

Book Reviews by Ian Robertson



ODLUM BROWN
Investing for Generations



Ian Robertson, CFA, MBA, MA – Vice President, Director, Portfolio Manager | T 604 844 5424 | Toll Free 1 888 886 3586 | irobertson@odlumbrown.com
Odlum Brown Limited | Suite 1100 – 250 Howe Street | Vancouver, BC V6C 3S9 | Member-Canadian Investor Protection Fund

Title: *Flash Boys: A Wall Street Revolt*
Author: Michael Lewis
Publisher: W.W. Norton & Company (2014)
Reviewed: April 2014



“An excellent book by a master at the top of his game.”

In his first book, *Liar's Poker*, Michael Lewis sketched colourful and entertaining characters to show us the excesses of a Wall Street titan – Salomon Brothers – at the peak of its game. Later, in *The Big Short*, he used his considerable storytelling abilities and yet more colourful and entertaining characters to help explain the financial collapse of 2007. With his latest book, *Flash Boys: A Wall Street Revolt*, Lewis again weaves a compelling story with still more wonderful characters. Rather than chronicling a market excess or explaining a financial crisis post hoc, this time Lewis investigates, uncovers and reports on the systematic Wall Street shenanigans by a small group of High Frequency Traders (HFT), their complicit and enabling stock exchanges, and the perverse regulations that permit or encourage the activity.

Rating:



Out of 5 Stars

While the book is enjoyable and entertaining to read, what Lewis reports will anger and sadden most readers, for it becomes very clear as the book progresses how enormously the odds are stacked against most investors. In the beginning, even “the most sophisticated investors didn’t know what was going on in their own market. Not the big mutual funds, Fidelity and Vanguard. Not the big money management firms like T. Rowe Price and Janus Capital. Not even the most sophisticated hedge funds.”

Flash Boys engages readers immediately with a story: the laying of a new and secret fibre optic cable between New Jersey and Chicago. The cable’s sole purpose is to be straighter, and therefore shorter and faster, than the existing phone company links used by futures traders. Time is money, and the prohibitively high cost for the new fibre line is more than offset by the financial advantage (via an edge in trade execution) to the few firms who lease the line.

From this, Lewis shifts to the integrity of programmed and algorithmic trading, then on to dark pools and several other trading strategies. Readers should not be put off by the industry jargon or the esoteric corner of finance that Mr. Lewis exposes. Each concept is introduced in turn and in the most concise and entertaining way possible. As both a liberal arts major and a former Wall Street insider, Lewis bests all other financial authors in taking complex issues and distilling them into memorable and understandable passages.

It seems no exposé of Wall Street’s shortcomings is complete without an appearance by Goldman Sachs, and Lewis doesn’t disappoint. Goldman’s role, however, is modest. First, like all of the major investment banks, they employ ‘dark pools’ where clients can trade anonymously and ostensibly for better execution, but where either the investment bank or, for a fee, an HFT firm will game the system to deliver poorer execution. The difference between good and poor execution is a small profit to the bank or HFT firm, repeated millions of times per day.

Second, Goldman saw there was even more profit in speedier execution and HFT, and to this end hired a Russian born computer programmer. Unfortunately Goldman's new programming was built atop years of antiquated and bloated code, and they never did realize the profits of smaller, sleeker HFT firms with all new coding. In any case, the Russian left Goldman and was subsequently convicted of stealing trade secrets. Just as Bob Dylan sang about Hurricane Carter, Lewis waxes poetic about the injustice, the ineptitude of investigators, and perverseness of Goldman's position in the matter.

The heroes of the book are Canadians: the Royal Bank of Canada, in general, and Brad Katsuyama, in particular. Of RBC, their 'nice guy' image, and their desire to enter Wall Street, Lewis says "it was as if the Canadians had summoned the nerve to audition for a role in the school play, then turned up wearing a carrot costume." An inauspicious start to RBC's Wall Street push, but a perfect setup to Katsuyama's role in exposing the HFT inequities and eventually setting up his own rival stock exchange where investors cannot be fleeced.

Forty years after Bernstein and Woodward's investigative journalism changed the American political landscape, perhaps Lewis' sleuthing will foment change in capital market structure. This is an excellent book by a master at the top of his game.