Algorithmic Trading Is Getting A Bad Rap

by Tom Basso, November 28, 2018

We've heard it every time that stock market takes a serious hit. "Those Algos are at it again" or "Algos are bad because they are creating more volatility in the markets."

Any time any of us creates strategy on Excel or a Trading Blox or similar platforms, you become an Algo. You are simply taking your own inventory of yourself (capital, skills, resources, available time) and creating something you hope will lead to what you deem success. I have 50+ years of trading experience, computer skills, math skills and am retired. My measure of success is to trade for capital preservation while increasing the value of my assets. Sleeping at night is important to me.

Others might opt for more leverage and "action" with larger overall profits. Still others might shoot for more reliability, looking to be more right than wrong in trade success. Some might like to trade with the trend, other might fade the trend. There's something for every taste and style here in the world of trading.

Algorithms are nothing more than the mathematical representation of the opinions and desires of the person creating the algorithm. I do agree that Algos have helped the market move more quickly, but I don't believe that is due to the algorithm as much as it is the more efficient execution of the algorithm designers' opinions and biases.

When I started automating my strategies back in the Trendstat days, I was proud to have a very new IBM PC in 1980 that was more powerful than anything I could get my hands on before. Today, my phone has more RAM and computing capabilities. I'm now running a laptop that fits in

my backpack for traveling that has 64 gigabytes of RAM, a quad processor and 2 tetra bytes of disk storage for $2800!

Let's go back into the time machine and look at what was happening when I graduated from Clarkson University back in 1974 as a chemical engineer. That was the end of a two-year bear market. Stocks had fallen by roughly 50% from the highs. The Wall Street Journal was printing opinions about how far the market had to go down to reach the bottom. When the New York Stock Exchange had more than 10 million shares traded, they broke out the champagne. Fast forward to 2018 and the Standard & Poor's 500 Index (S&P500) exchange traded fund (etf), ticker SPY, routinely trades 200 million plus shares in a day! This single ticker can easily trade more than 20 times the amount traded on the entire NYSE back in 1974!

So is it the algorithm that is causing it, or the fact that in every part of our life computers and fast communications have allowed the world to move faster? In 1974, it took two years to beat up investors enough with a bear market to cause investors to adopt the attitude: "Stocks are risky and I'm never going to get into them again". Nowadays, computers allow the market to move so fast that the same amount of pain can be inflicted more quickly with a similar attitude being adopted by those who didn't manage their risk well. And the other side of it, and something you'll never hear the public complain about, is the Algos make the up markets happen more quickly as well. So, do the Algos get credit during bull markets?

Nothing changed with the psychology of the situation. Traders will still be traders. There will still be excessive optimism at market tops and excessive angst at market bottoms and trading will go on. Algorithms and the traders running them are simply getting a bad rap.