, mainly Brad Katsuyama, have created an exchange known as IEX. This exchanged is designed to give their customers a level playing field (Flash Boys). They solved the issue of High Frequency Trading by coiling up 38-miles of cable in their server room to create a delay long enough for their software to work before the High Frequency Traders.

This may only be a temporary solution, but it is a step in the right direction. There are many solutions available to combat High Frequency Trading; we just need people with the resources to take action. Technology has opened the door to new worlds we never thought possible. Technology has created and solved numerous problems and continues to do so. However, some of these problems present greater urgency than others. One of which is High Frequency Trading.

The issue of High Frequency Trading was created by technology, but people must solve it. New regulations and restrictions must be implemented in order to fill the loopholes that High Frequency Traders are exploiting. Along with improved regulations, exchanges must improve their methods to deter High Frequency Traders and promote fair business. Through the evolution of our economic regulations, the progression of our understanding, and the advancement of our exchanges, the problem of High Frequency Trading can be solved. Works Cited Investopedia.

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