Taking hits from all sides

Traders are having to cope with a double-whammy of rising delay costs and dwindling order sizes, on top of high impact costs and a dearth of capital commitment from brokers.

Based on the GSCS Degree of Difficulty Index, conditions in the global equity markets continued to pose major challenges for traders in Q3. Price swings were extremely high throughout the quarter and there were relatively few days when traders could relax without worrying about incurring high costs of delay.

As in the previous quarter, the cost of moving out of one position into another remained at historically high levels. Market impact costs alone were more than 50 basis points (bps) in some major equity markets. Particularly unnerving for traders, however, is that sharply rising delay costs have coincided with a fall in the average order sizes. This, coupled with dealers' marked lack of willingness to commit to prices as principal, has resulted in a very difficult market.

Traders incurred delay costs of more than 50 bps in a wide range of leading markets including the US, Canada, Sweden, Switzerland and France.

> "As in the previous quarter, the cost of moving out of one position into another remained at historically high levels."

The data provided by GSCS Information Services is based on its global equity transaction cost measurement universe. This universe incorporates representative transactions from more than 300 investment management companies, using more than 500 institutional brokers. The total number of transactions in the universe grows at a rate of around six million per annum across more than 50 countries.

COUNTRY ANALYSIS – DEFINITIONS

Market impact
Market impact, expressed in basis points, is calculated based on a comparison between the execution price and the price of the security immediately before the trade was put in the market by the buy-side trading desk. This is commonly known as Release Time price.

Cost of delay
Cost of delay expressed in basis points represents the costs incurred as a result of delays between the decision to trade being made and the trade being put into the market.

Implementation shortfall
Implementation shortfall, expressed in basis points, reflects the difference of a paper portfolio versus the actual portfolio purchased. This is calculated based on a comparison between the execution price and the price prevailing at the time the decision to trade is made (or where this is not known, the open price on the trade date).

Average commission
Commission, expressed in basis points, reflects all trades (including program trades) that bear commission. However, it excludes any principal or zero commission trading activity.

% zero commission
This shows the relatively low proportion of activity in most countries that is carried out by dealers acting as principal and not charging a commission to act as a broker on behalf of clients.

> “Traders incurred delay costs of more than 50 bps in a wide range of leading markets including the US, Canada, Sweden, Switzerland and France.”

Emerging markets remained at least as problematic at the major centres. Cost of delay on trades in Brazil averaged almost 100 bps, while market impact costs in Greece, Ireland and Portugal were more than 50 bps. The lowest cost of turnover in any market was 50 bps in Thailand.

Agency commissions in these markets were lower than in the previous quarter and generally moved down to below 25 bps. The only exception was Thailand, where average agency commissions continued to be nearly 40 bps. At least in the latest period, taking all costs into account, higher commissions in Thailand would appear to be merited.

COUNTRY ANALYSIS

	Market impact (bp)	*Cost of delay (bp)*	*Implementation shortfall (bp)*	*Average agency commission (bp)*	*% zero commission (%)*
Europe – major					
Finland	31	61	92	12	4.0
France	6	-19	-13	8	15.6
Germany	20	44	63	11	3.3
Italy	18	37	55	11	2.9
Netherlands	26	37	63	11	4.9
Norway	22	51	73	14	2.0
Spain	14	17	30	12	6.7
Sweden	21	60	82	14	2.0
Switzerland	23	51	74	14	2.4
UK	30	32	62	12	9.5
North America					
Canada	12	58	70	12 (3.0 c/s)	3.6
US	17	51	68	10 (2.8 c/s)	6.3
Asia – major					
Australia	29	17	46	18	0.5
Hong Kong	55	39	94	15	1.4
Japan	29	9	38	11	0.7
Korea	76	14	90	21	0.3
Singapore	7	51	58	23	0.5
Taiwan	71	17	87	22	0.2
Other – select					
Brazil	19	93	111	18	2.9
Greece	50	6	57	17	4.5
Hungary	17	33	50	21	0.0
Ireland	52	43	95	15	12.4
Malaysia	1	64	64	23	0.3
Mexico	17	63	80	16	4.3
Poland	32	5	37	21	0.8
Portugal	55	37	92	13	2.8
South Africa	12	28	40	15	0.5
Thailand	7	17	25	39	0.1

Leading stocks – Q3 2008

Selling pressure

As might be expected in uncertain times, the most widely traded stocks in Q3 continued to be those with greatest liquidity. Also, in most cases, the value of sells exceeded buys as managers sought to raise cash to meet actual or anticipated redemptions in open-ended funds. For the most part these moves do not seem to have been motivated by strong investment preference, though some managers were buying oil shares – both BP and Statoil saw significantly more buying activity compared with the overall trend.

Banks saw a mixed picture. In two-thirds of the markets analysed, at least one bank stock was seen in the most heavily traded three. Of the 15 banks most widely traded, eight saw a balance in favour of purchases, including UBS, HSBC, Bank of America and J.P. Morgan. Seven saw more sells than buys including Unicredito, Commonwealth Bank and Kookmin Bank in Korea.

In terms of countries, Italy saw twice as many

LEADING STOCKS

	Market impact (bp)	Cost of delay (bp)	IS* (bp)	Buy (%)	Sell (%)	Leading brokers
US						
Halliburton	115	140	255	35.8	64.2	Banc America/Wachovia/Bernstein
Bank Of America	32	21	54	54.3	45.7	Lehman/Keefe/Morgan Stanley
JP Morgan Chase	58	19	77	54.4	45.6	Morgan Stanley/Goldman/Bernstein
Canada						
Barrick Gold	54	11	65	28.8	71.2	UBS/Goldman/Morgan Stanley
Potash Corp	117	12	129	25.8	74.2	UBS/Merrill Lynch/Nesbitt
Kinross Gold	81	21	102	48.1	51.9	UBS/Goldman/Scotia
Finland						
Nokia	12	116	128	37.7	62.3	Merrill Lynch/UBS/Credit Suisse
Fortum	25	128	153	35.9	64.1	Deutsche/Credit Suisse/Calyon
Sampo	99	-39	59	76.3	23.7	UBS/Svenska/Merrill Lynch
France						
Groupe Suez	17	-199	-182	7.7	92.3	Merrill Lynch/Lehman/Exane BNP
Total	18	6	24	39.2	60.8	Merrill Lynch/Deutsche/Calyon
France Telecom	19	-7	12	46.3	53.7	Calyon/Merrill Lynch/Deutsche
Germany						
Allianz	16	32	48	60.2	39.8	UBS/Deutsche/Citi
Bayer	7	25	31	61.4	38.6	UBS/Deutsche/Lehman
Siemens	3	14	17	47.9	52.1	Merrill Lynch/Exane BNP/Deutsche
Italy						
Unicredito Italiano	25	92	118	27.9	72.1	UBS/Morgan Stanley/Lehman
ENI	3	30	33	33.3	66.7	Credit Suisse/UBS/Instinet
ENEL	7	11	18	37.1	62.9	UBS/Lehman/Credit Suisse
Netherlands						
ING Groep	7	27	34	39.6	60.4	Credit Suisse/JPMorgan/Merrill Lynch
Unilever	11	13	24	32.2	67.8	UBS/Credit Suisse/Lehman
KPN	27	-3	24	42.4	57.6	UBS/Merrill Lynch/Deutsche
Norway						
Yara	41	42	83	46.3	53.7	UBS/JPMorgan/Merrill Lynch
Statoil	23	42	65	57.3	42.7	UBS/Instinet/Morgan Stanley
Norsk Hydro	1	124	125	3.3	96.7	Merrill Lynch/Enskilda/Svenska
Spain						
Telefonica SA	2	17	19	50.0	50.0	UBS/Credit Suisse/Deutsche
BSCH	5	43	48	40.3	59.7	Merrill Lynch/Lehman/Citi
BBVA	1	37	38	51.3	48.7	Merrill Lynch/Instinet/Citi

**IS = Implementation shortfall*

Leading stocks – Q3 2008

LEADING STOCKS

	Market impact (bp)	Cost of delay (bp)	IS* (bp)	Buy (%)	Sell (%)	Leading brokers
Sweden						
Swedbank	15	80	95	54.3	45.7	UBS/ABG/Enskilda
Lm Ericsson	14	112	126	71.4	28.6	ABG/Morgan Stanley/UBS
Hennes & Mauritz	50	40	90	51.2	48.8	UBS/Credit Suisse/Merrill Lynch
Switzerland						
Novartis	20	35	55	40.1	59.9	UBS/Merrill Lynch/Morgan Stanley
UBS	33	125	158	62.0	38.0	UBS/Credit Suisse/Merrill Lynch
Nestle	4	21	25	34.1	65.9	Credit Suisse/UBS/Deutsche
UK						
BP	15	21	37	68.4	31.6	Deutsche/UBS/Merrill Lynch
HBOS	98	166	264	64.1	35.9	Dresdner/UBS/Citi
HSBC	7	55	61	57.4	42.6	Credit Suisse/Deutsche/Citi
Australia						
BHP Billiton	14	-4	10	37.6	62.4	UBS/Credit Suisse/Citi
Rio Tinto	23	8	31	24.3	75.7	UBS/JPMorgan/Goldman
Commonwealth Bank	5	7	12	36.2	63.8	Goldman/JPMorgan/Credit Suisse
Hong Kong						
China Mobile	36	14	50	50.6	49.4	Deutsche/Citi/Credit Suisse
CNOOC	50	35	85	30.0	70.0	Citi/Morgan Stanley/Lehman
China Construction Bank	13	14	27	47.2	52.8	Citi/JPMorgan/Morgan Stanley
Japan						
Mitsubishi UJF	19	-23	-4	48.5	51.5	Citi/Credit Suisse/Nomura
Mitsubishi Corp	29	53	81	40.4	59.6	Morgan Stanley/Nomura/Macquarie
Hitachi	39	33	72	25.2	74.8	Merrill Lynch/Nomura/Deutsche
Singapore						
DBS Group	27	31	58	53.5	46.5	Citi/CIMB/Merrill Lynch
Singapore Telecom	17	45	62	82.8	17.2	JPMorgan/Deutsche/Credit Suisse
OCBC	20	3	22	72.8	27.2	Credit Suisse/CIMB/Morgan Stanley
South Korea						
Samsung	72	11	84	44.0	56.0	Morgan Stanley/JPMorgan/Exane BNP
Kookmin Bank	72	-2	70	29.3	70.7	Deutsche/Macquarie/JPMorgan
Posco	4	-3	1	34.7	65.3	Morgan Stanley/JPMorgan/CLSA
Taiwan						
TSMC	15	34	49	22.3	77.7	Morgan Stanley/Macquarie/Goldman
Hon Hai	61	2	63	35.6	64.4	Morgan Stanley/Exane BNP/Goldman
China Steel	99	45	144	11.2	88.8	Goldman/Macquarie/Morgan Stanley

**IS = Implementation shortfall*

LEADING STOCKS – DEFINITIONS

For each of 10 European major markets plus the US, the three most widely traded securities during the last quarter are identified. The 'Buy/Sell (%)' indicates the value of buys and sells as a percentage of the total value traded. It indicates the extent to which institutional investors as a whole were adding to their position during the period. The table identifies the three brokers that handled the highest proportion of trading activity in stock.

"In most cases, the value of sells exceeded buys as managers sought to raise cash to meet actual or anticipated redemptions in open-ended funds."

sells as buys across its three most widely traded stocks. By contrast, the ratio was strongly in favour of buys in Singapore's top three stocks.

Leading brokers – Q3 2008

A boost for algos

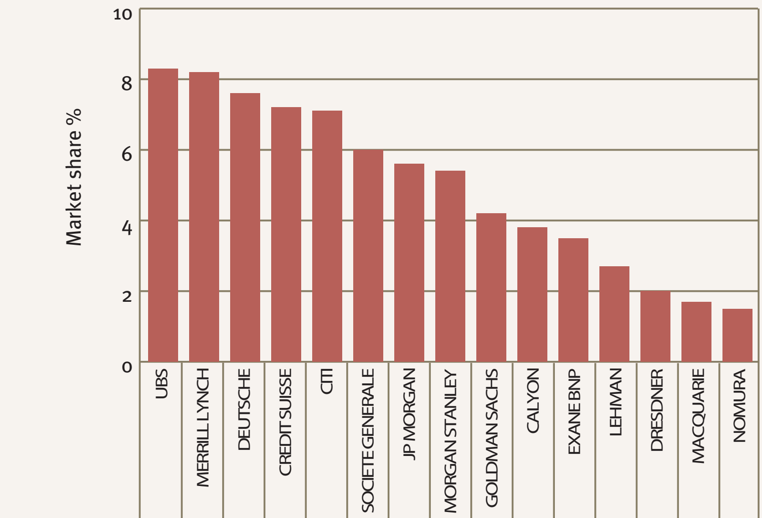
Brokers are continuing to struggle with falling average order sizes and a lower appetite for risk. This reduces their capacity to add value through capital commitment. At the same time smaller orders are inherently less profitable in an environment where commissions are based on value traded. There is considerable incentive in such circumstances to use technology as effectively and as much as possible, and higher levels of algorithmic trading should be expected if the trends continue for much longer.

UBS kept the top spot in the commissions ranking, with Merrill Lynch and Deutsche Bank maintaining their position in the top three. Macquarie, which has a strong presence in the Asian execution business, made an appearance in the global commission ranking and Société Générale's position in the ranking improved strongly to sixth from twelfth.

In the value rankings, Merrill Lynch took the top spot from UBS, which fell to second place. Citi dropped from third to sixth position, possibly reflecting a lower appetite for risk taking and aggressive pricing.

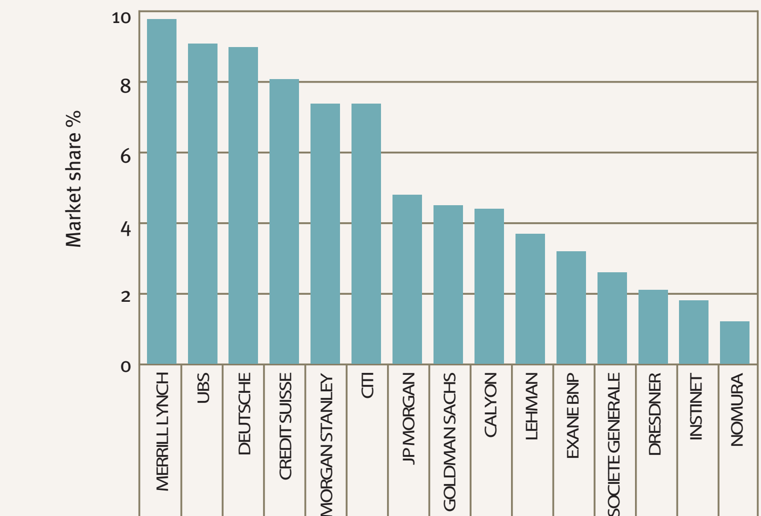
The good news for Citi,

Q3 2008 LEADING GLOBAL BROKERS – TOP 15 RANKED BY COMMISSION



	UBS	MERRILL LYNCH	DEUTSCHE	CREDIT SUISSE	CITI	SOCIETE GENERALE	JP MORGAN	MORGAN STANLEY	GOLDMAN SACHS	CALYON	EXANE BNP	LEHMAN	DRESDNER	MACQUARIE	NOMURA
Rank Q3 2008	1	2	3	4	5	6	7	8	9	10	11	12	13	14	15
Rank Q2 2008	1	2	3	5	4	12	8	7	6	10	11	9	13	–	15

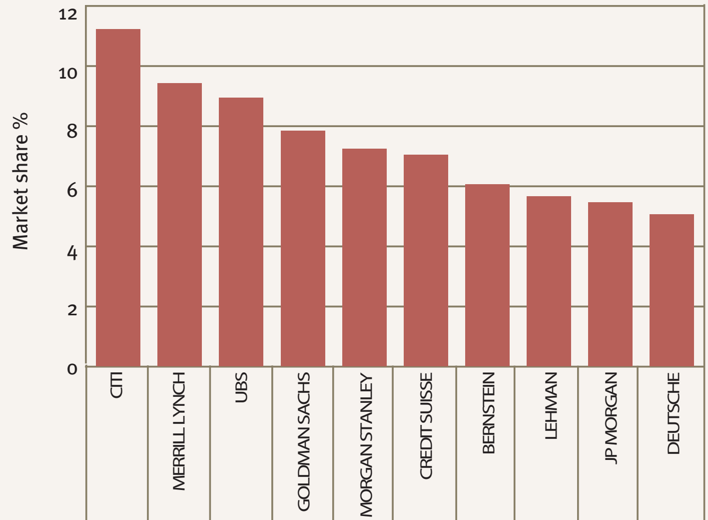
Q3 2008 LEADING GLOBAL BROKERS – TOP 15 RANKED BY VALUE TRADED



	MERRILL LYNCH	UBS	DEUTSCHE	CREDIT SUISSE	MORGAN STANLEY	CITI	JP MORGAN	GOLDMAN SACHS	CALYON	LEHMAN	EXANE BNP	SOCIETE GENERALE	DRESDNER	INSTINET	NOMURA
Rank Q3 2008	1	2	3	4	5	6	7	8	9	10	11	12	13	14	15
Rank Q2 2008	2	1	4	5	6	3	9	8	8	10	11	12	13	–	15

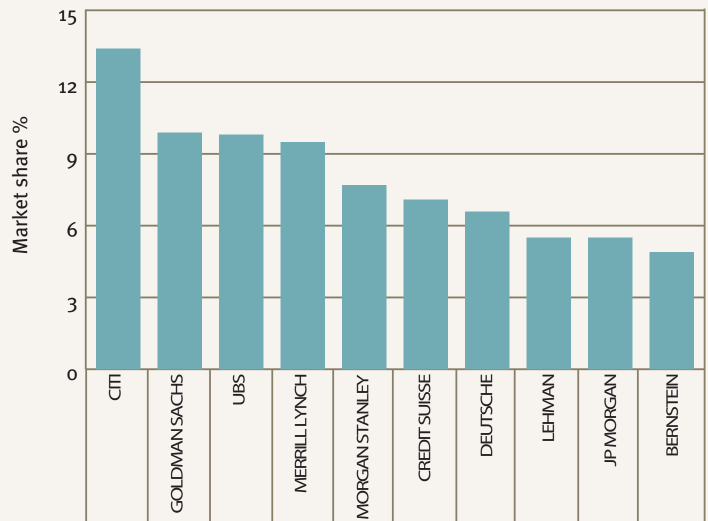
Leading brokers – Q3 2008

Q3 2008 LEADING US BROKERS – TOP 10 RANKED BY COMMISSION



Rank Q3 2008	1	2	3	4	5	6	7	8	9	10
Rank Q2 2008	1	2	4	7	5	3	9	6	–	8

Q3 2008 LEADING US BROKERS – TOP 10 RANKED BY VALUE TRADED



Rank Q3 2008	1	2	3	4	5	6	7	8	9	10
Rank Q2 2008	1	2	3	5	7	6	8	4	9	10

however, is that its position in the US market remains extremely strong. The firm has dominated the rankings for both commissions and value traded for two quarters running, and has a very strong market share.

Goldman Sachs and UBS stayed in the top three by value traded in the US, while Merrill Lynch and UBS did well in terms of commissions. Bernstein's two place jump to seventh in the commission ranking is also notable.

Perhaps unsurprisingly, the performance of Lehman, which still existed for part of Q3, declined sharply. Obviously clients, and perhaps the firm itself, decided to exercise caution in the run-up to the bankruptcy on 15 September.

LEADING BROKERS – DEFINITIONS

Market share 'by value traded' is calculated based on the level of trading completed across all global equity markets. The share 'by commission' reflects the combination of both the value traded and the average commission rates charged. It is reasonable to assume that where market share by commission exceeds market share by value, above-average levels of commission are generally being charged.

Trading momentum – Q3 2008

Three times as tough

The overall GSCS Momentum Index saw a slight decline in Q3, down to 32.8 from 34.9 in Q2. This suggests that portfolio managers managed to reduce the number of times they asked traders to sell into rapidly declining markets as assets were liquidated. The sell index declined to 37.1 in Q3 from a record 49.8 in Q2. It is not time to celebrate, however, as this value is still higher than any reached before 2008.

More interesting from a trading perspective is the GSCS Degree of Difficulty Index, which looks at the overall market volatility in which traders are asked to execute. Greater volatility offers traders an opportunity to make a meaningful difference to the alpha of the funds involved.

MOMENTUM TABLE

ALL	*Q3 2008*	*Q2 2008*	*Q1 2008*	*Q4 2007*	*Q3 2007*	*Q2 2007*	*Q1 2007*	*Q4 2006*	*Q3 2006*
Very Unfavourable	23.4	16.8	21.9	17.1	13.9	7.7	8.5	8.5	9.7
Quite Unfavourable	11.7	12.9	12.4	12.7	12.7	11.6	12.1	12.1	12.0
Somewhat Unfavourable	15.2	18.9	15.7	19.1	19.8	25.2	25.9	25.5	25.8
Neutral	12.5	18.1	12.8	17.4	18.9	23.1	21.9	23.7	20.9
Somewhat Favourable	12.7	15.2	13.6	15.7	16.5	20.4	19.1	19.0	19.5
Quite Favourable	10.2	9.2	9.0	8.4	9.1	7.6	7.4	6.6	7.3
Very Favourable	14.2	8.9	14.6	9.5	9.1	4.5	5.1	4.6	4.7
GSCS Momentum Index	32.8	34.9	30.9	34.7	25.0	22.4	26.4	29.1	30.6

> "It seems buy-side traders earned their salaries in Q3."

However, it also introduces higher levels of complexity into the trading process.

At Q1 2007 the Degree of Difficulty Index stood at 94.4 and in Q2 of that year it had declined even further. But by Q3 2008 it had risen to 261.1 implying that trading was nearly three times as difficult as a year earlier. Given that volumes were also higher due to smaller average trade size, it seems buy-side traders earned their salaries in Q3.

MOMENTUM TABLE DEFINITION

To compile the 'Momentum table' GSCS considered price changes in each security being traded on the date the trade was completed and compared closing and opening prices. To the extent that the difference was less than + or – 0.33%, the market was considered neutral in terms of its impact on trading. A movement of between 0.33 and 1.33% was considered somewhat favourable (if the manager was buying a stock whose price fell by an amount in that range) or somewhat unfavourable (if the manager was buying a stock whose price rose). A daily movement in the range of 1.33% to 2.33% was considered quite favourable or unfavourable, while if the movement was greater than 2.33% then the momentum was considered as very favourable or unfavourable.

The chart shows the results in terms of the value of trades falling into each category.