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Bring back the old fashioned way of trading

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May 2010 will not be remembered in the same way as October 1929 or October 1987, but it featured a pretty devastating share market crash nevertheless.

On Thursday 6th May 2010, the Dow Jones Index plunged nearly 1,000 points in less than 30 minutes. This crash differed from earlier ones though, as humans played a very minor role.

US investigators are still searching for the underlying cause and are wading through masses of data for clues as to what went wrong.

Initially there was some talk of the 'fat-finger' syndrome, where an order to sell was incorrectly keyed, setting off a frenzied reaction. However, it now seems that the fault lies with different rules applied by different electronic exchanges i.e. computers not communicating with each other properly.

It would be hard for the 24 gentlemen who started the New York Stock Exchange in the 1700s, by trading shares on the footpath of Wall Street, to imagine that the stock market could be brought to its knees by computer trading.

For two hundred years, shares were traded the old-fashioned way.

A buyer and seller would agree a price for a stake in a business, they would shake hands and the deal would be completed. In the early 1900s, the process was enhanced with the introduction of specialist traders who would act as middle-men, finding buyers and sellers and then facilitating a deal.

We've all seen images of these traders – the guys in jackets waving bits of paper and yelling at each other on the floor of the stock exchange.

In the 1970s, the handshake became an electronic one as an Intermarket Trading System was established to link the New York, American, Boston, Chicago, National, Pacific, and Philadelphia stock exchanges, the Chicago Board Options Exchange, and the NASDAQ .

Humans were still required, but increasingly, trades were completed electronically, allowing stock market trading to become faster, more efficient and less transparent.

Electronic trading has developed to the extent that it now comprises up to 70% of the daily volume on the New York Stock Exchange. Trading is no longer undertaken in a central spot - there are a dozen electronic exchanges in the US alone that trade between themselves, making it very hard for regulators to piece together what happened on the 6th May.

While it is hard to stop the juggernaut created by information technology, regulators have understood for a long time now that electronic trading needs to be reigned in, and circuit breakers need to be inserted in order to stop the sort of bedlam we saw ten days ago.



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In the old-fashioned exchange, common sense and restraint would stop a problem spiralling out of control. But computers don't have common sense, and a massive chain reaction can be triggered electronically that is difficult to stop.

Perhaps regulators should use the old-fashioned method of controlling an out of control electronic gadget – pull out the plug.

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