

June 7, 2011 - More on HFT

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Coincident with my rant in the weekly review on High Frequency Trading (HFT), the CBS show [60 Minutes] featured a segment on the issue the next day. It was very well-done, presenting both the pro and con sides of the merits of the high speed mechanical trading system that has come to dominate our financial and commodity markets. It features an HFT trader, a former US senator, a NYSE official and the chairman of the SEC. This segment focuses on the stock market, but the firms involved and the computer hardware and software are the same being used in COMEX silver. It runs about 13 minutes (with a commercial) and a written version is also available. I suggest you watch it.

<http://www.cbsnews.com/video/watch/?id=7368460n&tag=related;photovideo>

This is a very important issue of how our markets operate versus how they should operate and, most critically, who should decide? Right now, those deciding, by default, are the entities that have the most to gain, namely the HFT traders themselves and the exchanges that get compensated by the increased trading. I say default because my sense is that these trading strategies are so new that there is no existing body of regulation new enough to deal with how they should be governed. Technically, the HFT traders are not violating any known rules. However, there have developed unintended consequences to this frantic trading that have put the public's interest at risk.

On the pro side, the argument runs mainly to the increased volume and liquidity that the HFT traders claim is created. However, it seems to be a deceptive liquidity or more of an illusion of liquidity as this trading enhances, rather than dampens daily silver price volatility. On the con side, charges range from HFT being predatory, to the practice being parasitical, opaque, manipulative and susceptible to creating a financial accident. There is no great economic benefit created or purpose served by HFT trading. Those weren't my words; they were the words of others on the featured segment.

In silver, I believe HFT is a particularly pernicious practice. When dealing in stocks, the HFT traders deal in thousands of individual stocks. In commodities, each market is on one specific commodity. Therefore, the effect of HFT is more concentrated and more pronounced in silver. Further, the HFT traders aren't hedgers and don't produce or consume physical silver in any way; that makes them pure speculators. While there is nothing wrong with being a speculator (I am one myself on occasion), these HFT speculators control up to 90% of the daily trading volume and price volatility in a futures market whose economic justification is to promote hedging. It is inherently wrong that a concentrated band of extremely large day trading speculators has come to dictate prices in the silver market. This is not what the framers of commodity law envisioned.

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The HFT stock traders don't necessarily hold big long or short stock positions in addition to the daily frenzied day trading they conduct. But in silver, the biggest HFT traders (like JPMorgan) also hold significant overnight short positions. This increases the motive to depress prices to benefit the large silver short holdings. Unless my old eyes have deceived me completely, there is a distinct pattern in silver of prices falling more sharply when these HFT crooks are operating than of prices rising. I don't think that's an innocent coincidence.

I don't mean to beat a dead horse, but it always comes down to concentration; large holdings or dealings by the very few. We have laws against concentration and endless speeches bemoaning the past ill results caused by it. Yet, concentration remains the fact in silver. Concentration in short positions, daily volume and the most obvious HFT concentration □ dealing in one item, silver, instead of thousands of stocks.

After watching the □60 Minutes□ segment, I reflected on the one flagship mishap so far in HFT stock trading, namely, the infamous □Flash Crash□ of last May. That was when the stock market plunged 600 points in 15 minutes. That was about a 7% decline. There was instant and widespread attention given the matter, including a joint SEC and CFTC task force and subsequent investigations and findings. On May 1 this year, silver fell 13% in 12 minutes. Not only have there been no announcements from the regulators of task forces, there has been no single comment of any type uttered. Here's what struck me the most -

the silver market decline took place under the most suspicious of circumstances, namely, early on a Sunday evening when all markets were closed except the COMEX's Globex system. Can you imagine if the stock market indices on the Globex dropped 13% in 12 minutes in an overnight session with no fundamental news and the regulators chose not to comment?

This HFT trading in silver is evil, dangerous and manipulative. It is being promoted and championed by the CME Group to artificially inflate their revenues against the interests of the public. That the CME is allowed to orchestrate this harmful HFT trading as a front line Self Regulatory Organization is outrageous. Their silence and the silence by the CFTC to the highly unusual recent price events in silver are shameful.

I hate having to harp on all the manipulative dirty tricks on the part of the silver shorts. But what's the alternative □ ignore them? My biggest concern is that I may send the wrong message at times. We must fight to keep balance and perspective. There is a clear intent here that is not accidental. You must remember that these dirty tricks are designed to discourage you from buying or holding silver. That's because the manipulators want to buy as much silver as they can without outside competition, both to cover short positions and get long. There is not enough silver to go around for these manipulators to buy at attractive prices and on the up and up, so they keep inventing tricks to benefit themselves. It's tiresome and debilitating at times to keep up with their crooked

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tricks, but don't let them wear you down. The investment returns to come in silver will make it worth holding, same as it has in the past. And stay after the regulators and your elected officials to end this HFT scam.

I should have a new interview with Jim Cook published here in a couple of days.

Ted Butler

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Silver - \$37.00

Gold - \$1543