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## Flash crash explanation questioned

By Philip Stafford

A study has called into question the official explanation for the flash crash that hit US markets nearly three years ago.

The findings by Albert Menkveld, professor of financial economics at VU University and Duisenberg School of Finance in Amsterdam, dispute that the unprecedented selling was prompted by a single trade by Waddell and Reed, a Kansas-based mutual fund company.

Confidence in US markets was badly shaken by the May 6 flash crash when equity indices, weak on fears over the eurozone debt crisis, plummeted nearly 6 per cent only to rebound again, within just 20 minutes.

An investigation revealed the extent to which the industry had become reliant on automation and superfast computing to trade in fractions of seconds, far beyond the speed and comprehension of a human.

The report compiled by two main US regulators, the Securities and Exchange Commission and the Commodity Futures Trading Commission, pointed the finger at a trade by a mutual fund trade, since identified as Waddell and Reed.

However, Mr Menkveld, who has advised the European Securities and Market Authority (Esma), the regulator, and the French Autorité des Marchés Financiers, said the fund was relatively inactive at a crucial period.

His findings, released late on Tuesday, were based on trading data from Nanex, the US financial markets consultancy, and Waddell and Reed. It also used ultra-high frequency information timestamped at 25 milliseconds intervals. The SEC-CFTC report used wider timeframes.

The official version found that at 2.32pm eastern time Waddell and Reed entered an order to sell 75,000 e-Mini S&P 500 index futures worth \$4.1bn on the CME, the futures

exchange.

The fund used an automated algorithm to sell as much as 9 per cent of the market's volume over the previous minute, the official report said. This trade sparked a cascade of buying and selling in futures, equities and exchange traded funds that panicked market makers, leading them to stop trading, which resulted in the market's 6 per cent swing.

Most of the price declines in the flash crash took place in the two minutes before trading in the e-Mini contract was halted.

However, Mr Menkveld said the sales by Waddell and Reed did not directly cause any of the steep price declines and conducted few trades in the minute leading up to the halt of the e-Mini contract.

"[Waddell and Reed's] net sells were only 4 per cent of the total e-Mini net sells. Yet their long-run price impact was 19 times higher. Most of it kicks in after 300 milliseconds when other traders suddenly aggressively sell," he said.

"One reading of the new results is that the crash cannot be attributed to a single agent but really is the product of agent interaction," he said.

The study was not sponsored by industry participants.

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