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Why the correction? Machines have taken over

By Jeff Cox
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In days of old, a Wall Street blowout like Friday's would have featured harried traders shouting out sell orders on exchange floors, trying to limit their losses as the market crumbled.

The new market age is decidedly different: Rather than that seething cacophony, aggressive corrections like the current ones are directed by a faceless metronome of computer-generated orders, triggering irresistible momentum and trillions in losses.

Amid it all, market veterans are left to ponder when the script will flip and market direction will turn not by newfound optimism among traders in the pits, but rather by algorithms that generate "buy" rather than "sell" signals.

"It feels like sell program after sell program," said Michael Cohn, chief market strategist at Atlantis Asset Management, a boutique firm in New York. "It seems to happen first thing in the morning, and then however the market transpires during the day is how they close it. If it looks like it's coming back, they'll take it at the end. If it looks like it's heading lower, they'll slam it at the end of the day."

It's no secret that humans are having increasingly less influence on the markets generally. But traders feel the machines are having an outsized influence during the most recent slide, which has sent the major U.S. averages into correction territory.

Many believe the changing dynamics — rising interest rates from the Fed, a stronger dollar, weakness in China, plummeting oil prices, all of which seem intertwined — are causing a change in perspective from large investors that in turn is influencing computerized trading.

"Institutions are tweaking their asset allocations. Large pension funds, sovereign wealth funds, large holders of stocks are basically taking their allocations down," Cohn said. "It just seems like we're going to bide time until the close."

Friday's conditions were particularly in flux — the temptation not to be long going into the weekend against a huge options expiration that often is bullish — making the time ripe for momentum-driven programmed trading.

Dave Lutz, head of exchange-traded funds at Jones Trading, cited a "gaggle of down ticks" in early activity that suggested to him that programmed trading was dominating.

"A lot of these massive sell programs are capitulatory in nature. You get big sell programs toward the bottom of a move," he said. "We have the potential of a good snapback rally. The Street is very short. It's under-owned and we're in very oversold conditions. So the potential for a rally is very large. The pain trade is due north."

Indeed, programmed trading both taketh away and giveth. Much of the automated activity these days takes place in exchange-traded funds, which track indexes and can be traded like stocks. Because they cover a wide swath of the market, they are especially prone to momentum changes.

"When it becomes this much ETF-driven, you can believe on any given day an even greater proportion is electronic prop trading," said **Sal Arnuk**, a principal at **Themis Trading**.

The bright side is **Arnuk** thinks the momentum has gotten overdone and the pendulum is about to swing the other way.

"We're hitting a meaningful inflection point in the market. When you see this type of activity — big 2 percent moves up, 2 percent moves down — you see this type of volatility at market inflection points," he said. "If that's the case, you have to ask yourself if this is a point where you sell everything, or is this a point where you buy. With how much this market has fallen...a level-headed person is going to conclude the latter."