

**High Frequency Traders
The New Masters of the Universe?**

THE SPEED

TRADERS

Edgar Perez, Author, The Speed Traders

High Frequency Traders

The New Masters of the Universe?

- High-Frequency Trading is a set of tools that encompasses a rather diverse number of strategies that prioritize speed, low-latency, volume, liquid instruments and short timeframes
- High-Frequency Trading has been referred to as the natural progression of technology applied to the investing and trading worlds
- In the process, High-Frequency Trading has unmasked structural issues in the U.S. equity markets that are currently being examined by legislators and regulators
- Speed traders will continue finding alpha-generating opportunities by trading new asset classes in new geographies employing more sophisticated tools than ever



**Are the New Masters
of the Universe
Losing their Mojo?**

Man robs bank in clown pants,
fake breasts and blonde wig

Primary

Suspect?



LADY GAGA
BORN THIS WAY





1 on Twitter

15,945,272

followers



Lady Gaga

Creative Director

~~1000-800-8000~~

~~1000-800-8000~~

~~1000-800-8000, MN 55000~~

~~1000-800-8000~~





President Obama Calls Lady Gaga
'A Little Intimidating'

LADY GAGA

Best spokesperson
the high-frequency trading
community
could ask for



1.

I'm on the right track baby
I was born to survive

High-Frequency Trading a Natural Evolution of the Securities Markets

- There is a clear evolutionary process in the adoption of new technologies triggered by competition, innovation and regulation
- Like all other technologies, High-Frequency Trading enables sophisticated market participants to profit on their investments – especially in technology – and compensation for their market, counterparty and operational risk exposures



2.

Don't call my name,
don't call my name

FIA Principal Traders Group

- The group consists of 25 member firms, many of which use some kind of high-frequency-trading strategies. Such trading is now under increased scrutiny in Washington following the May 6 "flash crash" in the stock market. and amid growing interest by regulators in the role of high-frequency trading in U.S. markets.
- DRW Chief Executive Officer Don Wilson will serve as the FIA Principal Trading Group's chairman. DRW, along with Getco and Infinium Capital Management, ranks among the biggest proprietary-trading firms.
- Proprietary-trading firms account for an increasingly larger percentage of trading volume on equities and derivatives exchanges in recent years. Even before the May 6 flash crash in which the market plunged before staging a partial recovery, regulators at the SEC and the CFTC had begun to look closely at high-frequency trading as part of a broader review of market-structure issues.



3.

I want your love and
I want your revenge

You and me could write a bad romance

What is it about High-Frequency Trading that makes prominent investors speak up?



COURTESY: OMEGA ADVISORS

“High-frequency trading is destructive!”



“It doesn't raise fundamental questions.”



“It doesn't benefit the financial system and should be taxed.”



4.

It don't have a price

Understanding High-Frequency Trading

- At a recent investment management event, 66% of managers didn't have an opinion about High-Frequency Trading
- A recent poll by Greenwich Associates found that 20% of institutional investors don't fully understand the practice of High-Frequency Trading
- Algorithmic trading is broader, encompassing the automation of alpha-seeking and potentially execution trading decision making
- High-Frequency Trading specifically monitors the market for patterns that indicate alpha-making trading opportunities; then places orders to take instant advantage of those opportunities
- As market data is coming in fast, and conditions are changing by the millisecond, the firms that leverage High-Frequency Trading are able to jump on opportunities faster than the competition

Trends in Trading Activity, Partly Driven by High-Frequency Trading

Average daily trades

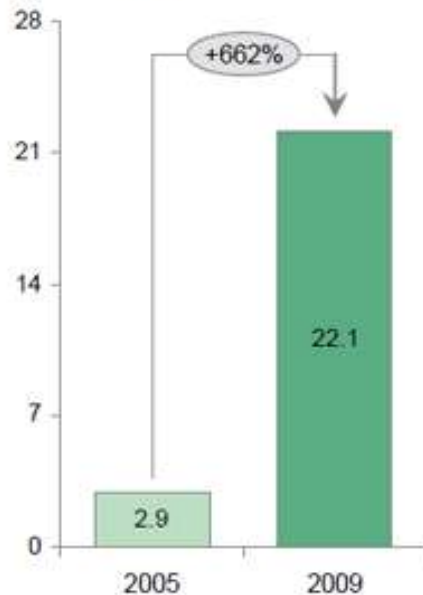
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Average trade size

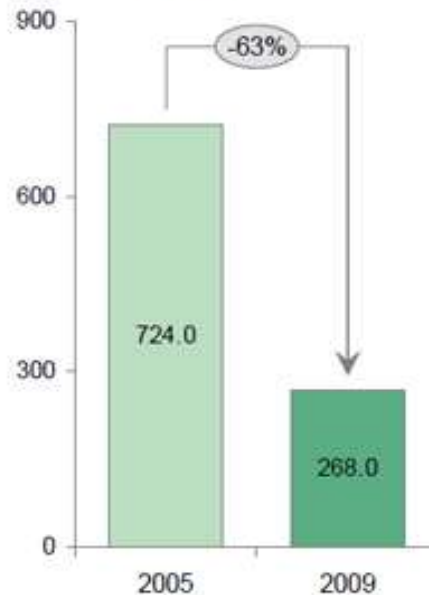
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Average daily volume

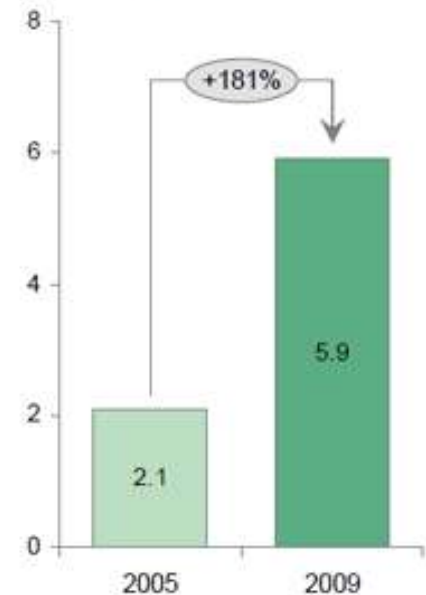
Trades (millions)



Shares per trade



Shares (billions)



Note: All data is consolidated NYSE-listed

Source: US Securities and Exchange Commission, "Concept Release on Equity Market Structure," 1/14/2010 [Release 34-61358; File S7-02-10], BCG analysis.



5.
I'm on a mission

The Mission of High-Frequency Trading

- Professional traders acting in a proprietary capacity that engage in strategies that generate a large number of trades on a daily basis
- Organized as proprietary trading firm, as the proprietary trading desk of a multi-service broker-dealer, or as a hedge fund
- Main characteristics:
 - Usage of extraordinarily high-speed and sophisticated computer programs for generating, routing, and executing orders
 - Co-location services and individual data feeds offered by exchanges and others to minimize network and other types of latencies
 - Very short time-frames for establishing and liquidating positions
 - Submission of numerous orders that are cancelled shortly after submission
 - Ending the trading day in as close to a flat position as possible (that is, not carrying significant, un-hedged positions overnight)
 - Focus on highly liquid instruments (e.g., Citi, Bank of America)

Let's take a walk down
memory lane...



What Happened to the Horse Cars?

- Horses deposited tons of feces and gallons of urine on the streets every day
- A horse could work only part of the day, but would eat all day
- A horse car could run all day, but it would require many changes of horses
- A line's investment in horses could be wiped out by diseases
- Horses could not pull cars up steep hills

Technology and Changes to Market Structure

Key Enablers

- **Technological innovation:**
 - Faster, cheaper computing power
 - Advancements in the field of complex event processing
 - Increase in availability of low-latency bandwidth
- **Shift to electronic trading**
- **Rise of alternative trading systems**
- **Decimalization**
- **Regulatory changes such as Reg NMS**

6.

I'm on the edge of glory and
I'm hanging on a moment of truth



The Flash Crash According to David Cummings

- “Wow! Who puts in a \$4.1 billion order without a limit price?”
- “This was a human mistake. The trader could have easily put a price limit on the order, but recklessly chose not to. The Sell Algorithm performed exactly as it was designed. It angers me when people blame technology for what are clearly lapses in human judgment.”
- “Now that the regulators know what happened, what are they going to do? Is there any penalty for massively disrupting the market? Are we going to let people throw around billion-dollar orders with no understanding of market impact?”

What do Warren Buffett and James Simons Have to Say About the Flash Crash?

- Buffett: “I didn’t know what was going on for 15, 20 minutes, but it didn’t make any difference. There’s probably some mechanical aspect that I don’t understand that needs some work, but it didn’t raise fundamental questions in my mind about either the economy or the markets.”
- Simons: “The crash of ’87, the market went straight down 22, 23 percent, in a few hours. Nobody stepped in to stop it. And everybody was selling, and it ended up flat on its back where it stayed for, you know, weeks and months, and— gradually crawled back. Flash crash lasted seven minutes, maybe. There was enough action, enough people came back, and the whole thing was reversed. In my opinion, the system worked beautifully compared to the way it worked in October of 1987, 23 years earlier”

A close-up photograph of Lady Gaga. She is wearing a blue dress with a gold floral pattern. Above her is a wide, ornate gold border. The background is black with gold decorative elements. The text 'LADY GAGA' is written in a serif font at the top right.

LADY GAGA

7.

And you're not gonna reach my telephone

What is the Securities and Exchange Commission to Do?

- **Circuit breakers:** adopted in May 2010 for 404 NYSE listed S&P 500 stocks and widened in September for Russell 1000 stocks to halt or slow down trades of a particular stock if the price moves 10% or more in a five-minute period
- **Limit up, limit down:** it would require that trades in all listed stocks be executed within a range tied to the recent prices for that security. It would impose a five-minute pause if trading is unable to occur within the price band for more than 15 seconds
- **Consolidated audit trail:** trade tagging and data collection system that would help the SEC track information about trading orders so it can better understand the fast-paced markets
- **Same responsibilities as traditional market makers:** as specialists at NYSE or Nasdaq, to have both a bid and an offer when they want to publish a quote



8.
Can't read my, can' read my
No, he can't read my poker face

New Asset Classes

- In U.S. equity markets, High-Frequency Trading has decreased to 53% of stock-market trading volume, from 61% in 2009
- In U.S. futures markets, High-Frequency Trading accounts for 28% of the total volume, an increase from 22% in 2009
- Of all foreign-exchange flows, High-Frequency Trading accounted for roughly 30%, as of 2010, compared with 13% in 2004
- Cross-asset trading:
 - Real-time position monitoring and efficient collateral management
 - Will enable participants to hide their strategy from competitors



9.

Hot like Mexico, rejoice

New Geographies

- The U.S. and European capital markets have been through a number of developments from the implementation of sophisticated trading technology to the evolution of their regulatory frameworks, which have fostered the emergence of High-Frequency Trading strategies
- High-Frequency Trading activity has so far been focused on the equity markets, and here it has ensured consistency in a fragmented European market
- Speed traders now account for around 15% of Asia-Pacific equity trading volumes
- Japan is the leading venue for High-Frequency Trading, accounting for nearly half of all activity in Asia-Pacific, with 45% penetration. Singapore and Hong Kong following closely
- High-Frequency Trading now accounts for 6% of Brazil's BM&Fbovespa's total volume and 25% of orders in India's Bombay Stock Exchange

A woman with long blonde hair and purple sequined eye makeup is holding a microphone. She is wearing a green sequined top. The background is dark with some blurred lights.

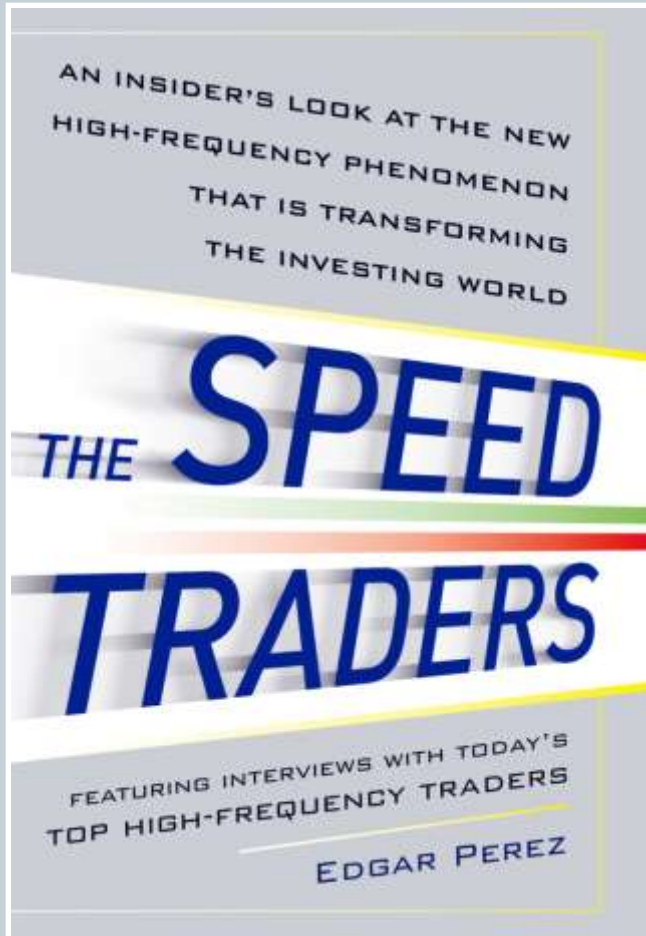
10.

I feel a moral obligation as a woman,
or a man,
to exercise my revolutionary potential
and make the world
a better place.

The New Masters of the Universe: Really?

- Is there something obscure or unfair about high frequency trading?
- Does it simply scalp liquidity from the market?
- Does it provide critical liquidity through its level of transactions?
- Does it pose a threat to market stability?
- If the transaction tax became reality, would it spell the beginning of the end of high-frequency trading?
- Would this tax would widen spreads in the markets?

More Information: The Speed Traders



- “Edgar’s book is fantastic . . . I recommend it highly.”
—**Bart Chilton, Commissioner, United States Commodity Futures Trading Commission (CFTC)**
- “Perez illuminates the world of speed. All in all, an enlightening book.”
—**Brenda Jubin, contributor to Seeking Alpha**
- “This is a comprehensive and compelling summary of the trading industry in general, as well as high-frequency trading.”
—**Paul Dowding, Managing Director, Meridian Equity Partners**
- “There is a new day in trading and speed is the key. Edgar Perez is the poster child.”
—**Eugene Steele, Managing Partner, Trading Rooms World Wide**

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