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## MV Capital Management Weekly Market Flash

### From the Eurobond to the “Flash Boys”

*April 4, 2014*

Michael Lewis, the ex-Salomon Brothers trader turned investigative author, has always had a particular sweet spot for the world of finance. His knack for shining a bright light into the obscure, murky corners of Wall Street was on display again this week with the publication of [Flash Boys](#). In the crosshairs of Lewis’s investigative storytelling this time was the little known, but very influential, world of high frequency trading (HFT).

#### *The Evolution of Modern Markets*

Critics of HFT point to its existence as a proxy for all that has gone wrong in securities markets – from being the oil which greases the wheels of productive investment to a giant casino where the house enjoys even better odds than in Las Vegas. There is more than a kernel of truth to this view. On the other hand, HFT is a logical outcome of the two forces that, more than any others, have shaped the fabric of modern markets: the steady pace of deregulation and the explosion of technology. These two forces collided in the early 1970s. The financial world was beginning to comprehend the power of Moore’s law (the inverse relationship between cost and capacity in data storage). Meanwhile the Bretton Woods framework for stable exchange rates was collapsing, the regulation-lite Euromarkets were taking off, and the era of fixed commissions was ending on the New York Stock Exchange.

#### *The Value of a Microsecond*

A frenzy of innovation ensued in all manner of financial products. As markets globalized, traders increasingly saw speed as one of their most important sources of competitive advantage. Getting an order from a trading floor to an exchange and back faster than your competitors got you a slightly better price at execution. For any given trade the advantage could amount to mere pennies or even less. But those pennies turn into millions of dollars when tens of thousands of trades are at play every day. As the technology improved, it became no longer a game of seconds, but of milliseconds (a thousandth of a second) and microseconds (a millionth of a second).

#### *No More Men in Funny Colored Jackets*

What happens when you place a trade? The image most people have is of an order being routed to the floor of a stock exchange, where burly men in brightly colored jackets and badges holler and wave their arms in strange ways to make the trade. That is an outdated image. Human floor traders have largely been replaced by black boxes in climate-controlled data centers strategically located near the world’s major financial centers. High frequency trading accounts for more than 65% of the daily trade orders whizzing in and out of these black boxes along glass fiber optic lines at light speed. Now, the revelations in Lewis’s latest book may spur action to rein in some of the most egregious byproducts of HFT. But it is not hard to imagine that somewhere, well outside of the public eye, some group of extremely smart, tech-savvy individuals is busy developing and testing the next big thing.

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