BACK TO BUSINESS

Illustration: Henry Wong

THE VIEW
RICHARD HARRIS

Not so fast on controls

HK exchange is after the wrong target in gunning for the algorithms and high-frequency traders

"HKEx to put in system to fight algo and high-frequency trading in Hong Kong."
SCMP, June 11

It is not hard to see why Europe is in such a fix when you see that even right-wing European politicians are somewhat to the left. Content, most of them, with living off the state, they have devised the ridiculous phrase "market failure".

Market failure allegedly occurs when the market does not work. Those of us who understand the market know that it always works. The market is neutral because it is the combination of numerous, maybe millions, of decisions that people make to create goods and services, make prices, and trade.

Unfettered markets can be unfair or work against laudable policy goals, like employment or growth. That is not market failure – that is, we don't like how the market is working. Hong Kong has benefited hugely by being a free market and we wouldn't have it any other way, but it is not hard to see where unfairnesses and undesirable consequences have occurred.

Targeted government intervention in the marketplace may sound unfashionably left wing, but the free market needs to be reset every so often through taxation, regulation, monopoly-splitting or legislation – to stay free.

The flag bearer of free enterprise, the United States, has done this often enough, even in the freest market of all – the stock market. Over time it has instituted curbs on how far prices can rise and fall in a period of time, initially temporarily and now permanently. We never know when the next crash is going to come along.

All of these curbs have been against the price movement itself – which is much more acceptable to free marketers than the European method of prohibiting wholesale trading techniques, such as short selling; a regulation too far.

Hong Kong is one of the few major markets in the world to have almost no circuit breakers – except the uptick rule on short selling, simply where the price has to move up before you can short. Yet we may be more in need of limits than most as we live in a region of high liquidity, active investors and emerging market volatility.

> **Algos are a legitimate part of the market with as much right to trade as anyone**

Just a month ago, Hanergy Thin Film Power Group, the silicon solar module producer, fell 47 per cent in a day, followed by two listed units of the Goldin conglomerate, which plunged as much as 60 per cent in a day. These movements are becoming only too common and are more appropriate to a casino than an investable stock market. They are not good for investors and not good for the stock exchange. In some ways the prices may not even represent rational free market pricing if you consider that Goldin Financial has a market cap bigger than China Telecom.

The HKEx is mulling over a proposal to establish a Volatility Control Mechanism that looks to limit these gyrations. The exchange favours the 10 per cent move in five minutes limit in order to, as they say, fight the algorithms (computer programs that trade automatically) and high frequency traders.

There are other ways of curbing frothy speculation. Photo: AFP

They are aiming at the wrong target. Algos are a legitimate part of the market and as long as they have no advantage over other market investors or do not manipulate the market, they have as much right to trade as anyone. Their problems are much more likely to be with the teenager with a PhD who is programming the dealing computer, or a fat fingered, well-lunched trader forgetting to enter the decimal point.

The HKEx aim is really to curb frothy speculation and manipulators who will look to game the rules, so it should also instigate a daily limit that will stop prices crawling up or down just inside the boundaries. Part of the circuit-breaking mix could include the US method of suspending trading if the whole market moves 10 per cent in either direction, as well as maintaining the uptick rule that provides a brake to short selling.

None of these price band methods interfere with the free market and they have been very effective in countering unusual market volatility and panic selling over the years.

They act like a seat belt, or a ban on smoking in public places. They place an automatic limit on our behaviour so that when everyone loses their heads, we don't hurt ourselves in our own panic – when the only thing to fear is fear itself.

Richard Harris is chief executive of Port Shelter Investment Management