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"High Frequency" Financial Trading, High-tech Highway Robbery on Wall Street

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The Securities and Exchange Commission (SEC) knows that High-Frequency Trading (HFT) manipulates the market and bilks investors out of tens of billions of dollars every year. But SEC chairman Mary Schapiro refuses to step in and take action. Instead, she's concocted an elaborate "information gathering" scheme, that does nothing to address the main problem. Schapiro's plan–to track large blocks of trades by large institutional investors– is an attempt to placate congress while the big Wall Street HFT traders continue to rake in obscene profits. It achieves nothing, except provide the cover Schapiro needs to avoid doing her job.

High-frequency trading (HFT) is algorithmic-computer trading that finds "statistical patterns and pricing anomalies" by scanning the various stock exchanges. It's high-speed robo-trading that oftentimes executes orders without human intervention. But don't be confused by all the glitzy "state-of-the-art" hype. HFT is not a way of "allocating capital more efficiently", but of ripping people off in broad daylight.

It all boils down to this: HFT allows one group of investors to see the data on other people's orders ahead of time and use their supercomputers to buy in front of them. It's called front-loading, and it goes on every day right under Schapiros nose.

In an interview on CNBC, HFT-expert Joe Saluzzi was asked if the big HFT players were able to see other investors orders (and execute trades) before them. Saluzzi said, "Yes. The answer is absolutely yes. The exchanges supply you with the data, giving you the flash order, and if your fixed connection goes into their lines first, you are disadvantaging the retail and institutional investor."

The brash way that this scam is carried off is beyond belief. The deep-pocket bank/brokerages actually pay the NYSE and the NASDAQ to "colocate" their behemoth computers ON THE FLOOR OF THE EXCHANGES so they can shave off critical milliseconds after they've gotten a first-peak at incoming trades. It's like parking the company forklift in front of the local bank vault to ease the transfer of purloined cash. Due to the impressive research of bloggers like Zero Hedge's, Tyler Durden and Market Ticker's, Karl Denniger, many people have a fairly good grasp of HFT and understand that the SEC needs to act. But Schapiro has continued to drag her feet while issuing endless proclamations about pursuing the wrongdoers. Baloney. She needs to stop yammering and shut these operations down.

In a recent posting, Market Ticker explained some of the finer-points of high-frequency trading, such as, how the banks/brokerages probe the exchanges with small orders in order to find out how much other investors are willing to pay for a particular stock. Here's a clip:

"Let's say that there is a buyer willing to buy 100,000 shares of Broadcom with a limit price of $26.40. That is, the buyer will accept any price up to $26.40. But the market at this particular moment in time is at $26.10, or thirty cents lower.

So the computers, having detected via their "flash orders" that there is a desire for Broadcom shares, start to issue tiny "immediate or cancel" orders – IOCs – to sell at $26.20. If that order is "eaten" the computer then issues an order at $26.25, then $26.30, then $26.35, then $26.40. When it tries $26.45 it gets no bite and the order is immediately canceled.

Now the flush of supply comes at $26.39, and the claim is made that the market has become "more efficient."

Nonsense; there was no "real seller" at any of these prices! This pattern of offering was intended to do one and only one thing – manipulate the market by discovering what is supposed to be a hidden piece of information – the other side's limit price!

With normal order queues and flows the person with the limit order would see the offer at $26.20 and might drop his limit. But the computers are so fast that unless you own one of the same speed you have no chance to do this – your order is immediately "raped" at the full limit price!

The presence of these programs will guarantee huge profits to the banks running them and they also guarantee both that the retail buyers will get screwed as the market will move MUCH faster to the upside than it otherwise would.

If you're wondering how Goldman Sachs and other "big banks and hedge funds" made all their money this last quarter, now you know." ("High-Frequency Trading is a Scam", Market Ticker)

The HFT uber-computers are able to find out the highest price that traders will pay in a millisecond and then extort that full amount millions of times to maximize profits. Clearly, this has nothing to do with efficiency or innovation. It's high-tech highway robbery; institutional bid-rigging on a grand scale, tacitly sanctioned by industry lackeys operating from within the administration. Schapiro was picked by Team Obama for this very reason; because she was known as a regulator with a "light touch" when she headed Finra the financial industry's self policing agency. As Finra's chief, Schapiro managed to keep her head in the sand during the Madoff scandal and the auction-rate securities flap. She also issued far fewer fines and penalties than her predecessor. Here's an excerpt from the Wall Street Journal which sums up Schapiro's regulatory doctrine:

"The Financial Services Institute, a trade group, was meeting, and Ms. Schapiro addressed the crowd about Finra's efforts to fight frauds aimed at senior citizens. Frank Congemi, a financial adviser, asked what Finra was doing to regulate "packaged products" such as complex mortgage securities. Mr. Congemi says that Ms. Schapiro replied: "We have rating agencies that rate them." The credit-rating agencies, by this time, were being heavily criticized for having given triple-A ratings to mortgage bonds that became unsalable as foreclosures rose." (Wall Street Journal)

If the financial crisis has taught us anything, it's that the system is NOT self-correcting. And it takes more than just rules. It takes regulators who are willing to regulate.

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