LAWSON KROEKER
INVESTMENT MANAGEMENT

As We See It

> "For as long as there has been a stock market, some people whose stocks went down instead of up, have accused Wall Street of robbing them." –Malcolm Forbes

A few months ago CBS's *60 Minutes* provided a forum for Michael Lewis, the author of *Flash Boys*, to announce that Wall Street is *rigged*. The focus of the TV segment was high-frequency trading (HFT)—an innovation now over twenty years old—which developed due to the Securities and Exchange Commission's efforts to lower trading costs.

The segment centered on slightly higher prices reportedly being paid by market participants—mainly institutions such as mutual funds and pension funds—that trade large blocks of stock. HFTs are trying to get an advantage of a fraction of a cent per share which makes a big difference when you are trading tens of millions of shares a day, but it is not a game changer for an individual investor who is buying a few hundred shares of a given stock.

It was far different prior to May 1, 1975, when commission rates were high and fixed. Before that date, the commission to buy 100 shares of a $50 stock was .715 per share—or $71.50 for the 100 shares. To buy 1,000 shares of a $50 stock the commission per share was .50—or $500 for the order. Today investors pay just pennies per share.

Moreover, the spread between the bid (what someone was willing to pay to buy your stock) and the ask (the price at which someone was willing to sell to you) was an eighth of a point until decimalization came in 2001. In other words, a purchaser of a stock with a $50.375 bid and $50.50 ask would usually end up paying $50.50. Today the spread between the bid and ask is just a few pennies for liquid stocks.

Also, years ago stocks traded on a single exchange—either the New York Stock Exchange, the American Stock Exchange, or the NASDAQ—and one firm was the market maker in each stock. These market makers controlled the order flow in their individual stocks and held the order book, giving them a tremendous informational advantage over every other participant. But they were the market intermediaries, providing valuable liquidity by quoting a two-sided market. When a customer wanted to buy the stock in which they made a market, the market maker would be the seller. If someone wanted to sell the stock in which they made a market, the market maker would be the buyer. They provided the liquidity that allowed participants to get in and out of their stocks. Their payment for providing this service was the bid-ask spread. Some viewed this as a monopoly which regulators spent decades breaking up, resulting in the current system.

In today's environment, small investors pay much lower commissions than they did when rates were fixed. Also, the activity of HFTs, enabled by federal regulation, has helped to narrow trading spreads, meaning investors are likely to get more fair prices than in previous eras. Moreover, trades are no longer limited to a particular exchange but are routed among numerous exchanges to obtain the best price. If the system is *rigged*, it just might be *rigged* in favor of the small investor.

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