Johnston Investment Counsel
LIFE THE WAY YOU PLANNED IT.

Is the Stock Market Rigged?

You may have heard about the 60 Minutes interview with author Michael Lewis, a former Wall Street broker, author of "Liar's Poker" and "The Big Short," who has just come out with a new book entitled "Flash Boys." Lewis is an eloquent and astute critic of Wall Street's creative and predatory practices, and in his new book (and in the 60 Minutes interview) he offers evidence that the stock market is "rigged" by a cabal of high-frequency traders, abetted by stock exchanges and Wall Street firms.

While it is true that certain parties may gain quicker access than others, some believe, the price discovery process (by allowing high frequency trading) is improved and, therefore, makes the process better for all. Regardless, for anyone practicing long-term investing, high frequency trading activities are essentially irrelevant

Lewis exposed an advantage that certain traders receive by building high-speed fiber optic cable feeds directly into exchange computers that match buyers and sellers. Some actually have their trading computers located in the same room as the New York Stock Exchange and Nasdaq servers. And some pay extra for access to more information on who wants to buy and sell.

All of this is perfectly legal, but Lewis points out that it is also shady. Why should some buyers and sellers have millisecond advantages over others? The problem is that these firms are able to jump in ahead of you and me and buy stocks at lower intraday prices, and then, a few seconds later, sell to the highest bidder before you and I would even see that bid on our screen. In short you may pay (receive) a penny or two more (less). If these firms can squeeze out additional pennies on each transaction, and if they do this thousands of times a day, it adds up to real money over the course of a year.

Why is this irrelevant to you? Many of those lost pennies are coming out of the pockets of either day traders, hedge fund managers, or others who practice very active trading but may not have direct feeds to the exchange floor. Many of these traders, watching the 60 Minutes report, discovered that they are getting routinely fleeced by Wall Street's money machine.

However, if you're invested for the long term, it really doesn't matter how frequently these trades occur on any given day. Your major concern should be that the companies you own are steadily building value over time. Your time frame is eons compared with the quick-twitch traders, who hope to be in and out of your stock in a few seconds rather than decades. While it is true that, when you trade, you <u>might</u> give up a fraction of a cent, it certainly will not have a measureable performance impact over a multi-year holding period. Somehow, this important fact was lost in the 60 Minutes interview.

In the end, the interview tells us several things. First, it exposes, yet again, that Wall Street culture will go to great lengths to grab money out of the hands of unwary investors. Second, the interview makes it pretty clear the folly of an average investor trying to outsmart the markets with short-term trading activities. And lastly, and perhaps most importantly, these revelations confirm the wisdom of having a long-term investment horizon. When you measure returns over multiple-year time horizons, milliseconds don't really matter.

a 2714 N. Knoxville
Peoria, Illinois 61604
w jicinvest.com
e info@jicinvest.com
t 309.674.3330
tf 877.848.3330
f 888.301.0514