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Spanish Fragmentation / Liquidity

Short Article – LM0010

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Spanish Fragmentation / Liquidity

Until the beginning of 2012 there had been little fragmentation in the trading of Spanish equities.

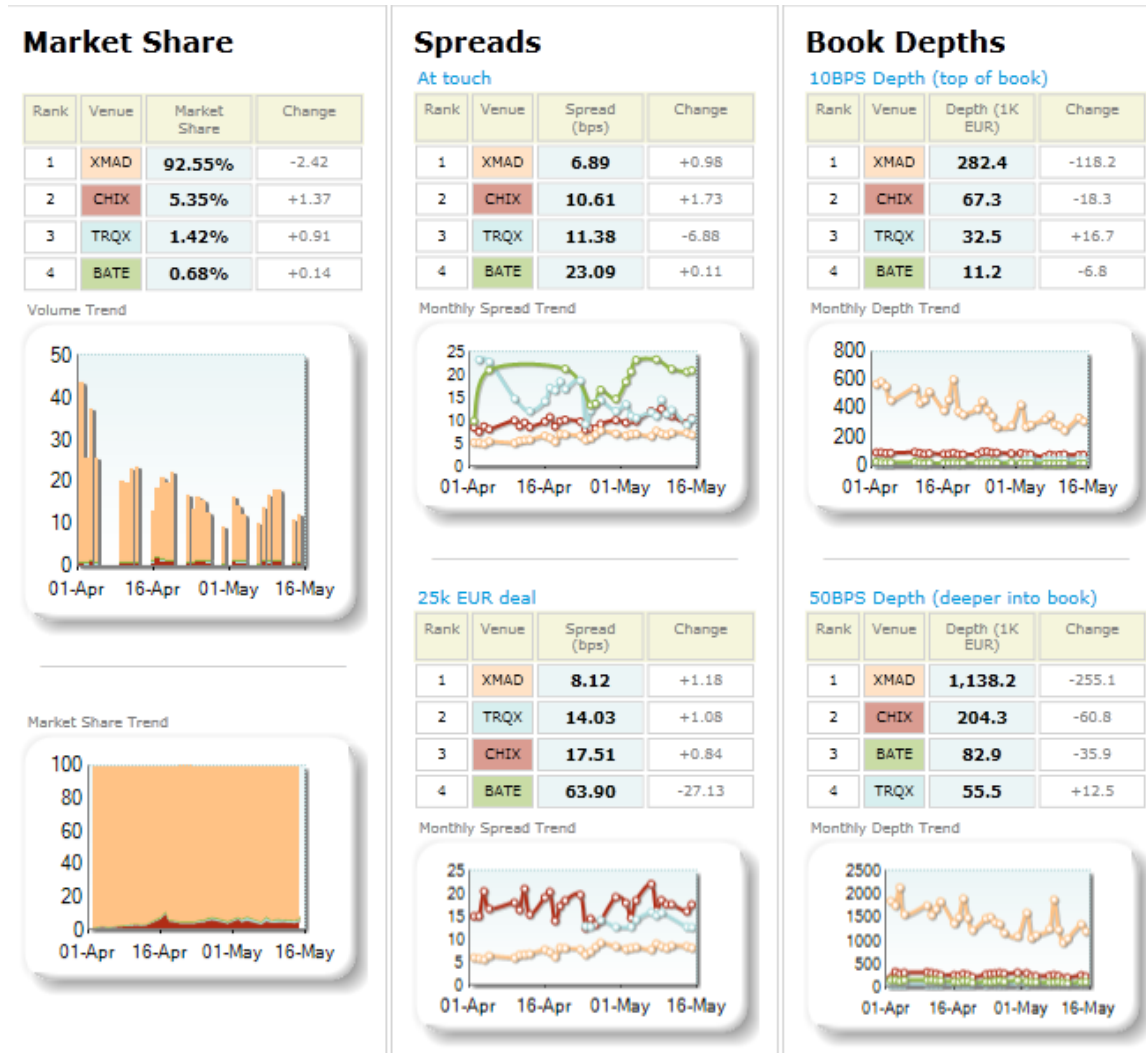
However, from February 2012 and accelerating more recently in May we have seen a small but significant amount of trading beginning to occur on MTFs (BATS/CHIX/TRQX) and a corresponding improvement in the quality of the liquidity (spreads/depths) resting on the MTFs.

This effect has been most apparent in the 6 Spanish stocks that are part of the EuroStoxx50 index:

- Banco Santander
- BBVA
- Iberdrola
- Inditex
- Repsol
- Telefonica

For the purposes of this article we have defined a daily traded value weighted basket of these stocks, which we will call the 'ES6' basket. We will look at how the fragmentation/market share, spreads and liquidity have behaved for the stocks of this basket in recent weeks.

ES6 - Current State of Play for 1-15th May 2012 versus April 2012



ES6 Battlemap - All screenshots are taken from the LiquidMetrix WorkStation

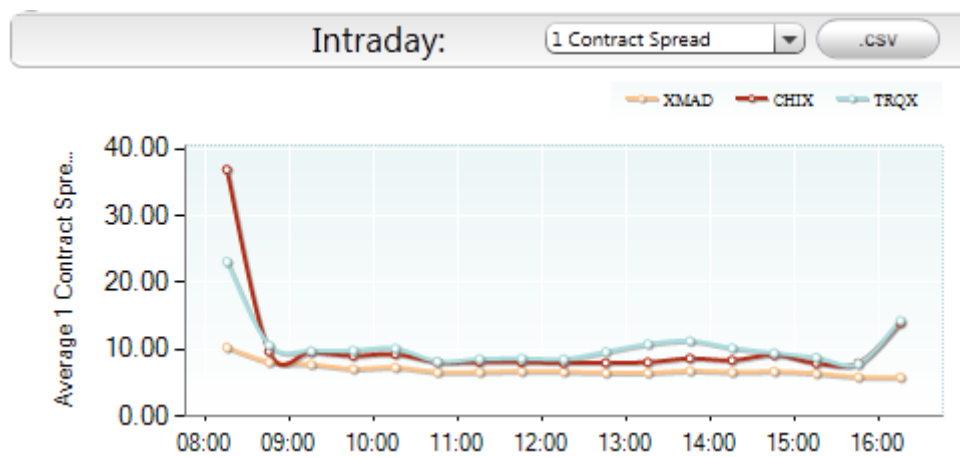
The LiquidMetrix Battlemap above shows market share / spreads and book depths for the ES6 basket of stocks comparing the first 15 days of May 2012 with April 2012. General points:

- Market share on the MTFs in May has increased, CHIX is now over 5% and TRQX has doubled its share very recently. Bolsa de Madrid (XMAD) still dominates with over 90% of market share but the current trend appears to be for this to decrease.
- Spreads on these stocks have generally widened on the primary market most likely due to recent market volatility but in the case of TRQX spreads at touch have significantly narrowed since the beginning of April 2012. The MTFs spreads are still considerably larger than the primary market but are competitive compared to where they had been over recent months.

- Book depths show resting liquidity on lit books have generally dropped (again due to the recent volatility) but as with spreads TRQX has improved enough to counter the general trend and shows increased liquidity.

So, in general we see that in the last couple of months MTFs are providing improved liquidity / spreads and benefitting from increased market share. Turquoise in particular has improved spreads / resting liquidity since the beginning of May and doubled its market share albeit still with 1.42% share overall.

Although the figures show the primary market having considerably tighter spreads than the MTFs (about 4 BPS) if we look at an intraday average spread, for instance over the most recent week (11-18 May 2012), we can see that most of this advantage is due to the first and last half hour of trading. During the majority of the trading day, the advantage of Bolsa de Madrid over CHIX and TRQX narrows to 1.5 – 2 BPS.

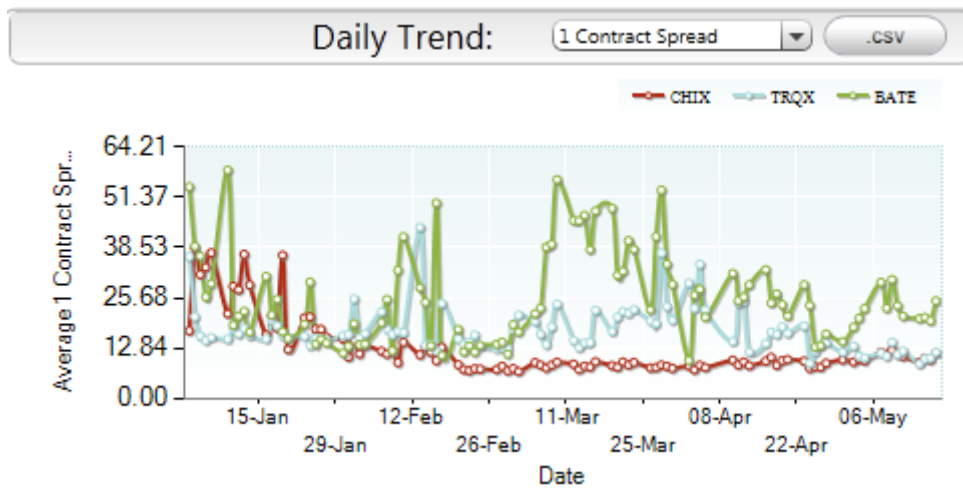


How We Got Here

As we said at the beginning of the article, fragmentation in the trading of Spanish stocks has only begun very recently.

1 Contract Spreads

The chart below shows touch BBO spreads for the ES6 basket for the 3 MTFs (CHIX, TRQX, BATS) since the beginning of the year.

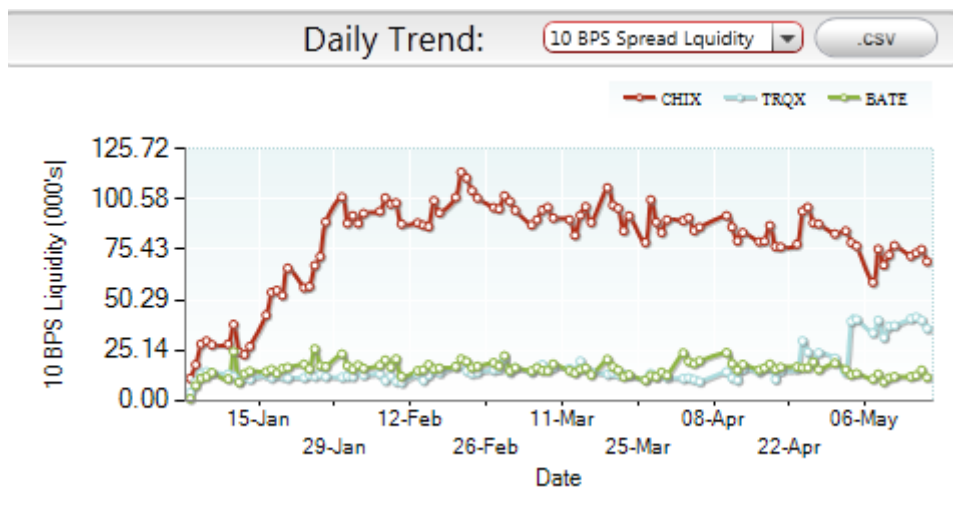


At the start of the year spreads were generally uncompetitive / volatile on all MTFs. At the beginning of February spreads narrowed and became more consistent on CHIX, BATS and TRQX. However, later in February spreads on TRQX and BATS widened again, whereas CHIX remained stable.

Very recently (beginning of May) spreads at touch on TRQX became much more competitive matching CHIX spreads.

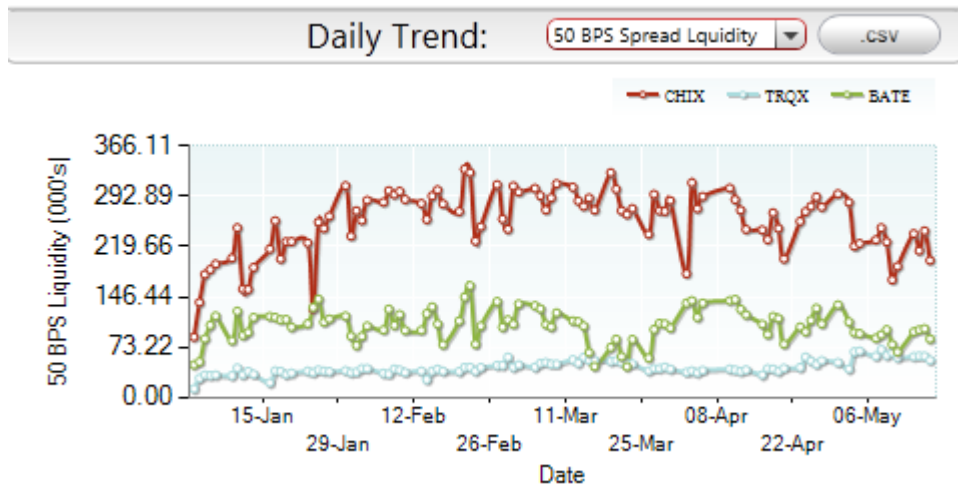
BATS spreads remains somewhat wider though it tightened for a week in late April (possibly after technical integration with CHIX) before widening again.

10 / 50 Basis Points Spread Liquidity



The picture with resting liquidity at the top of the book (within 10 BPS of mid) shows a similar story, CHIX improved and maintained good liquidity from early February, Turquoise has got much more competitive since the beginning of May.

Interestingly, liquidity deeper in the book (within 50BPS of mid) shows that Turquoise's improvement with resting liquidity has mainly been at the top of the book, BATS actually has more resting liquidity within 50BPS of mid.



Summary

From February this year spreads and liquidity on the three main MTFs (BATS/CHIX/TRQX) for the 6 Spanish stocks that are part of the STOXX-50 has improved significantly. This has led to more trading occurring on MTFs and MTFs in the first half of May 2012 account for about 7.5% of market share. More recently and coinciding with start of a price promotion on Spanish stocks, Turquoise has tightened spreads / improved liquidity from the beginning of May leading to a doubling of its market share.

Having said this, the primary market still offers average spreads 4-5 BPS better than the MTFs averaged over the day and around 1.5 – 2 BPS throughout the day and liquidity near the top of the book is about 5 times greater on the primary market compared with the MTFs.

For market shares / fragmentation to move to levels similar to other European markets we would probably need to see spreads at touch on the MTFs matching or exceeding the spreads on the primary venues as they do for instance in UK trading where CHIX have consistently had tighter spreads (by about 0.4 BPS) at touch than the primary venue (LSE) for most of the last 2-3 years.