Feedback effects and endogenous risk in financial markets

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Over the last decades, financial markets have become increasingly dominated by large financial institutions, which use automated algorithms or follow rule-based strategies and trade in a systematic manner. Many empirical studies shed light on the feedback effects and the endogenous risk generated by systematic trading by large financial institutions. Such feedback effects materialize in a wide range of situations: options trading, rebalancing by leveraged exchange-traded funds, fire sales and distressed selling, predatory trading, rebalancing by large institutional investors, etc... In this minicourse, we are going to review the various types of feedback effects generated by systematic trading and propose a model to quantify their impact on the dynamics of financial assets. We will develop tools that will be useful to better tackle and anticipate liquidity events caused by large trades and that may also be used in a systemic risk-management perspective as they enable to quantify price-mediated contagion.