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# European Market Quality: A Metric in Need of a Standard

January 2012

## Executive Summary

Buy-side traders and their brokers must feel like the world has turned upside down. The mind-bending changes that have taken place in the European equities markets over the past five years have altered the equity landscape forever. It is an exciting and disorienting time to be an equity trader, and there is much to be done to keep one's head on straight and find the optimal path to best execution.

Complexity in the markets is not going away. If anything, as new rules and regulations are implemented and the economics of investing and trading are altered, innovative minds and technologies will pop up, presenting new and uncharted challenges to institutional investors and their broker partners.

For the foreseeable future, change and uncertainty will continue to hold sway across the lit and dark equities venues in Europe. And yet, one certainty stands. Where there are new challenges to the buy-side trader, where there are new complexities and increased rates of change, there will be opportunities for leadership in the development of standards and methodologies that support optimal complex trade decision-making.

The character of a venue's liquidity may mean the difference between alpha saved and alpha forfeited. Best Execution for any given order is not merely a matter of price, so the question must be asked, "I take that liquidity at what relative cost?" If spreads widen, if liquidity disappears, if prices revert and if a trade in one market removes liquidity instantaneously in another, then the cost of the subsequent trade has been adversely impacted. The measurable differences in these behaviours across markets are a good place to start to determine which liquidity venues offer higher quality results and which ones don't.

Spread size and spread sensitivity, the relative transience of liquidity, the immediacy of reaction at the touch – these are pain points for buy-side traders and their brokers. And every broker worth its quantitative analysts and its software developers is attempting to tackle these very same issues in a way that offers clients a framework and a methodology for proactively avoiding the pitfalls.

This will be the year, in 2012, when the battle for order flow will raise the bar on the battle for share of mind through differentiation in market quality. This will be the year when fiduciaries and their brokers become far more proactive in asking for an increased return on their investment. They invest with their order flow. It's time for the marketplace to increase the return on that investment in the form of a framework for analysis and preservation of precious alpha.

The TABB Group Vision Note **European Market Quality: A Metric in Need of a Standard** is based upon conversations with key players in the European equity marketplace, including heads of sell-side electronic trading desks, exchanges and third-party market data providers, and head traders at major European-based asset management firms. The note covers the challenges and the demands for the development of a framework to compare the quality of liquidity across lit venues in Europe. While brokers continue to advance their capabilities in analysing individual venue performance with differing types of order flow, their methodologies are unique and proprietary. Hence there is a growing demand for a transparent and actionable set of metrics to support the direct comparison of the quality of liquidity across lit venues in Europe. It is up to the marketplaces themselves to take leadership on this issue as 2012 unfolds.

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