Australian Standfirst

Definitions of 'Algo' & DMA

The fundamentals of investing and trading have not changed for decades, if not millennia.

Nevertheless, the modern trading environment bears very little resemblance to that of the 1980's, or even the early 1990's as electronic trading has transformed markets, making them more accessible than any time previously.

Tools like Direct Market Access ("DMA") and algorithmic trading ("Algo") give investors more control over how their strategies are executed; for instance, DMA enables investors to send orders directly to exchanges, whilst still employing their broker's infrastructure and in so doing minimising latency as cost effectively as currently possible.

Algorithmic trading ostensibly distils existing human knowledge and heuristic patterns into pre-packaged rule-sets, or algorithms.

A computerised system is then responsible for executing orders by strictly following these rules, offering an efficient alternative to manual trading.

In order to get the maximum benefit from technologies like algorithmic trading and DMA it is vital to have a thorough understanding of them, their governing dynamics and evolving regulatory compliance requirements, domestically and abroad.

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How 'Algo'/DMA Traders Backstop Major American, Asian & European Markets

How 'Algo'/DMA Traders Backstop Major American, Asian & European Markets:

The Past, Present & Future Of Investing Without Surrendering Your Human Edge

Transcendental Meditation, or TM, is a widely practiced and voguish meditation technique that is distinct from other forms of introspection, simply by difference of the mantra repeated and the way a focused outcome is achieved.

While other meditation practices encourage emptying the mind of all thoughts, TM welcomes superfluous thoughts to come and go, as so long as the near-meaningless *Sanskrit* mantra is repeated as the vehicle to help the mind settle and achieve genuine focus and most importantly of all, an objective clarity that aides one to parse incorrect interpretations of their past and today's present.

This is one heuristic example of how a human technique can contend with a computers unconscious algorithm and deliver an equally effective answer to a prescient challenge confronting our current deliberation.

Technology-enabled platforms and services have unequivocally helped facilitate an expansion of online activity and one would hope productivity but they in turn have also clouded objectivity via the strange mathematical paradox that ends up understating critical data exegesis because of human imputation bias influenced by the zeitgeist of that era - namely in September 2021, the market's singular and *en-masse* focus on, "*economic reopening*" at cost to almost all else.

To borrow from jurisprudence, a court is not affected by the winds of the day but will be by the climate of the era {the law is never finished and is always a work in progress, so too one may argue is the bedrock of financial market microstructure and architecture}.

Suppose, Australian Standfirst holds the view that ***Risk-On*** bourses will retrace, or at very least, pullback, sometime along the *mid-to-latter-end* of September's ominous trendline and after evidencing the continuation of ***The Global Reflation Supercycle*** to all in July 2021, does our DDPM team today abandon their long-standing valuation process – which broadly looks for fungible investments that are constructively geared toward the positive incumbent economic backdrop – or do they heed the meta-analysis, *de minimis* and logical conclusions of computerised risk systems, which acknowledge extant strong corporate earnings on the one hand but raise the spectre of risks via means of ratcheting inflation, threats of rising interests rates and, of course, the ***Global Corona Crisis's*** (***GCC***) continuing vex, now led by Delta and others emerging viral variants?

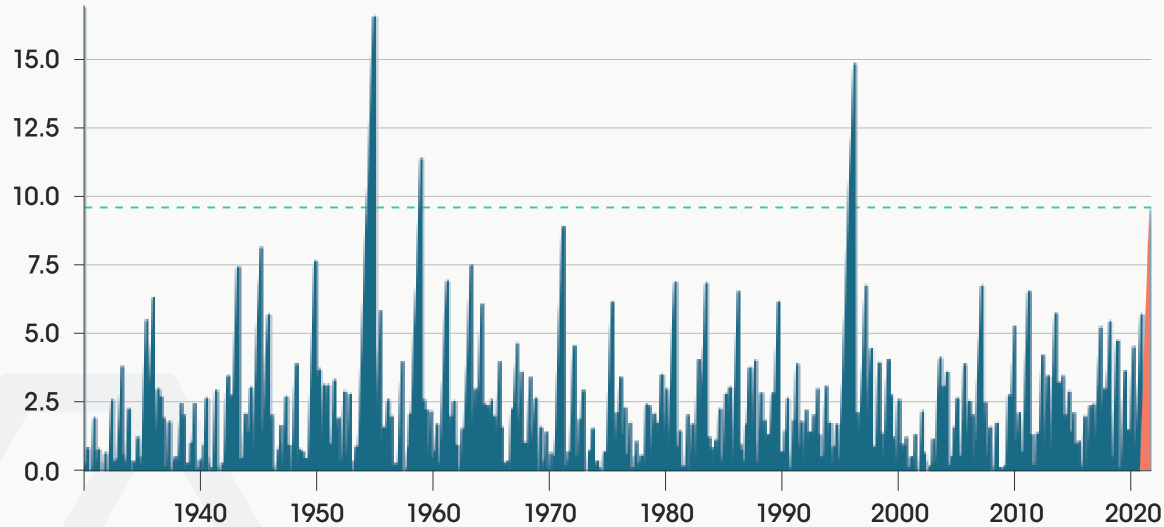
Cite:- Automation, Artificial Intelligence & Bionic Markets, 1 March 2019
Cite:- Special Purpose Acquisition Companies (SPAC's): Funding Blind Pools, Mature Unicorns & Family-Owned Businesses During The Great Corona Crisis (GCC), 26 July 2020

Through bitter experience, the DDPM team has learnt that long-standing and established valuation practises matter irrespective of the quantum of liquidity manipulation afoot but that the minutiae outputted from computerised meta-analysis is not moot but rather acutely instructive about where and when bionic market actors (id est, Algorithmic traders, DMA 'Bots', et al) backstop major markets, asset buckets or risk 'factors' (an awfully abused and now hijacked analytical categorisation).

Cite:- Cheating, On Cheating, On Cheating: Maintaining Portfolio Quality In The Era Of Cheating, 13 March 2020

The US's S&P500 hasn't fallen over a two-month period since October - the fourth longest such streak ever

Months since the last time the S&P500 closed below its level from 2 months earlier



Source: Bloomberg

There are now plenty of precedents and anecdotal examples of Algo and DMA investing teams' balustrading major listed equity and bond bourses and in so doing backstopping the natural emergence of retracements: the best two and timely episodes were seen between 2014 – 2016 when fears of a double-dip recession (following the Great Recession, or Global Financial Crisis, or GFC) hovered large and secondly, during February-March 2016 when the global hedge fund "*Momentum*" trade imploded dovetailing with the Trumponics recovery and subsequent bull run, triggered by President Trumps' surprise victory in November 2016.

Our seminal albeit short contribution on the latter can be found at, "*Will The Instosdriven Donald Trump Rally Last Long*", published 6 December 2016 in The Australian newspaper.

This piece evidenced how the post Trump ascendency in November 2016 fuelled a markets resurgence that had the fingerprints of market technicians all over it, namely Algorithmic trading and DMA hedge funds domiciled in the Caribbean, Singapore and of course North America.

Cite:- Trump's Bull Rally, 22nd Amendment & How The First American Republic Ends, 19 December 2019

During the long stretch between 2014 and late 2016, genuine and frankly justified reservations about the resurgence of issues trailing from the ***Great Recession*** sparked listed market concerns about the withdrawal of unconventional monetary programmes support which had been deployed first during the 2007 and 2008 ***Credit Crunch*** and extended up and until said stretch.

Cite:- A Sober Eye To The Realities Of Our Global Boomcrash Opera, 9 August 2014
Cite:- Passive But Correct Advice Wins Investment Race, 16 August 2014
Cite:- Let History Lead To Brighter Future, 18 October 2014
Cite:- Surviving The US Federal Reserve's Monetary Policy Rollercoaster, 21 March 2015
Cite:- Intervention Can Distort The Markets, 5 September 2015
Cite:- Truth Stranger Than Fiction As Yellen Sounds Death Knell For Economy, 19 September 2015
Cite:- It's Time For A Fresh Rethink Of Balancing Act, 3 October 2015
Cite:- Fed Rate Rise Talk Puts Focus On Fixed-Income Markets, 21 November 2015

Alongside puritanical Algo/DMA hedge fund institutional participants, 2014 onwards saw additional disruption led by "Active ETF's" solutions, *Robo-Advisors* and Smart Beta plays, which were no longer buzz words relegated to white papers; each solution created opportunities and risks for incumbents with a promise to alter the investing landscape – they all did but they also aided the transformation of the underlying market architecture, especially that set in New York, Chicago, Hong Kong and eventually the City of London.

A popular belief in the marketplace during 2014-2016 was that ETF's were vulnerable to settlement issues given they made up a double-digit percentage of "*failed trades*" as noted by the SEC in the first half of March 2015.

According to the SEC, a settlement failure occurs when the buyer or seller in a transaction fails to deliver either cash or securities within a predefined period.

Nevertheless, quantitative analysis completed in 2016 placated this market liquidity concern because the majority of the ETF settlement "*failures*" were only technical in nature and as such did not add to another layer of risk to trading Active nor Passive ETF's and given their structure and usage in the market (increasingly so since 2014-2016), while the economic interest in a security traded is transferred at the time of the trade irrespective of when it settles, by definition, all parties have thereafter been made whole and insulated from counterparty risk.

Following the TM analogy, Active ETF settlement failure fears were eventually proven as superfluous and did not go to the objective focal point of active investors deliberations balancing risk *tête-à-tête* reward; Direct Market Access (DMA), in reality, only served to bolster the latency and productivity of individual investors and traders throughout this stretch of underlying economic uncertainty.

However, where Algorithmic traders and DMA actors made their presence and backstopping support known most was during the "***Taper Tantrums***" of 2013 and "***Rate Riots***" of 2015.

Cite:- Rates Riot Behind The Market Correction, 29 August 2015

The events of August 2015 were seismic by any yardstick and as we noted on 29 August, "*Viewed in isolation, the events of Monday were epic, compared to any historical comparisons. The US Dow Jones opened down more than 1000 points, before eventually closing 588 points lower. This was the largest single session drop in total terms — price level multiplied by aggregated volume — in US stockmarket history. But the institutional concern was not focused on the drop alone but the immediate "price action" that promptly and erratically followed. The Dow and S&P 500 indices "ratcheted" up and down, in "arithmetically" identifiable parcels of about 3 to 5 per cent, more than four times, within two trading hours in New York. Coupled with the single largest drop on the Hang Seng since 1987's "Black Monday" — remembering that Hong Kong's 1987 fall triggered the 1987 global stockmarket crash — these events have led institutional participants to deeply* *question how involved automated algorithmic computer systems have become. The presence of computers throughout markets is an obvious reality that will need to be accepted*."

Further digitalisation of market movements were evident in September 2017 during the gigantean Equifax breach, the short selling squeezes of 2016 and 2017 and the UCITS arbitrage ploys speculated throughout 2017.

Backstopping major American, Asian and European listed markets from retracements and volatility at *prima facie* appears as admirable and may have become normalised, voguish and even accepted as 'business as usual' but as Rod Serling reminded us, "*Coming up with ideas is the easiest thing on earth, putting them down is the hardest. Remember, there is nothing in the dark that isn't there when the lights are turned back on*."

Australian Standfirst takes the responsibility of managing our client's investments seriously and welcomes all feedback.

Stirling Larkin, CIO,
Australian Standfirst Asset Management

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