

What Is Algorithmic Trading?

In the battle of man versus machine, sometimes computers win out. Here's how algorithmic trading works, and why this trend has grown so popular among investors.

Many of us are coming to rely more and more on computers and technology than ever before, and investors are no exception. Thanks to algorithmic trading, a growing number of investors are taking advantage of what they consider to be optimal market conditions to come out considerably richer.

Also known as algo trading, algorithmic trading is a method of stock trading that uses intricate mathematical models and formulas to initiate high-speed, automated financial transactions. The goal of algorithmic trading is to help investors execute on specific financial strategies as quickly as possible to bring in higher profits. While there are a number of key benefits to algorithmic trading, there are also some risks to consider.

How algorithmic trading works

An algorithm is a process or set of defined rules designed to carry out a certain process. Algorithmic trading uses computer programs to trade at high speeds and volume based on a number of preset criteria, such as stock prices and specific market conditions.

As an example, a trader might use algorithmic trading to execute orders rapidly when a certain stock reaches or falls below a specific price. The algorithm might dictate how many shares to buy or sell based on such conditions. Once a program is put in place, that trader can then sit back and relax, knowing that trades will automatically take place once those preset conditions are met.

Benefits of algorithmic trading

One major advantage of algorithmic trading is that it automates the trading process, ensuring that orders are executed at what are deemed to be optimal buying or selling conditions. Because orders are placed instantly, investors can rest assured that they won't miss out on key opportunities. Manual orders, by contrast, can't come close to mimicking the speed of algorithmic trading. Additionally, because everything is done automatically by computer, human error is virtually taken out of the equation (assuming, of course, that the algorithm is developed correctly).

Furthermore, algorithmic trading often limits or reduces transaction costs, thus allowing investors to retain even more of their profits. Finally, algorithmic trading eliminates the dangers of acting on emotion instead of logic, which investors are known to do.

Drawbacks of algorithmic trading

One major disadvantage of algorithmic trading is that one simple mistake can rapidly escalate in a major way. It's one thing for a trader to make a bad call and lose money on a single transaction, but when you have a faulty algorithm, the results can be downright catastrophic. That's because a single algorithm can trigger hundreds of transactions in a matter of minutes, and if something goes wrong, millions of dollars can be lost in that same time frame.

In fact, there have been multiple incidents of "flash crashes" on global markets resulting from problems with algorithmic trading. For example, algorithmic trading was blamed for the "Flash Crash" of 2010, which led U.S. stock indexes to collapse (though they rebounded within an hour), as well as an October 2016 crash that saw the British pound plunge toward its 31-year-low in a single night.

Algorithmic trading has also been linked to significant market volatility. While quality control measures can help prevent losses owing to poorly defined or coded algorithms, investors should be aware of the dangers of giving up control and letting computers do all of the work.

Our advantage is constant monitoring of the operation of machines in order to avoid any risks to lost money. Three-level control is implemented at the level of brokers and depositories

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Cheers,