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FLASH BOYS—LEWIS' LATEST BOOK AN ENTERTAINING READ ON HIGH FREQUENCY TRADING

By Jeff Passmore

Flash Boys, A Wall Street Revolt is the latest book by Michael Lewis, the bestselling author of *Liar's Poker*, *Moneyball* and *The Blind Side*. The book was published March 31, 2014 by WW Norton and Company. It tells about the evolution of high frequency trading (HFT) through the stories of a few of the key participants. The general theme is that HFT is an unfair practice that benefits a very few high frequency trading firms and large investment banks at the expense of the remainder of the U.S. equity market participants.

LEWIS IS A BESTSELLING AUTHOR AND FLASH BOYS FOLLOWS SUIT

Lewis is as prolific as he is accomplished. Since his first book, *Liar's Poker* in 1989, Lewis has written 25 books. All but one have become bestsellers. In this regard, *Flash Boys* is no exception. Shortly after release it was #1 on the Hardcover Nonfiction list of several national publications. It has been three years since his last book, *Boomerang: Travels in the New Third World*. Given that amount of time, it is a little surprising that this book seems as though it was a little rushed. For example, it does not even have an index. More significantly, it does not have Lewis' usual clarity of exposition. It also seems to overreach in attempting to make its point that high frequency trading is something the average equity trader needs to worry about. Even so, it is an interesting story and has Lewis's gift for making technical subjects both accessible and interesting.

Lewis is most famous for his two sports related books that became movies: *Moneyball* (2003) and the *Blind Side* (2006). He is also well known and respected for his investigative financial journalism. Even before *Moneyball*, he had become famous by making financial nuances understandable to non-experts while at the same time doing thorough investigation into the behind-the-scenes people and events that drive the headlines. His ability to weave these together into compelling narratives makes his books as page turning as very good fiction.

AN EXCITING BEGINNING—THEN TWO NARRATIVES WITHIN THE STORY

Flash Boys begins with the story of a Russian-born computer programmer who was arrested and charged with stealing computer software used for high frequency trading from Goldman Sachs. This short introduction sets up many of the questions that the remainder of the book attempts to answer. The remainder unfolds in two stories. The first is about Spread Networks. This start-up company laid a straight line of 827 miles of fiber optic cable connecting equity trading markets in Chicago and New York City. The network went live in mid-2010. Because of its straightness and therefore speed, this new connection was able to sell subscriptions to the line to various investment banks and high frequency trading firms for $300,000 per month. The speed advantage of this line is remarkable in that it is so small. Other networks could make the roundtrip, Chicago to New York and back, as fast as 14.65 milliseconds; Spread could do it in 13 milliseconds. A millisecond is one thousandth of a second.

The second story fills the majority of the book and it tells about Brad Katsuyama and the team that he assembled at the Royal Bank of Canada to combat HFT. This team later left RBC to start their own stock exchange, IEX, with a similar intent. That is, IEX was intended to address HFT by taking a market-oriented approach, offering investors an exchange where high frequency traders do not have an informational advantage. IEX went live October 2013. This story of Brad's team has numerous side stories to provide background into the various team members and to present different perspectives on the evolution of HFT.

HIGH FREQUENCY TRADING—HOW BAD IS IT?

Lewis' opinion, that HFT is both unfair and unethical if not illegal, is never clearly quantified in its context "how much does this cost us?" Nor does Lewis make clear what remedy he advocates regarding HFT—he does not answer the ques-

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tion "what should be done to fix this?" On the contrary, he seems to imply that HFT is just the latest example of market participants exploiting regulatory loopholes.

Lewis points out that HFT is a consequence of Regulation National Market System (Reg NMS) that was established in 2005. Its aim was to foster both "competition among individual markets and competition among individual orders." Reg NMS provides much of the regulatory structure of the electronic trading in U.S. equity markets. By his own admission, the history of Wall Street regulation is one of cat and mouse—each time a new regulation seeks to close existing loopholes, new strategies are created that exploit new loopholes. He also points out that this general trend is one of decreasing frictional costs, e.g., the advent of electronic trading has seen both decreasing commissions and tightening bid-ask spreads.

According to Lewis, HFT profits by driving spreads wider than they otherwise would be to the benefit of the high frequency trader and to the detriment of the investor, without providing any economic benefit. High frequency traders counter that they are acting within the law, that spreads have generally gotten tighter during the period of HFT and that they are providing liquidity to the markets (for this perspective see for example *Flash Boys: Not So Fast, An Insider's Perspective on High-Frequency Trading* by Peter Kovac). Lewis does not dispute the first two points, i.e., legality of HFT or the decreasing trading costs. He does convincingly dispute the third regarding liquidity. However his vitriol seems misplaced given his observation of the nature of financial regulation: close one loophole and another, albeit smaller, loophole opens. Profiteers are not eliminated, but they do have narrower opportunity for profit. In the process, markets become increasingly efficient. He also does not provide context for the U.S. equity markets in comparison to other equity markets of the world or the U.S. markets for other asset classes. Is the U.S. equity market the most efficient, despite HFT? Are other asset classes impacted by HFT in the way that equities have been?

CONCLUSION

Even given these missed opportunities, Lewis has written a very entertaining book and provides an easily accessible description of HFT in a quick read; the book is only 274 pages. The book is available in hardcover and e-book format. The e-book works well; there are no pictures, charts or tables that sometimes complicate e-reading.

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