European Equities Market Microstructure Survey

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Introduction

Welcome to our Q1 2022 survey of market volumes and fragmentation trends in European equities.

If you are unfamiliar with the topic, you may want to first visit our website and read our **Microbites series** for an explanation of market microstructure. The terms we use are defined in the appendix.

For a comprehensive view of market volumes and many more metrics on all the European indexes and trading venues, please visit our **Liquidity Cockpit**. If you are not already a subscriber, please **request a trial**.

For a definition of the terms used in the Survey please go to the Appendix.

Highlights

New record quarter (€72B ADVT)

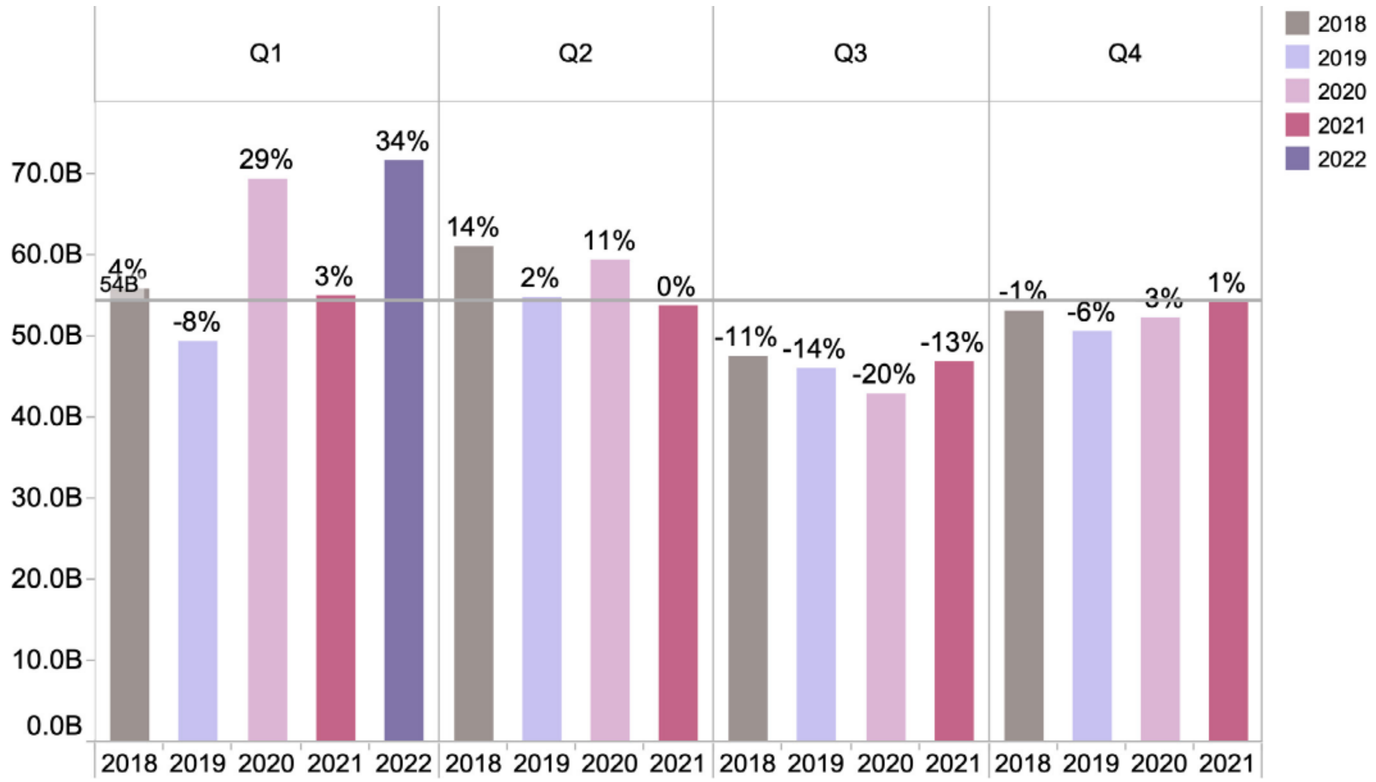
Volumes +31% v Q1 2021

Seasonal record volumes in January and February

SI trading reduces 12.5% v 2021

Summary

Market Overview - Quarterly ADV€

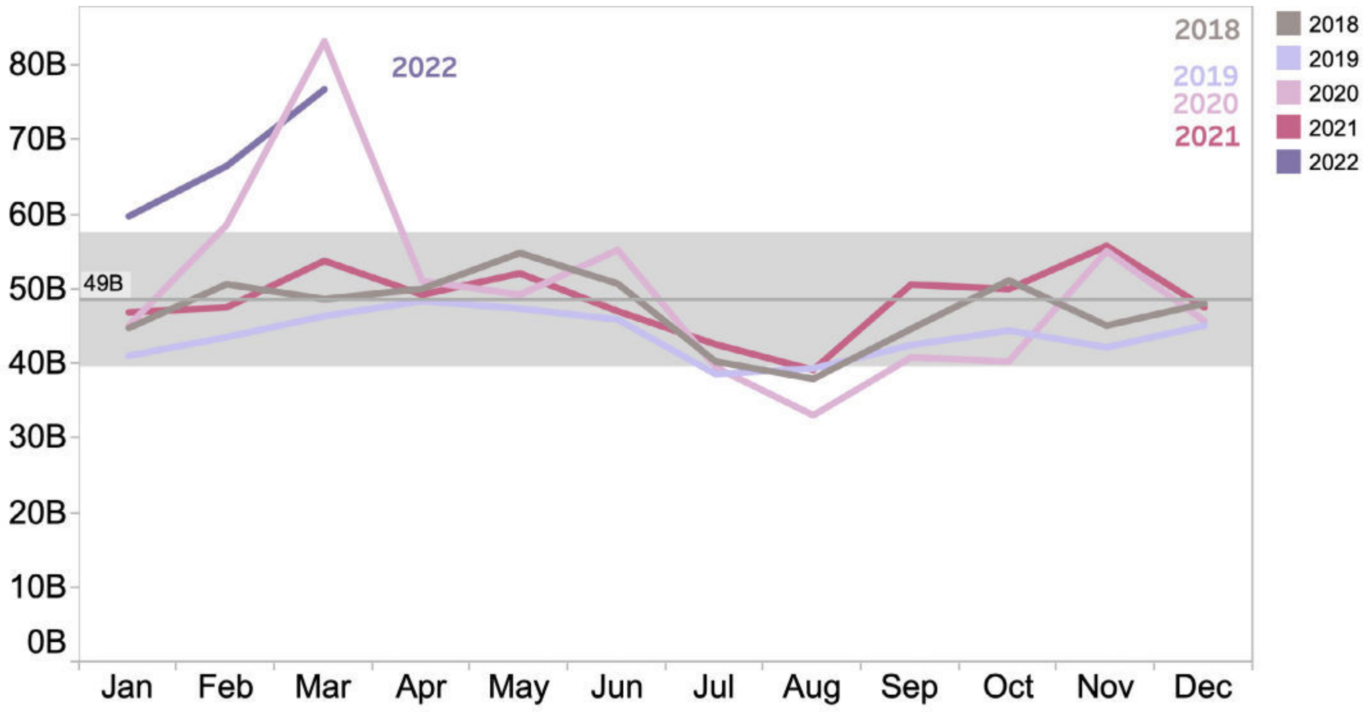


Trading turnover in European equities posted a new MiFID II era record in Q1, 34% higher than the four year average, as investors reacted to the cocktail of inflationary fears and war. Back in Q1 2020 it felt like we were watching a truly exceptional event but despite lower volatility, the markets managed to deliver something even more unpredictable. Throughout this survey we will be focussing on the parallels between these two exceptional events.

When just looking at on-order book, electronically traded volumes, Q1 2022 stands at +39% of the four year ADV compared with +33% in Q1 2020, indicating that the latest quarter could have witnessed an all-time high. This would seem likely from the sheer volume of data we have collected in Europe, which was 66% greater than in Q1 2020 and many times higher than the data broadcast to the market back in 2008.

Monthly Market Volumes

Average Daily Volumes €, 2018 to 2021

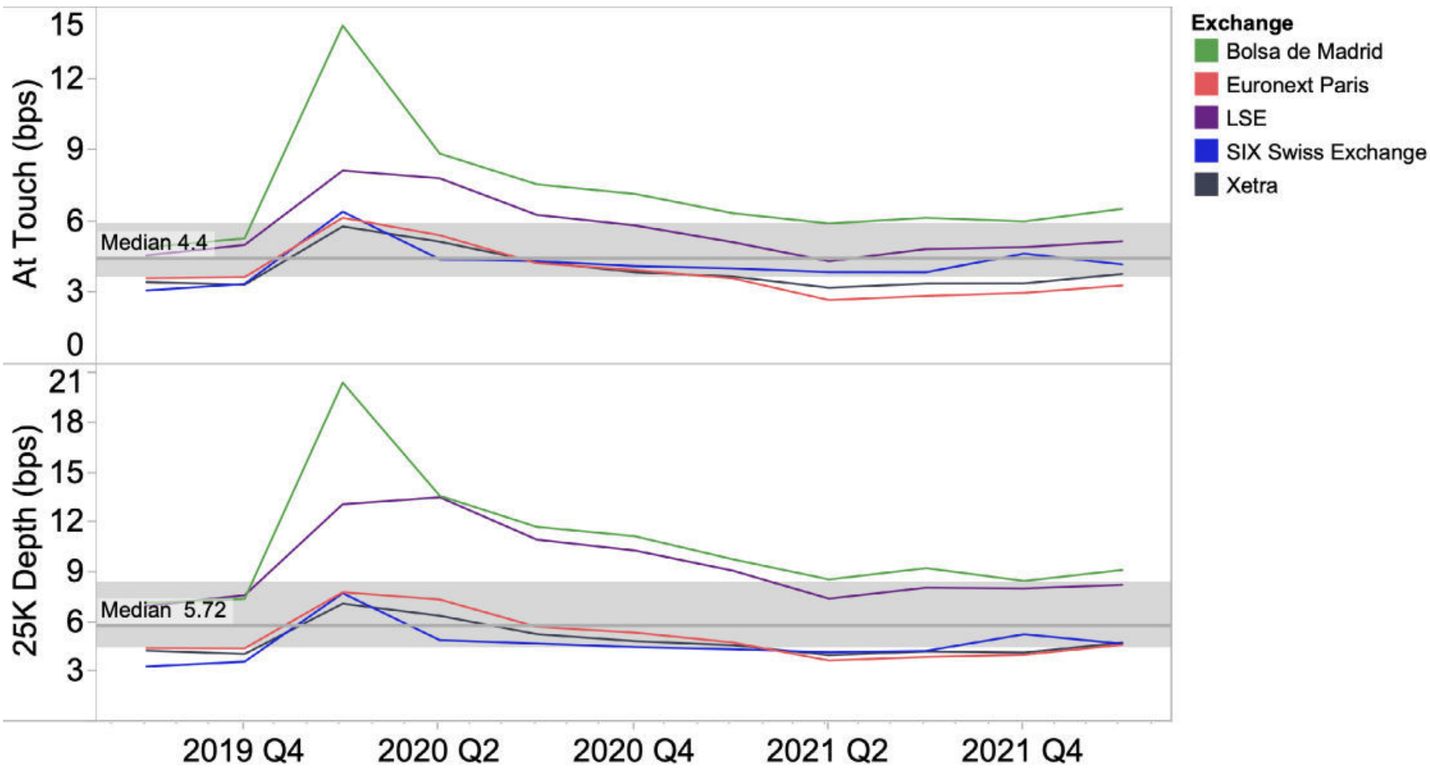


Both January (€63B ADV) and February (€70B) set new MiFID II era records for their respective months, while March (€81B) became the second biggest month overall, beaten only by March 2020 (€91). The quarter is notably different from Q1 2020 in that elevated trading volumes began immediately in the new year, leading to sustained high volumes over a longer period, at least partly explaining why Q1 volumes are higher overall despite comparatively lower volatility.

Inevitably, contribution to this huge spike in volumes was not uniform, reflecting variation in investor reaction to underlying sector and country conditions. Norway experienced a 32% increase over the long term average, followed by the Netherlands (29%), Italy (22%), and the UK top 100 (22%). At the other end of the scale, the UK Mid Caps and Spanish ES35 were just 3% and 6% respectively above the average.

Spreads

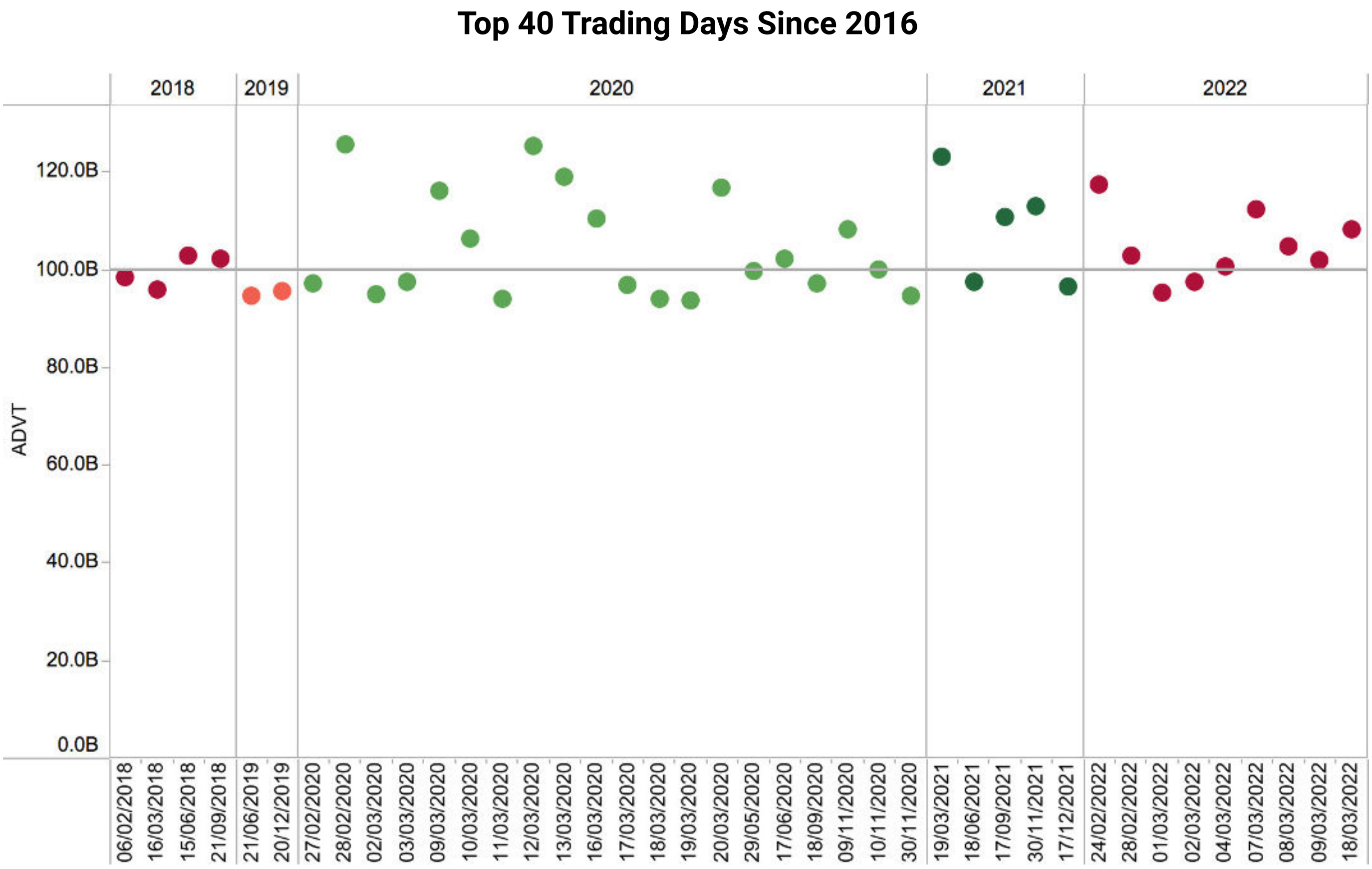
Primary Exchange Spreads



We have been tracking European spreads since before the Covid crisis began and watching them slowly return to pre-crisis levels. Here we show the at-touch spreads and a second measure which is the simulated spread based on the number of order book levels required to execute a trade of €25K in one clip. For the five indexes shown, the median at touch spread since August 2019 is 4.4bps, with the peak of late February and early March 2020 reflecting the very high volatility of the time.

Given differences in the size and liquidity of the indexes, their average spreads are not directly comparable but we can detect patterns and trends over time. Having (in most cases) taken fully two years to return to their pre-crisis levels, spreads are once again on the rise, signaling an accompanying rise in trading costs.

Top Trading Days

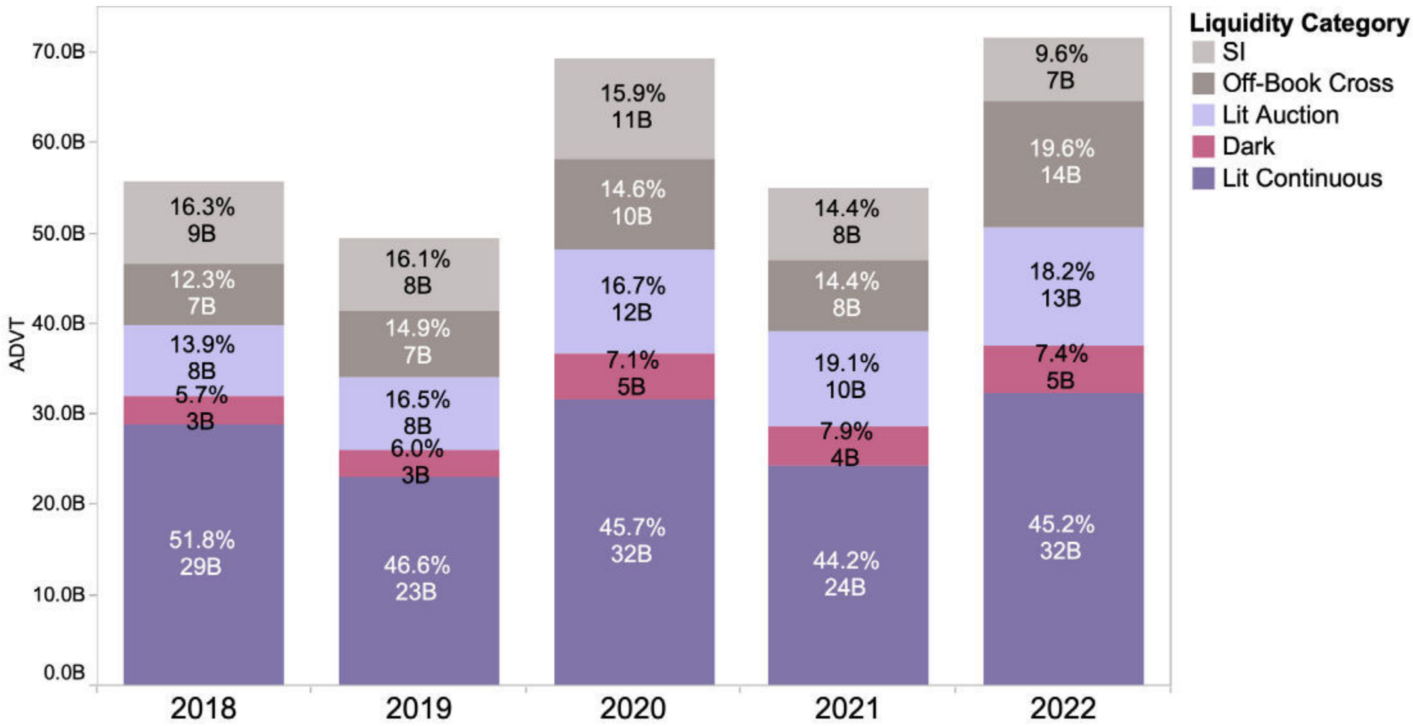


Regular readers will know how we like to look at the biggest days, when the market system is stretched to new levels. This graph shows the period since 2016, during which there were 22 days above €100B, 40 above €94B and of which 40% were Fridays; the average during this time was €54B and there were none before 2018. This demonstrates how market stress is highly concentrated into very short time periods. In 2020, 14 of these giants squeezed into 17 consecutive business days, while in 2022, nine also occurred within a 17 day period, coincidentally both in the first few weeks of March.

Despite index rebalances often being huge events in the normal course of business, they do not feature prominently in this list except where they have resulted in large sector shifts. A striking feature is that without the high levels of trading automation we see today, these volumes would have to be spread over many days, which begs more questions that we have space for here.

Fragmentation: Another Downturn for SI Trading

Top 40 Closing Auctions Since 2016

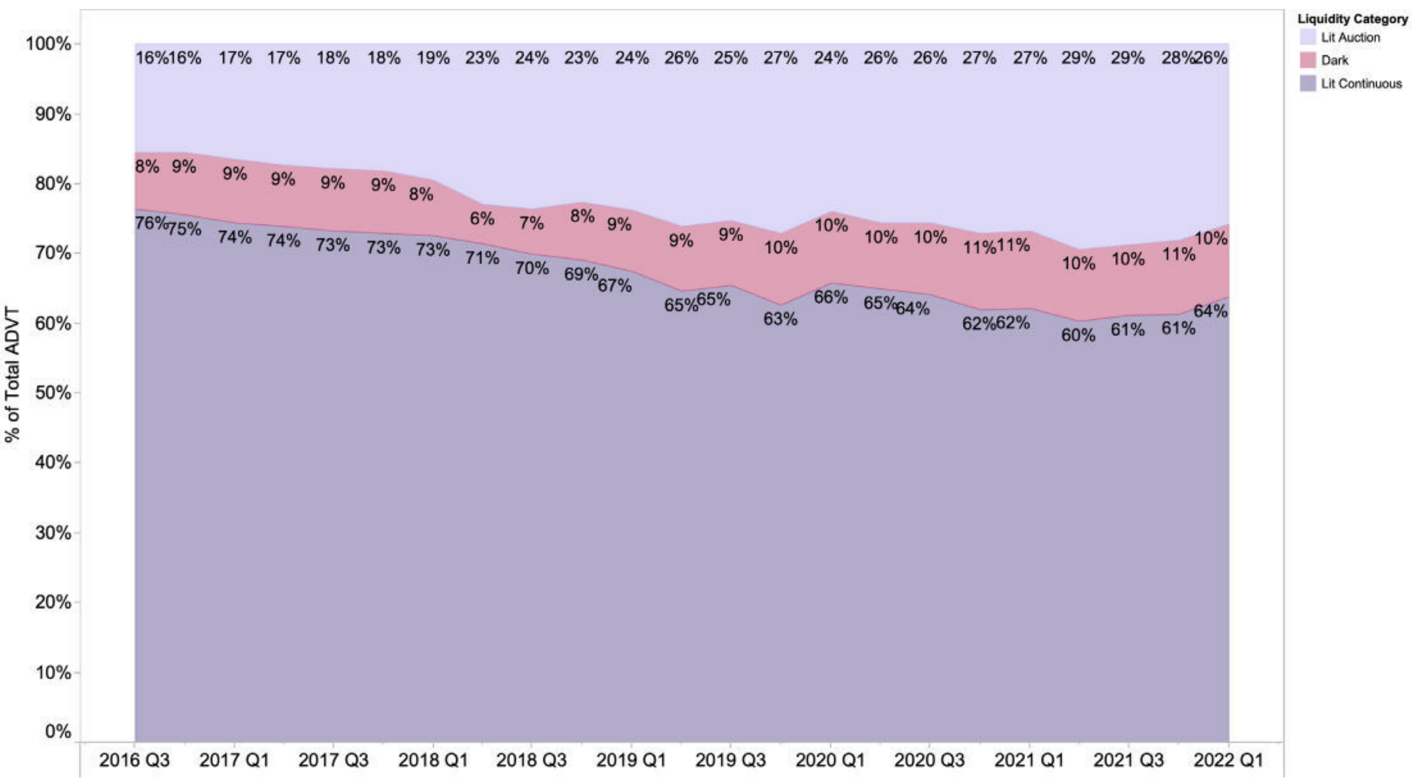


As market fragmentation varies seasonally, we have compared the first quarter periods of the last five years. Looking just at Q1 2020 and Q1 2022, the proportion of off-order book trading remains broadly the same, at roughly 30% of the whole market, which is the normal level. However in Q1 2022 there was a substantial increase in off-order book manual crossing of orders, at the expense of SI trading. SI trading has been in decline as a proportion of market share over the last 18 months and fell 12.5% in absolute terms (despite the higher volumes) in Q1 versus the full year 2021, and by as much as 33% in market share.

This rather surprising change during the recent quarter could be down to the fact that as the crisis took longer to unfold than in Q1 2020, there was more natural liquidity in the market available than in Q1 2020, and therefore less requirement for short term risk capital. We will have to wait to see if this reverses.

Lit Continuous Makes a Come Back

Order Book Fragmentation

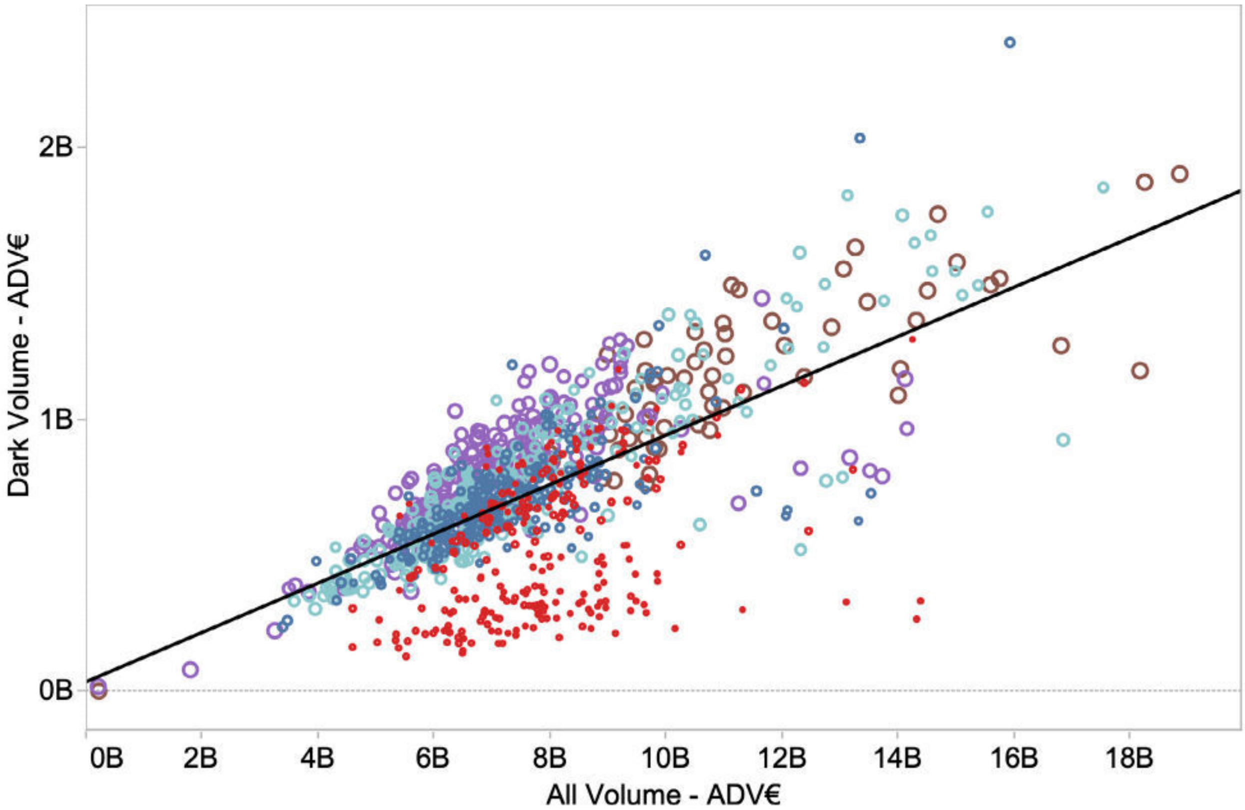


The lit order books for intraday trading have been fighting a losing battle with the closing auctions for electronically traded liquidity for years, reaching a low of 60% in Q2 2021. We put this down to the growth of passive trading in funds with NAVs benchmarked to the closing price. However in Q1 2022, they took back 3% of market share to reach €32B per day. This is exactly the same pattern that we saw in Q1 2020 reflecting that traders are less willing to wait for the closing auctions during periods of choppy prices.

Meanwhile, the dark order books maintain a steady 10% market share which is unchanged in two years and despite the UK's abandonment of the double volume caps. While on the subject of the UK, auction market share in the top 350 names is now consistently above 30% per day and dark market share is above 15%.

Dark Trading Check In

UK Large Cap Dark Trading Since 2018

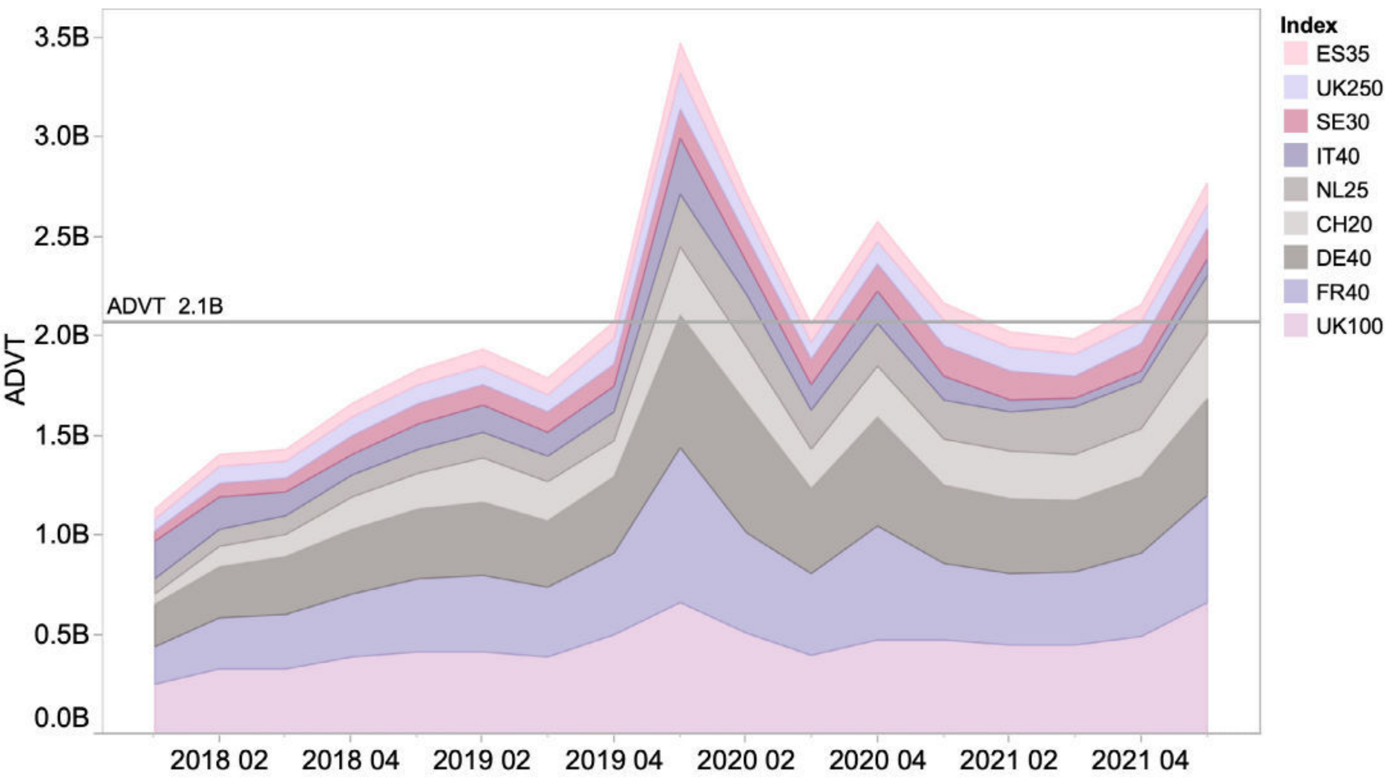


If you are still with us, it's probably because you like the details. We are monitoring dark market share to see if the end of the dark caps in UK names 12 months ago reveals anything new. The cluster chart shows the relationship between dark trading and overall market volumes in the top UK names since the implementation of the MiFID II changes, and each circle represents a day. This illustrates the gradual growth in dark trading in the index as the dots move above the line. We also note that dark pool liquidity becomes less predictable when overall volumes are lower.

Dark market share in the top UK names increased gradually from 11% to 14% of order book trading throughout 2019, adding another 1% in 2021. (Inside the EU, dark trading climbed from 7% to 10% in the same period and following the same pattern) The indication is that the effect of the removal of the dark caps in the UK early last year produced only a 1% increase in dark trading in the UK100. However, in the less liquid UK250 there was an increase from 15% to 19%, indicating the dark caps were having a bigger impact on less liquid names.

Systematic Internalisation Going Electronic?

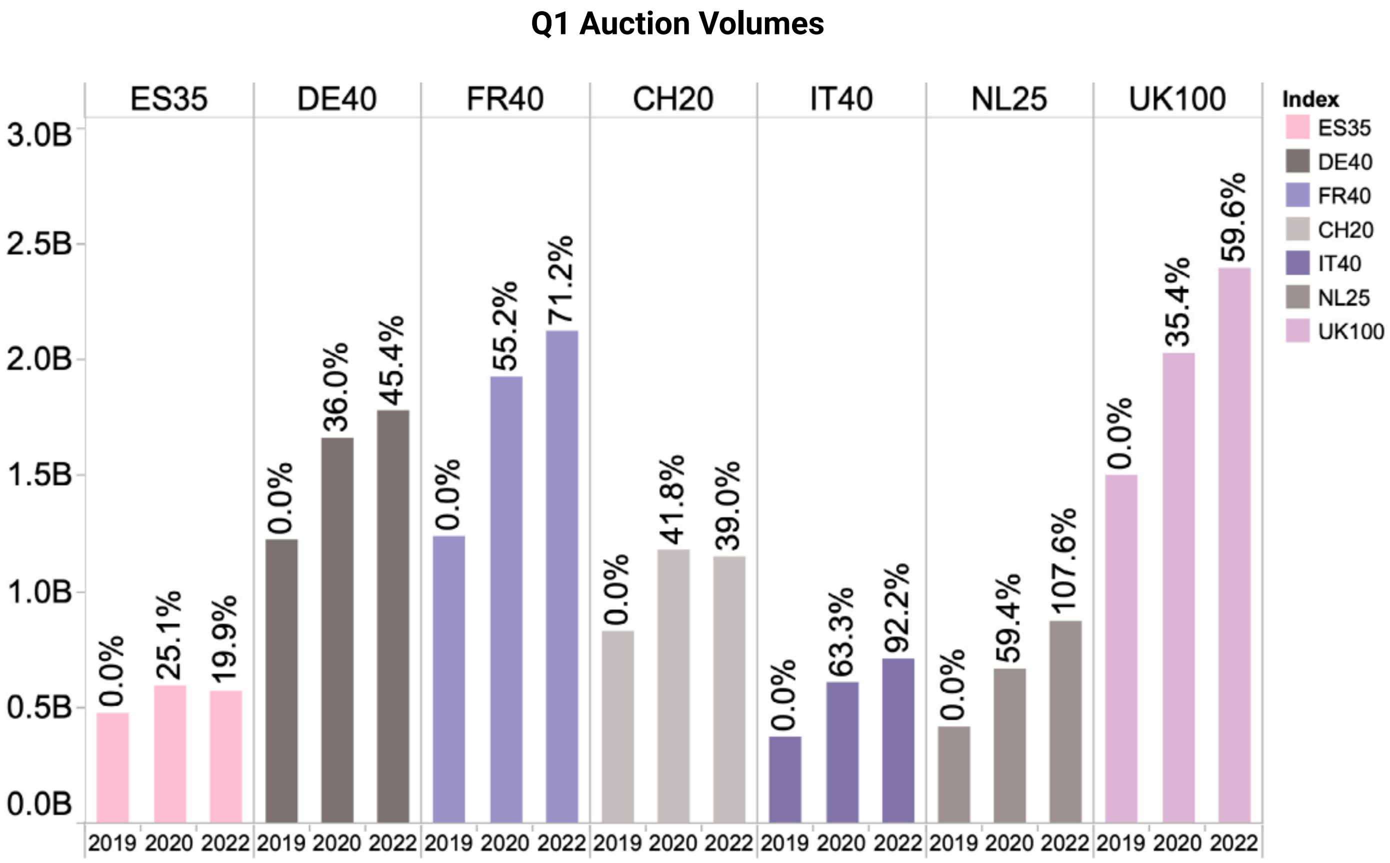
SI Trends in Intraday, Non LIS Trades



We commented in the Q4 2021 survey that SI trading had reduced by 32% over the course of last year when overall market volumes had decreased by only 6%. The trend has continued into 2022, with a substantial 12.5% drop in absolute value traded from €8B to €7B per day, in comparison with Q1 2021 (whereas overall volumes increased by 30%), and a fall from 14.4% to just 6.5% market share. SI trading has only lost €1B to €2B in value since 2018, but this translates to nearly 41% in market share.

Reversing the pattern is the trend for smaller (sub LIS) intraday trades, that are mainly traded electronically as SI platforms continue to grow in value. This area enjoyed a sharp increase in Q1 2022, as shown in the graph. While not reaching the same levels as in Q1 2020, this segment continues to grow consistently, and accounts for over €2B per day - more than 2x the level at the start of MiFID II. This further points to the reduction in block level capital commitment by perhaps as much as 50% in the last four years, and is a trend that is accelerating.

Postscript



A high level overview does not fully capture the variation at country and sector level or between specific liquidity pools and venues but we can detect that patterns forming in the microstructure are still at work:

- reduction in block level capital commitment;
- gradual rise of SI electronic trading platforms;
- ongoing growth of closing auctions, tempered during higher volatility;
- increasing growth of mid cap dark trading, especially in the UK.

This final chart shows the further substantial part played by the auctions in Q1 2022 (using Q1 2019 as a benchmark) having consistently grown quarter by quarter in the last two years.

Despite a small reduction in market share in Q1, the reliance on the auctions grows ever greater, with nearly a fifth of daily volume traded on the closing print.

Appendix: European Microstructure 101

All Types of Trading

- **On Book** – Trades conducted electronically on an Exchange or MTF where all participants trade on equal terms (price, size and time).
  - **Lit Continuous** – Intraday lit trading includes the continuous trading period on the Exchanges and Multilateral Trading Facilities, where the order book is published and excludes any type of auction.
  - **Auction** – Intraday Auctions include five main types: OPEN, CLOSE, MIDDAY, TRADING HALTS and PERIODICS.
  - **Dark** – Dark pools include MTF trading on both continuous and 'block' or 'Large in Scale' modes. Some Dark Pools offer conditional order types.
- **Off Book** – Trades negotiated 'bi-laterally' between a broker or market maker and their client; maybe either electronic or manual.
  - **Systematic Internaliser** – Systematic Internaliser trades include both phone-based and electronic trading platforms where price and size is negotiated between two parties, one of whom must be trading as principal.
  - **Off Book Crosses** – The rules permit some trades to be conducted away from an Exchange, MTF or SI, under certain defined circumstances known as the 'waivers'. They may not be automated, so these are usually manual trades. They are still considered to be 'On-Exchange'.
  - **Over The Counter (OTC)** – There are circumstances where trades may be reported as Off-Exchange, such as if they are technical in nature and not price forming. We ignore these for the purpose of this analysis.

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