

High-Frequency Traders First Go Against Order Flow, Study Shows

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High-frequency traders are more prone to first go against the flow of orders by large institutions, according to a study based on trade data provided by investors including Norway's \$890 billion wealth fund.

The study found that HFTs "lean against the order" in the first hour and then turn around and go with the flow in the case of multi-hour trades, the study by University of Amsterdam professors Vincent van Kervel and Albert J. Menkveld released Thursday showed. Trading costs are 39 percent lower when the HFTs lean against the order, "by one standard deviation," and 64 percent higher when they go with it, they said.

"The results are inconsistent with 'front-running' in the sense of HFTs who detect a large, long-lasting order right from the start and trade along with it," van Kervel and Menkveld said. "We speculate that HFTs eventually feel the imbalance caused by it. In response, they trade out of their position as they understand that leaning against such order as a market maker requires a long-lasting inventory position. HFTs prefer to be flat at the end of the day."

The study is based on data from Swedish stock trading in 2011 to 2013 and also includes information from DNB ASA, Swedbank's Robur and APG.

The "market structure" debate should "recenter around end-user costs," they said.

“It should be in the interest of end-users, retail and institutional investors to make their trade data available,” van Kervel and Menkveld said. Otherwise “regulators might demand more data granularity from data centers.”

The U.S. Securities and Exchange Commission’s recent move to amend a rule and allow regulators to audit data is “a step in the right direction.”

Norway’s wealth fund has said it has worked out how to dodge traders in the U.S. trying to profit on its orders by leaving no pattern for them to track.

“As a large institutional investor, we are obviously interested in good academic research in this area,” said Marthe Skaar, a fund spokeswoman.