Controversial high-frequency trading study says practice boosts liquidity

By Eric Garcia
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WASHINGTON (MarketWatch) — While many have stated concern that high-frequency trading can hurt market stability, a new academic study shows the practice contributes to market stability.

Since the so-called flash crash of 2010, concern has been raised about high-frequency trading’s relationship to extreme price fluctuations, notably in Michael Lewis’s popular book, Flash Boys.

But the study found that high-frequency trading firms trade in the opposite direction during extreme price jumps and supply liquidity to non-high-frequency trading firms as well as contribute to market stability. In addition, the study shows that during normal times, high-frequency trading firms as a whole demand more liquidity than they supply, but during times of financial stress, they provide more liquidity.

The late November study was conducted by four professors, including Jonathan Brogaard at the University of Washington.

A Jazz Quartet Explains High-Frequency Trading

(2:00)
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“We find that during intervals of extreme price movements, HFTs stay in the market and they provide more liquidity than they take,” Brogaard said in an email, adding in the past, research had only focused on average markets as opposed to extreme events.

The data set used for the study came from the Nasdaq and included twenty stocks traded on the Nasdaq and New York Stock Exchange between 2008 and 2009.

The study has its critics. Joe Saluzzi, partner and co-founder of Themis Trading, said it was disingenuous to use dated information and only from Nasdaq.

“They continue to use one set,” he said, referring to researchers on the subject who are in favor of high-frequency trading. “You’ve got to have the exact real data.”

Brogaard said the reason for using the data sets was Nasdaq has been willing to provide the information to academics while others have not.

“If we had more data we’d use it,” he said. “This time period is of particular interest given that it’s when markets were highly volatile and we regularly saw large price movements.”
Saluzzi also said the study only looked at one asset class, stocks, which he said further added to the inaccuracy of the study.

“You can’t tell me they are providing liquidity from one asset class when they can be demanding from another,” he said.