
Vanguard answers RIJ questions about HFT

By Editorial Staff Thu, Apr 17, 2014

For answers to our questions about the impact of high-frequency trading, we turned to Vanguard. The no-load index fund specialist seems to think HTF does more good than harm.

Amid the furor over Michael Lewis's new book on high-frequency traders (HFT) and his statement on "60 Minutes" that the stock market is "rigged," RIJ sought out Vanguard's responses to a few questions about HFT. Here are the questions and Vanguard's official responses:

RIJ: Does high frequent trading affect mutual fund investors?

Vanguard: We believe a majority of "high frequency traders" (note that is not a defined term) add value to our current structure by "knitting" together today's fragmented market centers. Nevertheless, there are some high-frequency traders that may be unfairly taxing the system.

That said, the overall cost of investing in the equity markets has actually come down quite significantly due to changes in regulation, technology enhancements, and increased competition. Vanguard also has refined our trading practices over the years to mitigate the adverse impact of trading costs.

RIJ: Does it affect ETF investors?

Vanguard: We'd answer that the same way as above. You could argue that ETF trading costs have benefitted from HFTs tightening the spreads.

RIJ: Is HTF a new form of the same front-running threat that has always faced large-block traders? Or does it have nothing to do with institutional traders per se? From the news coverage I read, it sounds like HTF is a general threat, but perhaps the actual situation is more nuanced. Are institutional traders more affected than individual traders, fund companies more than fund owners, ETF owners more than fund owners?

Vanguard: Traditionally, front running refers to leakage of information that can lead to others trading against you. Yes, the actual situation is more nuanced—as mentioned above, we believe most high frequency traders add value, but some might be disruptive. As a result, we can't say specifically which group would be more affected.

RIJ: Does Vanguard do internal trading before going to the market, i.e., settling buy and sell orders in the same funds in-house at the end of the day?

Vanguard: We don't discuss our trading strategies.

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