Abstract

The algorithmic trading revolution has had a dramatic effect upon markets. Trading has become faster, and in some ways more efficient, though potentially at the cost higher volatility and increased uncertainty. Stories of predatory trading and flash crashes constitute a new financial reality. Worryingly, highly capitalised stocks may be particularly vulnerable to flash crashes. Amid fears of high-risk technology failures in the global financial system we develop a model for flash crashes. Though associated with extreme forms of illiquidity and market concentration flash crashes appear to be unpredictable in advance. Several measures may mitigate flash crash risk such as reducing the market impact of individual trades and limiting the profitability of high-frequency and predatory trading strategies.
References:


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