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High Velocity Trading---Should we be worried?

It may turn off some investors, but it is not all bad for Dock Street clients

Since the "Flash Crash" of May 6th when the Dow fell hundreds of points in 15 minutes, much of the blame has been placed on computerized high-velocity trading. One article profiled a firm whose average holding period for a stock is 11 seconds!

All this activity is computer driven and the lack of human involvement in these trades has convinced many that the market is rigged against the individual investor.

We do not think these activities will have any long-term effect on the value of our portfolios, however, we do acknowledge that the volatility these trading operations intensify will make stock investing even more nerve-wracking than has been in the past.

But it is not all bad for Dock Street clients.

First, what is high-velocity trading? Computers are programmed to identify trading patterns and execute trades without a human being involved in the trading decision. These operations are day-traders---they own nothing at the end of the day. Any profits they make come from other day-traders who bought and sold that day.

For investors like us, these wise-guys provide additional liquidity. Because of all the computerized activity there's always stock to buy or sell at a given price.

How does this benefit us? Starting in 2009 our primary broker offered our firm a computerized trading system that allows us to place large orders without the worry of our activity pushing the price up or down. Our experience with this system has been highly satisfactory. Instead of taking most of the day for a trader on a desk to "work" an order and then see that our trade was made over a range of 25 to 50 cents per share, we now see trades finished in an hour and within a range of 3 to 5 cents per share.

Aside from greater efficiency this system is influencing the kinds of stocks we can buy for clients. We can now look at smaller companies that were off-limits before. The stocks of these smaller businesses trade 200,000 shares a day instead of millions of shares. Under the old system it would have taken days to buy shares for clients and worse, days to sell.

Now we can invest in these smaller companies with the confidence that trading will not be an issue for us. Thanks to all those day-trading computer programs our universe of companies has expanded.

The trade-off is more volatility. We think the regulators understand this and they are working to put in place circuit-breakers and other rules that will make days like May 6th less likely. In the meantime 100 point days will be more common-place both on the downside and upside.

Best regards,

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A copy of our Form ADV Part II regarding our advisory services and fees is available upon request.

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