Optiver | 20 YEARS THE TRADE

Buy-side European cash equity trading trends

April 2024

Introduction

In late 2023, Optiver partnered with The Trade to conduct a buy-side survey, with the aim of identifying emerging trends in cash equity trading and market structure.

Our survey included a broad range of respondents in terms of firm type, size and regional coverage. Active asset managers made up roughly one-third of respondents, with private banks accounting for 20%. The vast majority of respondents traded European markets, with 46% also trading in North America and a further 30% trading in Asia. Larger firms were well represented, with a quarter of respondents holding more than $250 billion AUM, alongside a wide spectrum of firms holding less than $50 billion in assets.

Responses from 225 buy-side traders reveal:

Traders saw little improvement in liquidity conditions during the year

Over 65% of respondents believe European on-screen liquidity worsened or stayed the same, with less than 35% seeing an improvement.

Despite low volumes, many plan to increase broker lists

Despite the weak liquidity picture, many respondents still plan to increase the number of brokers they trade with over the coming months.

Over a quarter send more than 10% of their flow to market makers

Asset managers continue to develop relationships with market makers, trading either directly or via a broker on ELP SIs.

Traders identified IS as the benchmark of choice

Implementation shortfall is the most frequently used benchmark by 24% of respondents, although VWAP remains a popular choice with 22% using it most frequently.

Data fees and consolidated tape top market structure concerns

Market data fees and the consolidated tape remain top of mind for the buy-side amid ongoing regulatory efforts on both fronts.

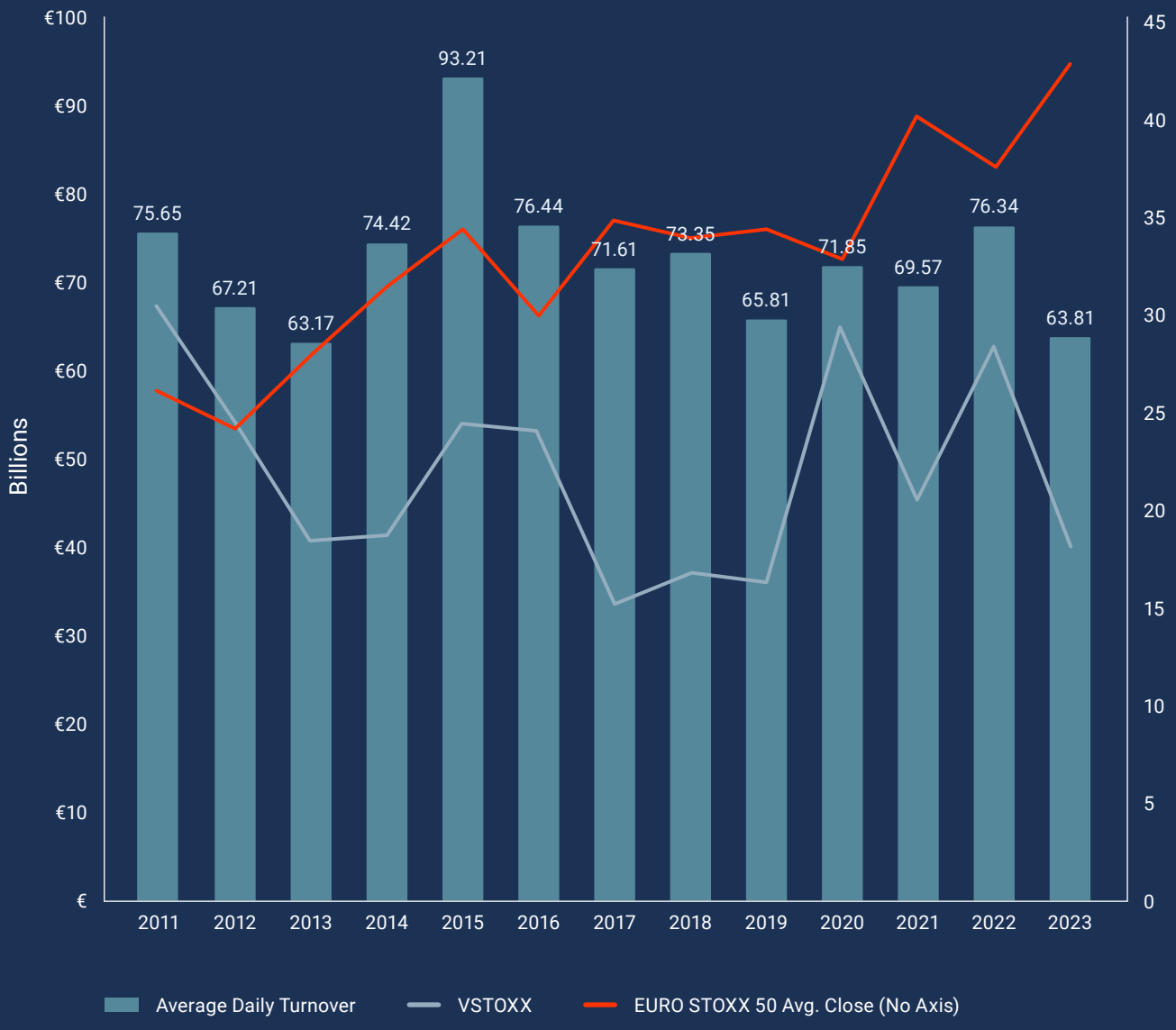
Optiver has built a central risk book that collates single-stock equity risk from our internal market-making desks, which we use to offer competitive two-way liquidity in over 1,600 equities directly to buy-side firms. Have feedback on the survey or wish to learn more about trading with Optiver? Visit our website at **optiver.com/institutional-trading** or contact **Delta1Europe@optiver.com**

1. Traders saw little improvement in liquidity conditions during the year

At the time we conducted our survey, European equity volumes were stagnant, with 2023 average daily value traded falling 16% from the previous year to €63.8 billion, the lowest in a decade.

European Equity ADVT and Volatility

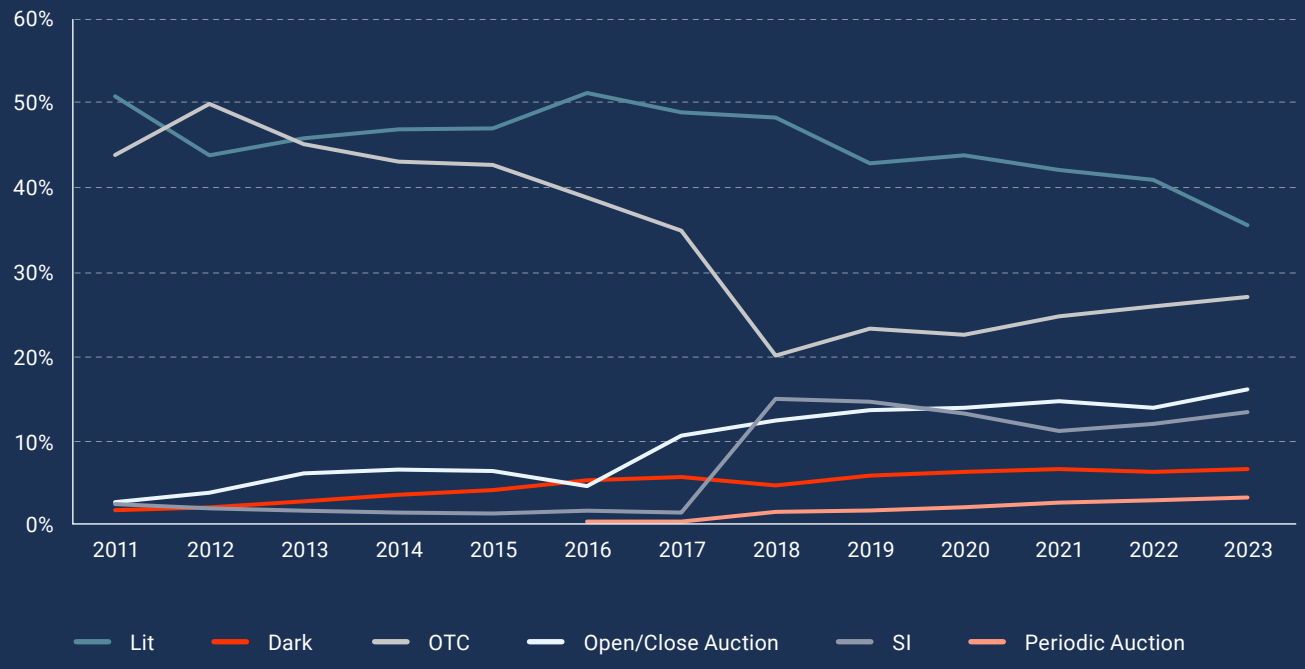
Source: Rosenblatt Securities



Trading on displayed markets also declined to 35% of total volume, with more trading occurring in dark pools, periodic auctions and off-exchange markets. The combination of lower overall volumes and subdued volatility is likely to have contributed to the decline in lit volumes. During quiet markets, traders concerned about causing market impact when exposing orders to lit venues may instead make greater use of dark markets or bilateral liquidity sources, where pre-trade information is not disclosed.

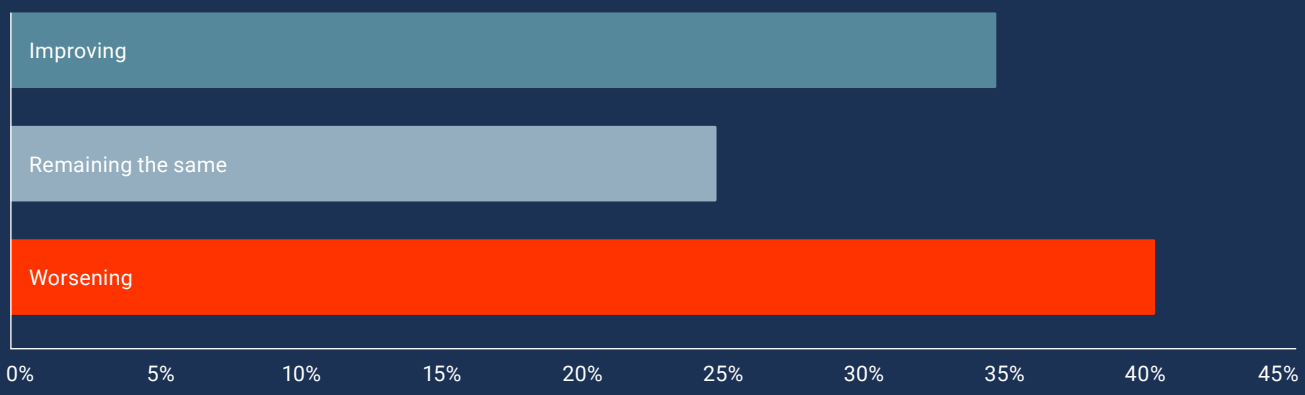
Annual Market Share by Category

Source: Rosenblatt Securities



> "The current low volume environment means we need more time to execute orders, as the demand for liquidity has not changed. That makes it important for us to look at all options such as SIs or direct connections to market makers, for example. The lit market is usually the last destination we look to execute given the higher impact we have when trading there."
>
> – Markus Specht, Head of Equity Trading, Deka Investments

How do you view European on-screen liquidity over the past 12 months?

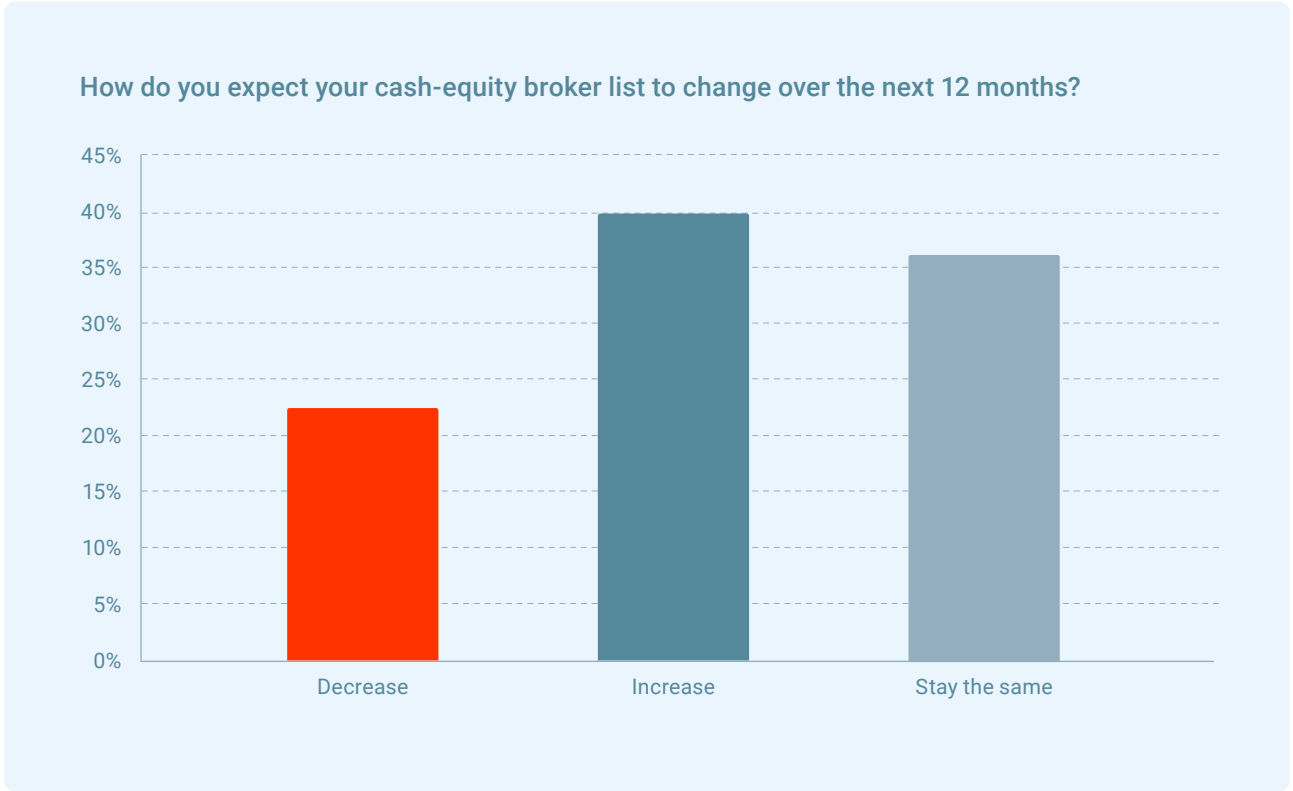


2. Despite low volumes, many plan to increase broker lists

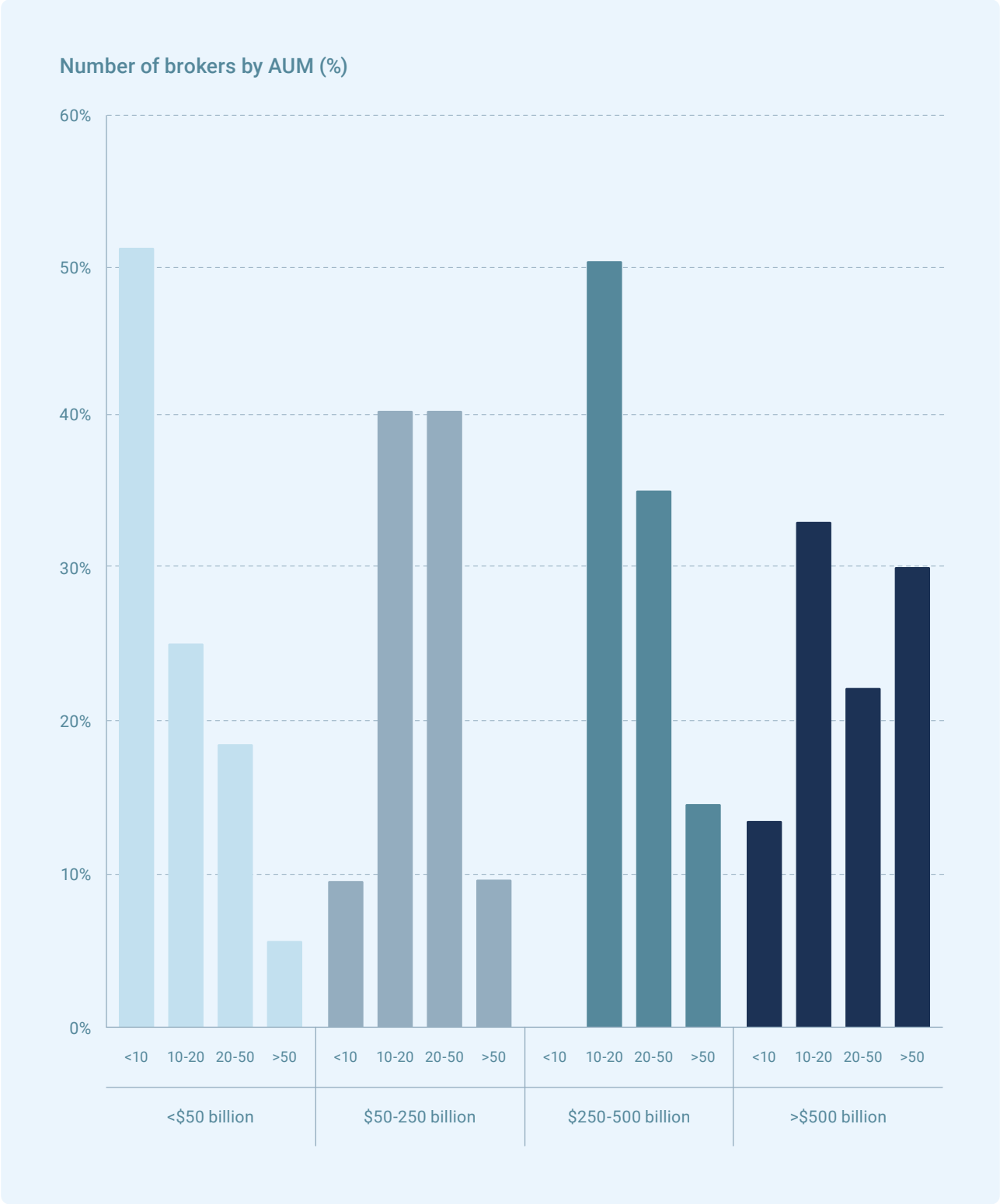
Against this backdrop, it's perhaps surprising that 40% of respondents still planned to increase their cash-equity broker list over the next 12 months.

"Thinking back to MiFID II, we expected to shrink our broker list a little once the dust had settled. In truth, that never really happened, and, if anything, the list has grown modestly. On the electronic side, we've found that brokers have their own niche when it comes to liquidity seeking, dark aggregation, and interacting with the close. In terms of high-touch, liquidity has become so challenging in Europe that having more connections and options is now vital."

– Ben Smith, Head of Trading, Independent Franchise Partners



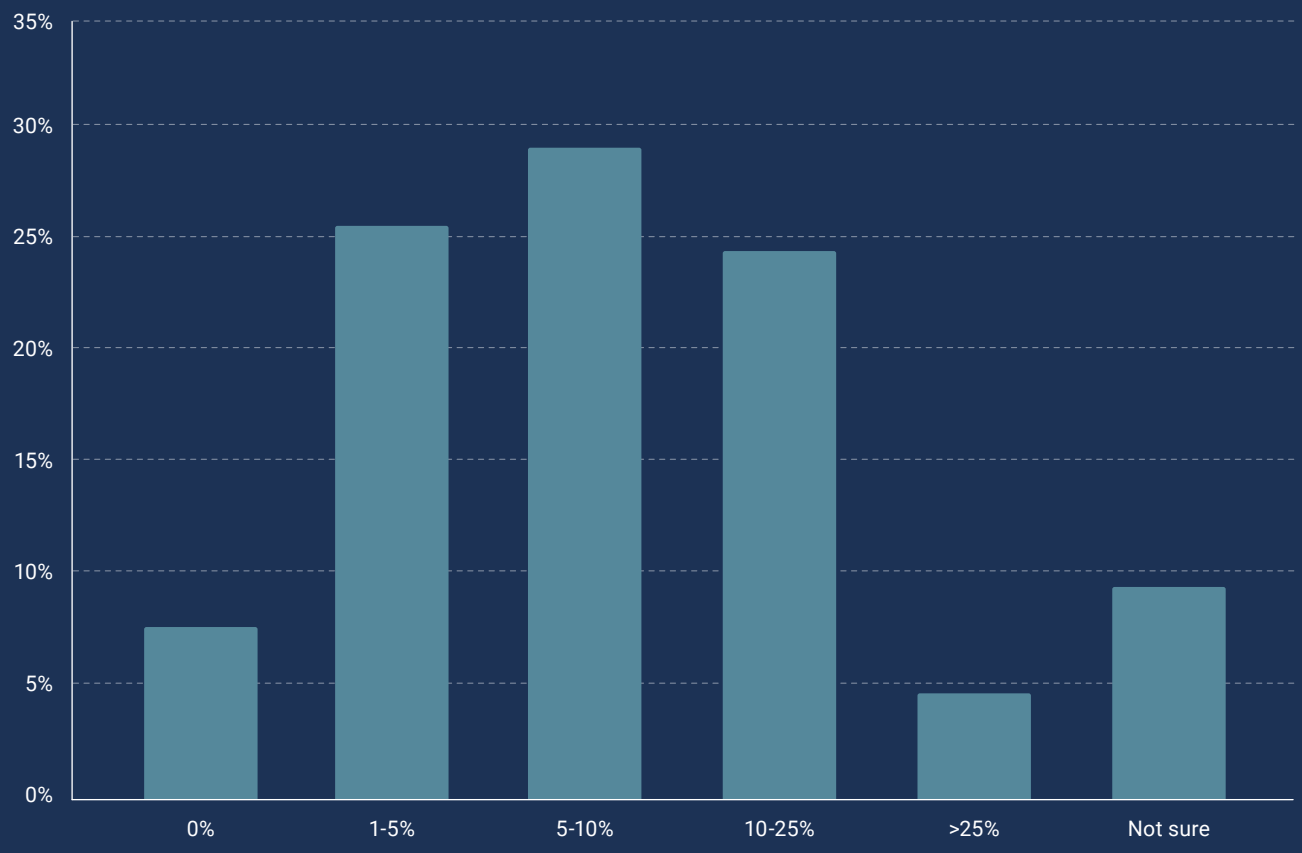
Most firms keep between 10-20 firms in their broker roster but this varied, unsurprisingly, by size, with 30% of the largest buy-side firms trading with more than 50 counterparties.



3. Over a quarter of respondents send more than 10% of their flow to market makers

Over a quarter of buy-side firms send more than 10% of their order flow to market makers – almost unheard of a decade ago – demonstrating the evolution of the relationship between the buy-side and market makers.

What % of your firm's cash equity trading is done with MMs (directly or with ELP SIs)



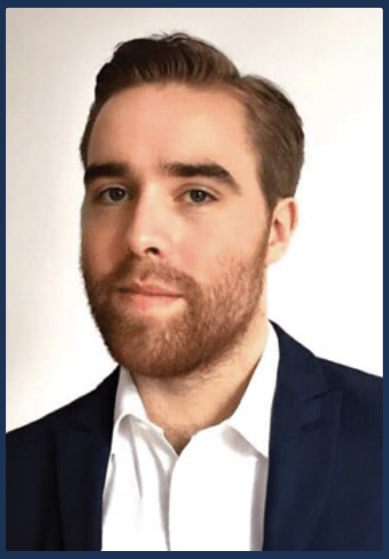
Prior to the introduction of MiFID II in 2018, many buy-side firms traded indirectly against electronic market makers via broker-crossing networks, with varying levels of transparency on execution quality. MiFID II led to the creation of electronic liquidity provider (ELP) SIs, through which market makers provide liquidity to buy-side firms via broker smart order routers. This development allowed buy-side firms to directly measure the execution quality they receive when trading with market makers, which in turn helped to deepen understanding of ELP firms.

"The trend [of trading directly with market makers] started specifically in the ETF market but our goal is to develop step-by-step in other assets like options, bonds."

– Global Head of Trading, Large French Asset Manager

Optiver has taken this a step further by directly providing two-sided liquidity from its central risk book to buy-side counterparties. Alongside other direct market-maker liquidity products, this is a step change in European market structure that gives buy-side firms a distinct alternative to agency algorithmic strategies and bank risk.

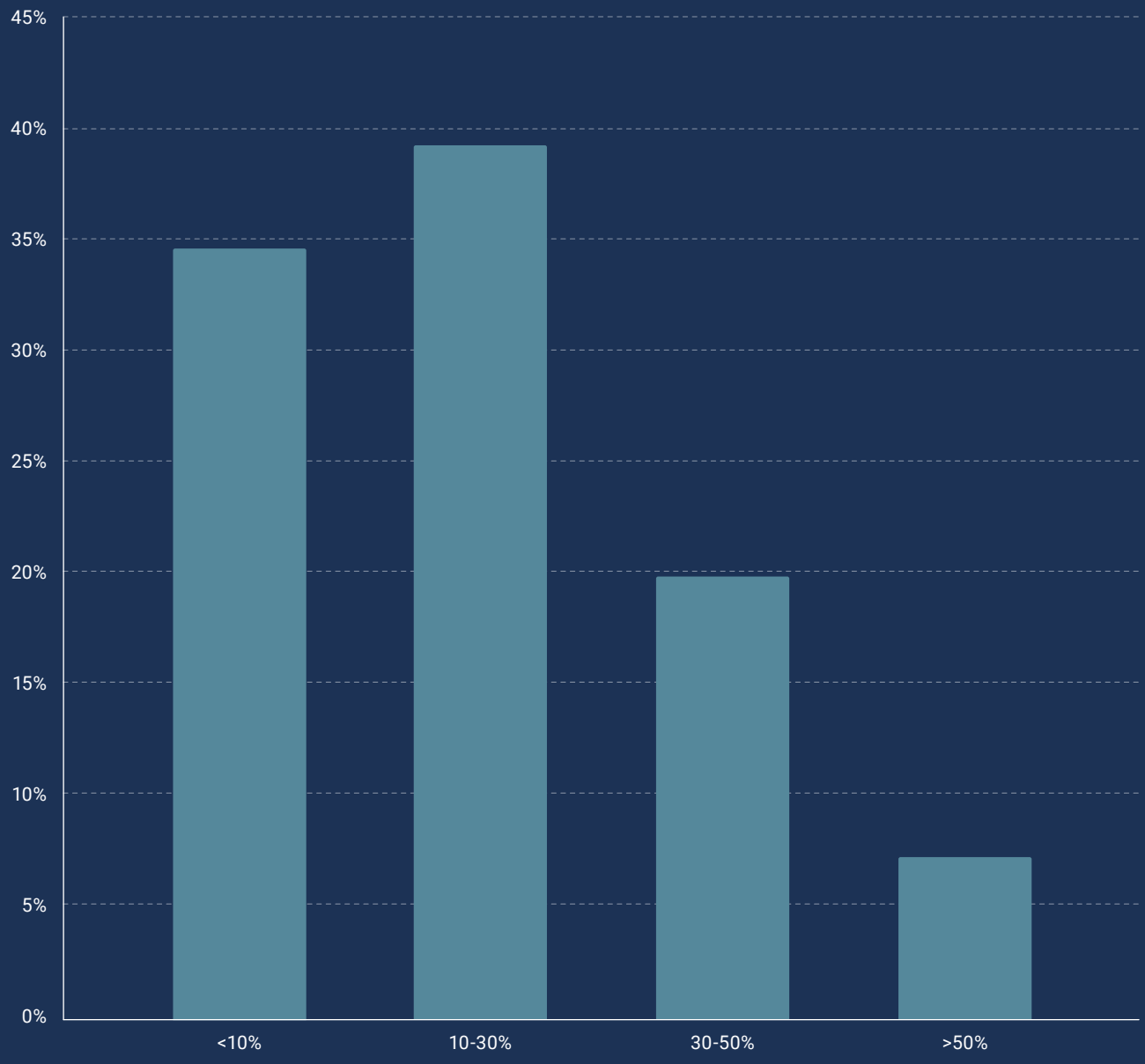
Immediacy of execution and the need for buyside desks to leverage balance sheet remains an important consideration, with over a quarter of respondents executing 30% or more of their cash equity trading on risk.



"With lower volumes across Europe, it's not surprising to see buy-side firms establishing direct bilateral relationships with market makers, especially in the area of systematic, cashflow trades containing no / low investor alpha. At T Rowe Price, we monitor the execution landscape very closely and will interact with counterparties such as market makers when we feel it would be beneficial to our execution outcome. However we also take a very thoughtful approach to all of our counterparty interactions to ensure we're achieving best execution on behalf of our underlying clients, as many of our flows have nuances which don't always lend themselves to the market maker workflow."

– Evan Canwell, Equity Trader and Market Structure Analyst, T Rowe Price

What % of your firm's cash equity trading is done on risk?

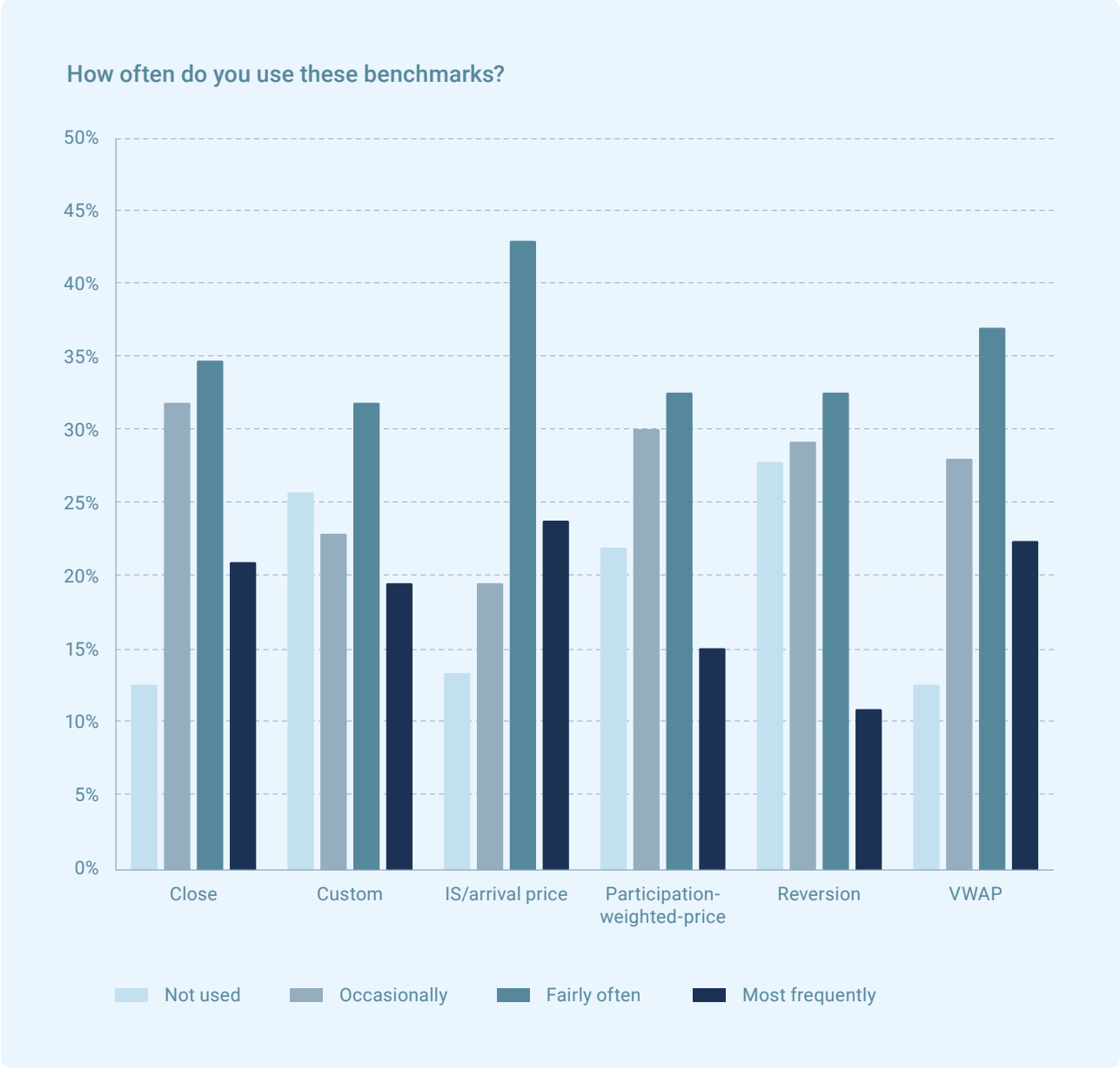


"Our appetite for risk liquidity is always there and we are always happy to interact with it where it makes sense for our orders. As new liquidity sources have come into the market, larger banks initially struggled but have more recently developed new order types that target parent order liquidity. We do still see banks finding it hard to offer liquidity at the touch, which could be due to risk management challenges."

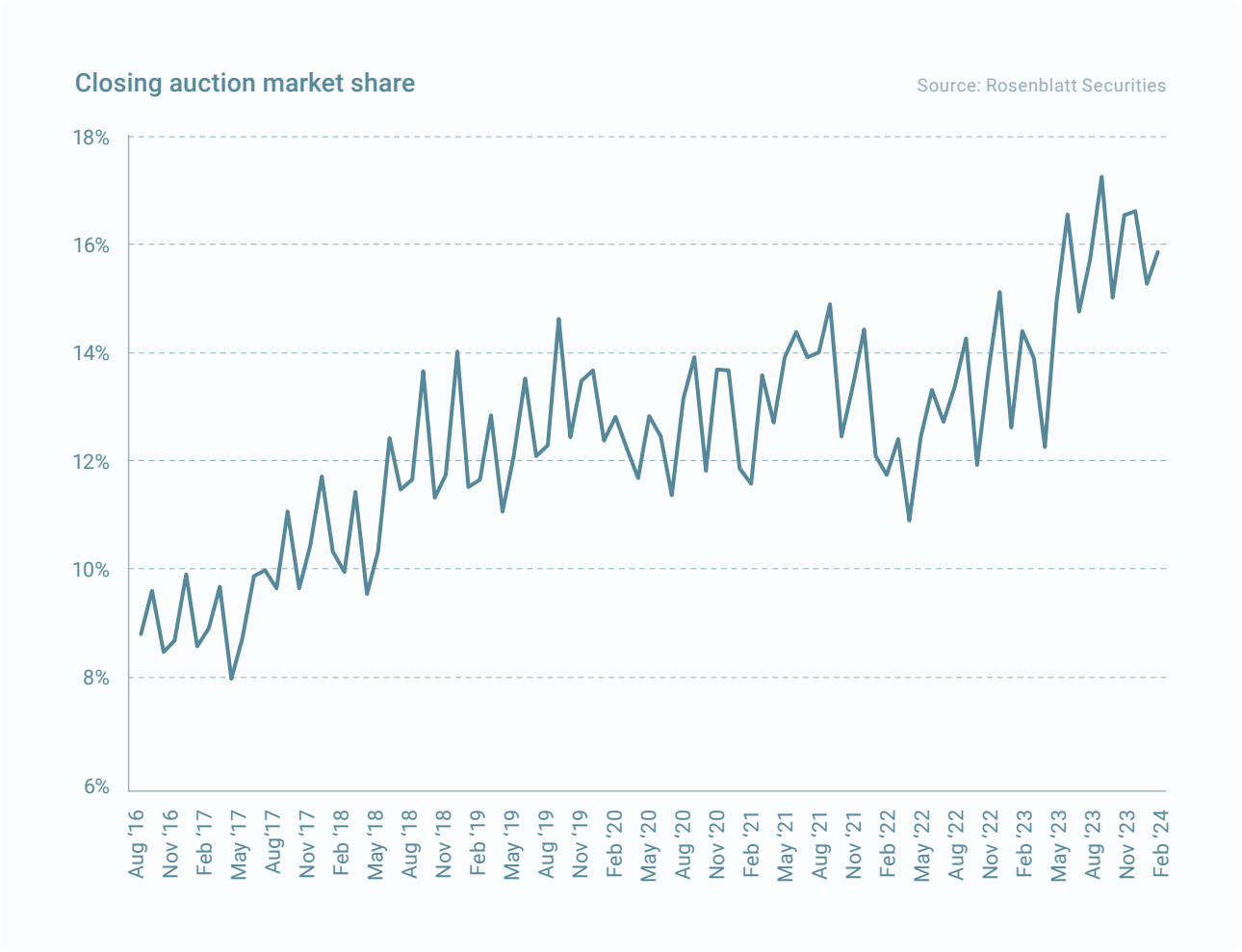
– Markus Specht, Head of Equity Trading, Deka Investments

4. Traders identified IS as the benchmark of choice

Implementation shortfall (IS) – the difference between the price of a security at the time a trading decision is made and the final execution price – was the most popular benchmark, used fairly often or most frequently by two-thirds of respondents. Over the years, IS has steadily overtaken VWAP – which uses a volume-based participation schedule – as the benchmark of choice.



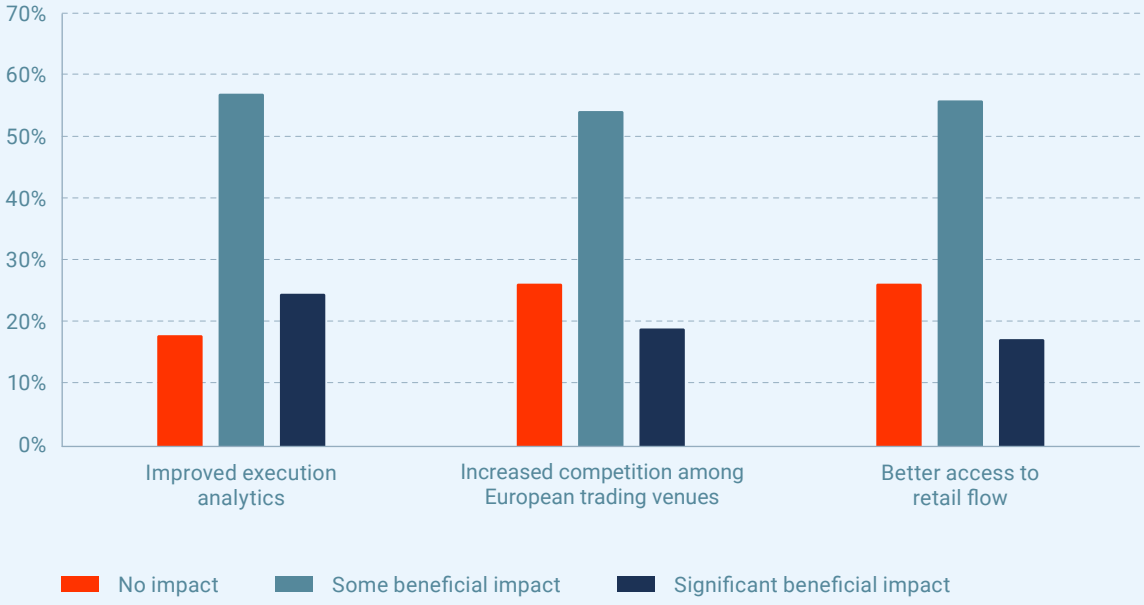
The close was also a popular benchmark and one that has grown in recent years thanks to the increasing number of passive funds that use end-of-day prices as a benchmark. Closing auction market share is often in excess of 35% on triple witching days, which see the simultaneous expiry of stock options and futures products.



Our survey revealed a desire for improved execution analytics, specifically when it comes to real-time TCA, which traders use to determine the best strategy for a given order or to adjust the parameters of a schedule-based participation strategy while it's live in the market.

> "In my view, the broader topic is the increasing demand for additional data points to help traders make optimal decisions at the point of execution, as well as far more detailed post-trade analysis. The industry is becoming increasingly quantitative and we should continue to harness the potential of the huge amounts of data which are being generated every day – at T Rowe Price, this means a greater number of data points available throughout all stages of the trading process, as well as using interoperability to seamlessly link various datapoints together so traders have a holistic view of the lifecycle of every trade."
>
> – Evan Canwell, Equity Trader and Market Structure Analyst, T Rowe Price

What impact would the following have on your trading desk?



What would most improve your TCA process?

5. Data fees and consolidated tape top market structure concerns

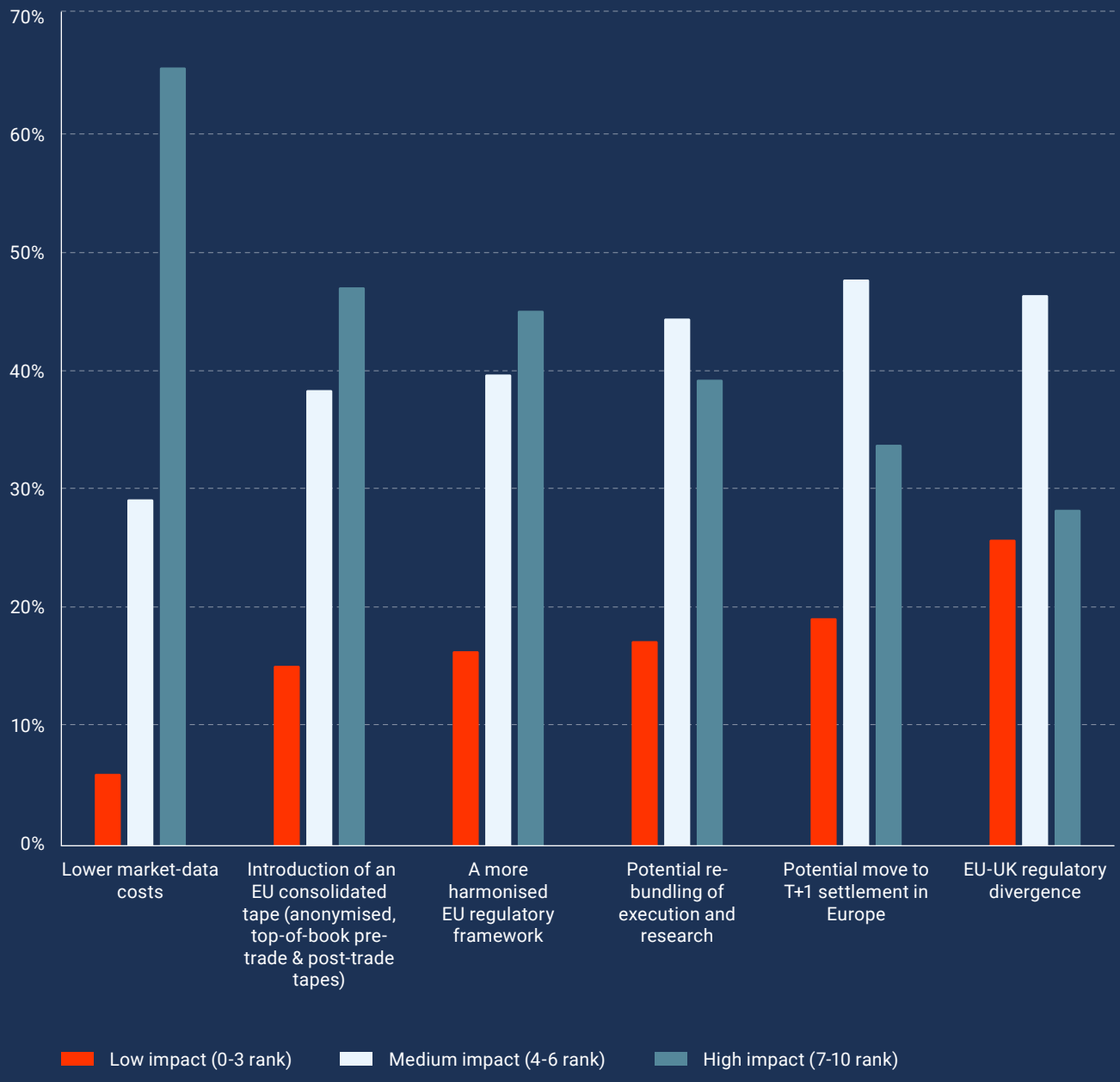
Respondents identified market data issues as the most impactful market structure topic. In particular, they expressed concern over data fees, reflecting an industry-wide debate that has persisted for years.

The consolidated tape (CT) also ranked highly, following a decision by EU policymakers to mandate its creation as part of revisions to MiFID II. The equity CT will likely come into existence during 2026 and comprise an anonymised top-of-book feed alongside a real-time post-trade tape.

> "Although one can get a decent view of pan-European liquidity on leading market data platforms (e.g. Bloomberg), we think that Europe would benefit greatly from a consolidated tape. Foremost, it would serve as baseline and help to democratise access to market data. Importantly, it would make Europe appear more as 'one market', hiding away some of the complexity of its market structure that has become anathema to global investors. Thirdly, it could help to keep trading going when a primary venue suffers an outage, as it does in the US."
>
> – Ben Smith, Head of Trading, Independent Franchise Partners

> "The topic around the consolidated tape makes sense for us and we consider that it'd be helpful to enrich any database, to increase transparency and to capitalize on this to deploy more robust AI models around execution."
>
> – Global Head of Trading, Large French Asset Manager

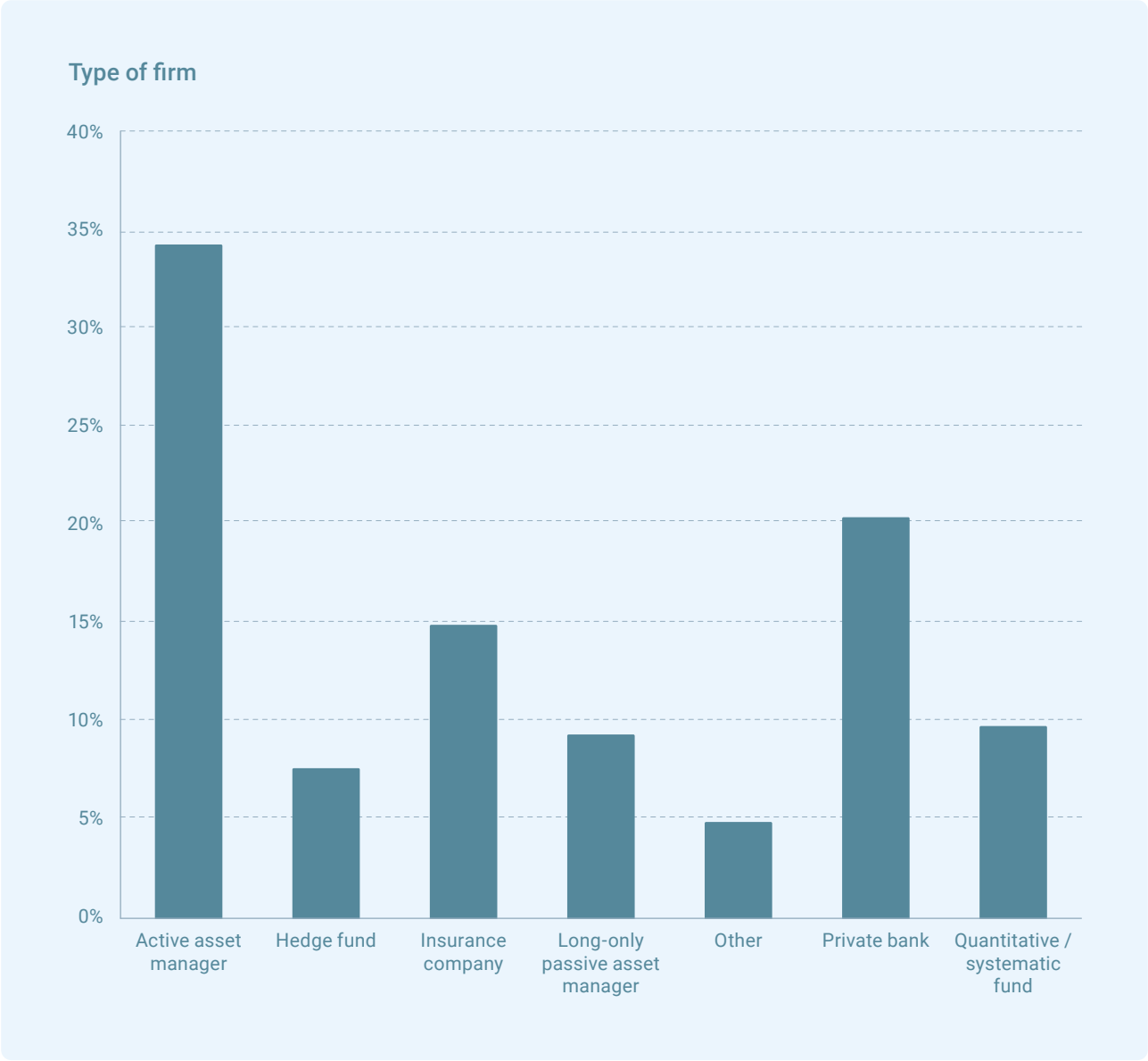
What impact will these market structure & regulatory topics have on your firm?



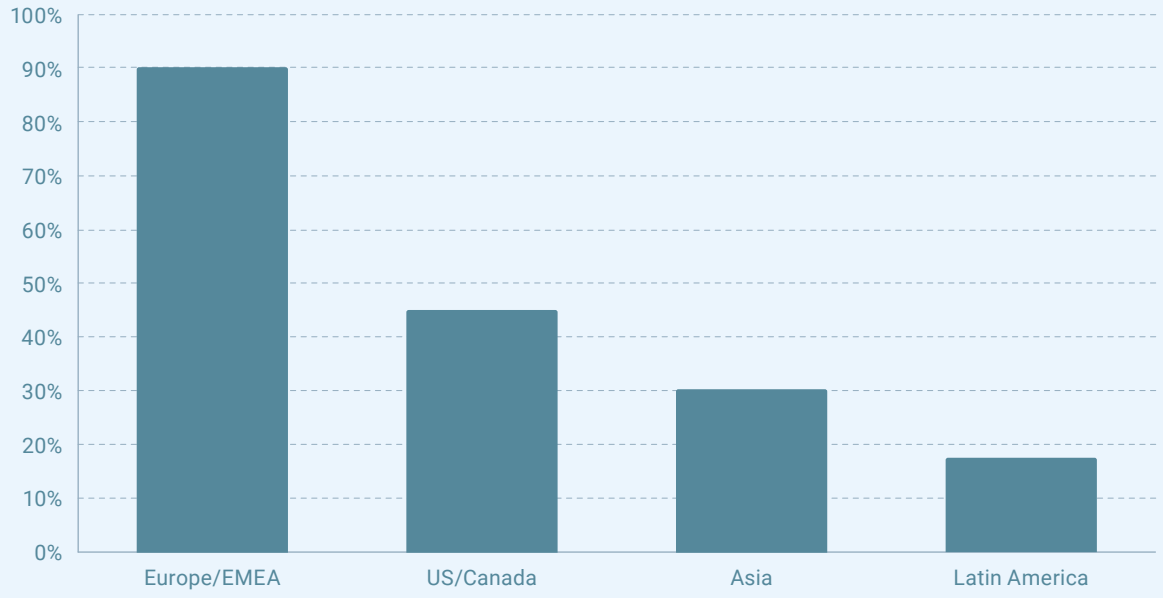
Appendix

Our survey included a broad range of respondents in terms of firm type, size and regional coverage.

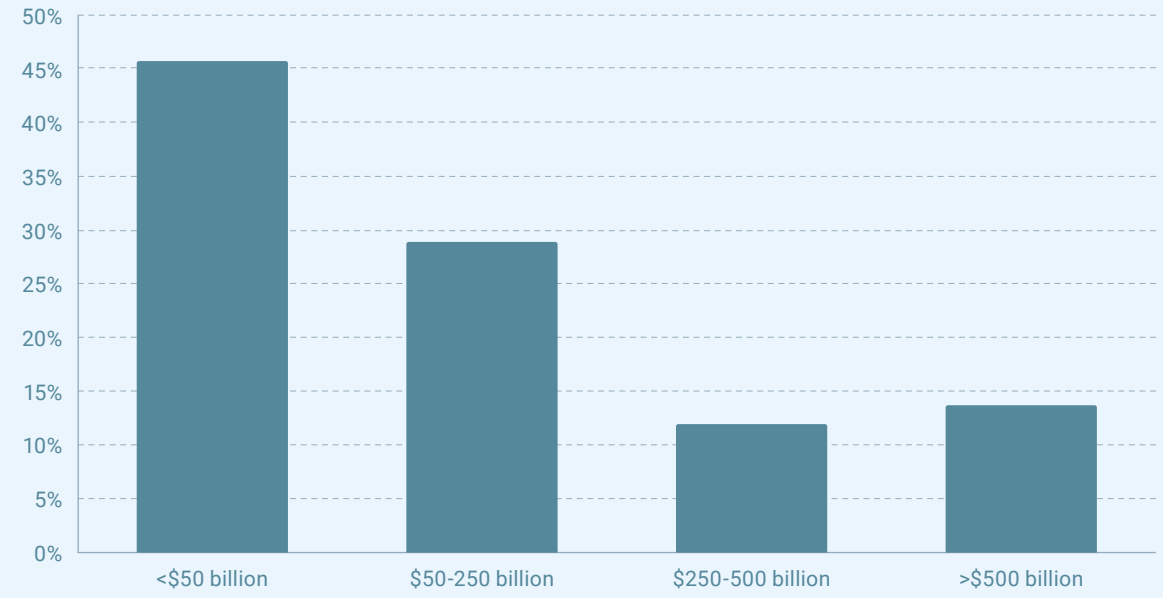
Respondent breakdown



What regions does your desk trade?



Assets under management



Contact us

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