

Trading costs place PMs on alert

Global equity markets continued to be volatile in the latest period. More defensive asset allocation and limited new money meant that equity business tended towards a net sell position, which, though not unique, remains relatively unusual for most traditional asset managers. Based on the Momentum Index for sells (see page 152), the timing of trading was generally less favourable than in some periods. The result was that the cost of delay on trades was typically between 20 bps and 50 bps

Portfolio managers would be well advised to monitor the cost of trading in major markets closely as costs climb to over 100 basis points on average.

across the major European markets, with similar levels also recorded in North America and most of Asia. A slight widening of spreads was also apparent, no doubt due to the higher market volatility. This was reflected in bid-ask spreads and also

the market impact costs of trading.

It is interesting to note that average agency commissions declined marginally during the period, while zero commission trading was consistent with earlier periods, typically ranging from 5% to 10%

“At the high end in terms of costs were the UK (166 bps) and Hong Kong (190 bps).”

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.

Country analysis – Q2 2008

of total activity. The small gains from lower commissions were not enough to offset the higher costs of trading. The effect was that in most major markets a switch out of one stock and into another typically cost around 100 bps or more. Within the major markets of Europe and Asia, the lowest switching costs were seen in Australia (50 bps) and Spain (62 bps). At the high end in terms of costs were the UK (166 bps) and Hong Kong (190 bps). At these levels portfolio managers need to consider their investment decisions carefully to ensure that they fully take account of these and other costs (for example tax and clearing and settlement costs).

In terms of emerging markets, the position was also very volatile. In Brazil, for example, cost of delay averaged more than 100 bps. However, in central European markets such as Hungary and Poland, overall trading costs were very low due to much more favourable costs of delay. As in major markets, commissions in these countries continued to decline by a small but perceptible amount. ■

COUNTRY ANALYSIS

| | Market impact (bp) | Cost of delay (bp) | Implementation shortfall (bp) | Average agency commission (bp) | % zero commission (%) |
|-----------------------|-----------------------|-----------------------|----------------------------------|-----------------------------------|--------------------------|
| <i>Europe – major</i> | | | | | |
| Finland | 27 | 22 | 48 | 11 | 5.2 |
| France | 13 | 21 | 34 | 9 | 22.9 |
| Germany | 12 | 23 | 35 | 11 | 8.5 |
| Italy | 13 | 34 | 47 | 9 | 8.2 |
| Netherlands | 10 | 32 | 41 | 10 | 4.8 |
| Norway | 10 | 39 | 50 | 13 | 4.7 |
| Spain | 13 | 8 | 21 | 11 | 2.0 |
| Sweden | 23 | 42 | 65 | 14 | 10.5 |
| Switzerland | 25 | 32 | 57 | 13 | 5.1 |
| UK | 21 | 52 | 73 | 10 | 6.9 |
| <i>North America</i> | | | | | |
| Canada | 22 | 13 | 35 | 14 (2.9 c/s) | 8.5 |
| US | 20 | 35 | 55 | 9 (2.8 c/s) | 9.4 |
| <i>Asia – major</i> | | | | | |
| Australia | 22 | -17 | 5 | 20 | 1.6 |
| Hong Kong | 34 | 45 | 79 | 16 | 1.3 |
| Japan | 20 | 10 | 31 | 10 | 3.6 |
| Korea | 48 | 1 | 49 | 20 | 1.1 |
| Singapore | 16 | 26 | 42 | 20 | 2.2 |
| Taiwan | 40 | -5 | 34 | 24 | 0.3 |
| <i>Other – select</i> | | | | | |
| Brazil | 16 | 109 | 125 | 16 | 7.9 |
| Greece | 32 | 68 | 100 | 17 | 4.5 |
| Hungary | 0 | 3 | 3 | 28 | 0.0 |
| Ireland | 51 | 2 | 52 | 14 | 18.0 |
| Malaysia | 23 | 53 | 76 | 26 | 2.3 |
| Mexico | 15 | 44 | 58 | 13 | 7.3 |
| Poland | 20 | -25 | -5 | 26 | 6.7 |
| Portugal | 13 | 11 | 23 | 13 | 6.0 |
| South Africa | 8 | 31 | 40 | 17 | 0.8 |
| Thailand | 11 | 5 | 16 | 36 | 3.2 |

Leading stocks – Q2 2008

Profit-taking sets the trend

With markets being both volatile on a daily basis and flat-to-down in terms of trend, the opportunities for solid, easy-to-spot, winning investment ideas were even thinner on the ground than usual in the latest period. Among the most widely traded stocks in each country there was generally a fairly even balance of buys and sells, proving once again that ‘one man’s meat is another man’s poison’. There were, however, a few securities that stood out in terms of trading. TSMC in Taiwan saw buyers outnumber sellers six to one. This may reflect a take up by institutional shareholders of the shares sold by Philips. As a purchase in the short term it has not performed particularly well in either absolute or relative terms, but for long-term holders this may be less of an issue.

Two shares that were fairly widely sold during the period were Hennes & Mauritz (H&M) in Sweden and BSCH in Spain. In each case, sellers were five times as active as buyers. H&M recorded its highest share price at the start of the period and has since fallen by as much as 28%, though in

LEADING STOCKS

| | Market impact (bp) | Cost of delay (bp) | IS* (bp) | Buy (%) | Sell (%) | Leading brokers |
|-----------------------|--------------------|--------------------|----------|---------|----------|----------------------------------|
| <i>US</i> | | | | | | |
| Exxon Mobil | 3 | -22 | -19 | 28.1 | 71.9 | Citi/Bernstein/Credit Suisse |
| Bank of America | 13 | 43 | 56 | 25.1 | 74.9 | Goldman/Morgan Stanley/WM Blair |
| General Electric | 2 | 9 | 11 | 23.9 | 76.1 | UBS/Lehman/Citi |
| <i>Canada</i> | | | | | | |
| Barrick Gold | 41 | -6 | 35 | 34.3 | 65.7 | UBS/MLynch/Goldman |
| Canadian Natl Railway | 22 | -21 | 1 | 27.3 | 72.7 | UBS/Nesbitt/MLynch |
| Goldcorp Inc | 45 | 13 | 58 | 37.9 | 62.1 | CIBC/UBS/MLynch |
| <i>Finland</i> | | | | | | |
| Nokia | 9 | -8 | 2 | 41 | 59 | Citi/Credit Suisse/UBS |
| Outokumpu | 17 | 102 | 118 | 51.2 | 48.8 | UBS/Citi/Morgan Stanley |
| Fortum | 4 | 107 | 111 | 71.1 | 28.9 | Lehman/UBS/Citi |
| <i>France</i> | | | | | | |
| Total | 22 | 5 | 27 | 45.4 | 54.6 | MLynch/Deutsche/Lehman |
| France Telecom | 5 | 24 | 29 | 54.3 | 45.7 | CA Cheuvreux/MLynch/Deutsche |
| Groupe Suez | 18 | -12 | 6 | 34.6 | 65.4 | MLynch/UBS/Exane BNP |
| <i>Germany</i> | | | | | | |
| Siemens | 18 | 32 | 50 | 32.6 | 67.4 | UBS/Deutsche/Morgan Stanley |
| E.On | 25 | 10 | 35 | 31.1 | 68.9 | UBS/Lehman/MLynch |
| Allianz | 8 | 12 | 20 | 57.7 | 42.3 | Morgan Stanley/JPMorgan/Deutsche |
| <i>Italy</i> | | | | | | |
| Unicredito Italiano | 2 | 49 | 51 | 50.3 | 49.7 | UBS/Citi/HSBC |
| ENI | 10 | 5 | 16 | 33.1 | 66.9 | Citi/Lehman/MLynch |
| Fiat | 16 | 52 | 67 | 55 | 45 | Morgan Stanley/UBS/MLynch |
| <i>Netherlands</i> | | | | | | |
| Royal Dutch | 19 | 59 | 78 | 66.9 | 33.1 | MLynch/Lehman/Credit Suisse |
| ING Groep | 14 | 42 | 57 | 39.6 | 60.4 | Exane BNP/CA Cheuvreux/JPMorgan |
| KPN | 8 | 8 | 15 | 59.9 | 40.1 | HSBC/Lehman/MLynch |
| <i>Norway</i> | | | | | | |
| Statoil | 13 | 48 | 61 | 35.6 | 64.4 | UBS/Carnegie/Credit Suisse |
| Yara | 12 | 52 | 64 | 47.7 | 52.3 | Credit Suisse/UBS/Carnegie |
| DNB Nor | 34 | 28 | 62 | 65.6 | 34.4 | JPMorgan/Carnegie/ABG |
| <i>Spain</i> | | | | | | |
| Telefonica Sa | 1 | 19 | 20 | 45.6 | 54.4 | UBS/MLynch/Citi |
| BSCH | 1 | 13 | 14 | 19.8 | 80.2 | UBS/Citi/Credit Suisse |
| BBVA | 10 | 0 | 10 | 30.3 | 69.7 | UBS/Citi/Credit Suisse |

*IS = Implementation shortfall

Leading stocks – Q2 2008

LEADING STOCKS

| | Market impact (bp) | Cost of delay (bp) | IS* (bp) | Buy (%) | Sell (%) | Leading brokers |
|------------------------|--------------------|--------------------|----------|---------|----------|---------------------------------------|
| Sweden | | | | | | |
| LM Ericsson | 18 | 123 | 141 | 57 | 43 | Credit Suisse/UBS/CA Cheuvreux |
| Hennes & Mauritz | 18 | 69 | 88 | 18.7 | 81.3 | MLynch/Deutsche/Carnegie |
| Electrolux | 43 | 64 | 107 | 48.4 | 51.6 | Carnegie/Morgan Stanley/SG Securities |
| Switzerland | | | | | | |
| UBS | 78 | 60 | 137 | 69.6 | 30.4 | UBS/Credit Suisse/Goldman |
| Roche | 5 | 3 | 8 | 61.6 | 38.4 | UBS/Morgan Stanley/Citi |
| Novartis | 12 | 54 | 66 | 66.2 | 33.8 | UBS/Citi/Credit Suisse |
| UK | | | | | | |
| Royal Bank of Scotland | 20 | -10 | 10 | 77.7 | 22.3 | MLynch/UBS/ABN Amro |
| BG Group | 17 | 29 | 46 | 46.1 | 53.9 | UBS/MLynch/Deutsche |
| BP | 5 | -8 | -3 | 49.7 | 50.3 | Deutsche/UBS/MLynch |
| Australia | | | | | | |
| BHP Billiton | 9 | -9 | 0 | 63.5 | 36.5 | Macquarie/JPMorgan/MLynch |
| Rio Tinto | 4 | 32 | 36 | 68.9 | 31.1 | Macquarie/UBS/Deutsche |
| Incitec | 11 | -18 | -7 | 55.6 | 44.4 | Goldman/UBS/MLynch |
| Hong Kong | | | | | | |
| China Mobile | 34 | 47 | 81 | 37.2 | 62.8 | JPMorgan/Goldman/Lehman |
| CNOOC | 46 | 16 | 62 | 62.5 | 37.5 | Lehman/China Intl Cap/Deutsche |
| China Life | 79 | 9 | 89 | 41.9 | 58.1 | JPMorgan/CLSA/Credit Suisse |
| Japan | | | | | | |
| Mitsubishi UJF | 10 | -36 | -27 | 48.3 | 51.7 | NOMURAMLynch/CLSA |
| Mizuho | 16 | 19 | 35 | 44.6 | 55.4 | MLynch/Nomura/Citi |
| Japan Tobacco | 36 | 50 | 87 | 46.8 | 53.2 | Nomura/Deutsche/Credit Suisse |
| Singapore | | | | | | |
| Keppel | 5 | 91 | 96 | 61.7 | 38.3 | Goldman/UBS/Macquarie |
| DBS Group | 17 | 4 | 21 | 86.2 | 13.8 | Deutsche/JPMorgan/MLynch |
| Capitaland | 1 | 17 | 18 | 44.6 | 55.4 | Deutsche/MLynch/Lehman |
| South Korea | | | | | | |
| Samsung | 19 | 1 | 20 | 65.4 | 34.6 | Deutsche/Exane BNP/JPMorgan |
| LG Electronics | 93 | 6 | 99 | 45.7 | 54.3 | Citi/JPMorgan/UBS |
| Posco | 39 | 3 | 42 | 63.5 | 36.5 | Deutsche/Exane BNP/CLSA |
| Taiwan | | | | | | |
| TSMC | 13 | -8 | 4 | 85.4 | 14.6 | Goldman/CLSA/UBS |
| Hon Hai | 22 | -19 | 3 | 77 | 23 | Exane BNP/Deutsche/CLSA |
| High Tech Computer | 20 | -8 | 12 | 36.8 | 63.2 | Exane BNP/CLSA/Goldman |

*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.

“Two shares that were fairly widely sold during the period were H&M in Sweden and BSCH in Spain.”

recent weeks it has moved back up. Nonetheless, there were certainly profit opportunities from the move down. A similar opportunity was evident in BSCH, with a peak-to-trough decline of around 25% during the period in which the trading took place. Hopefully, investors were the prescient beneficiaries of the price movements. ■

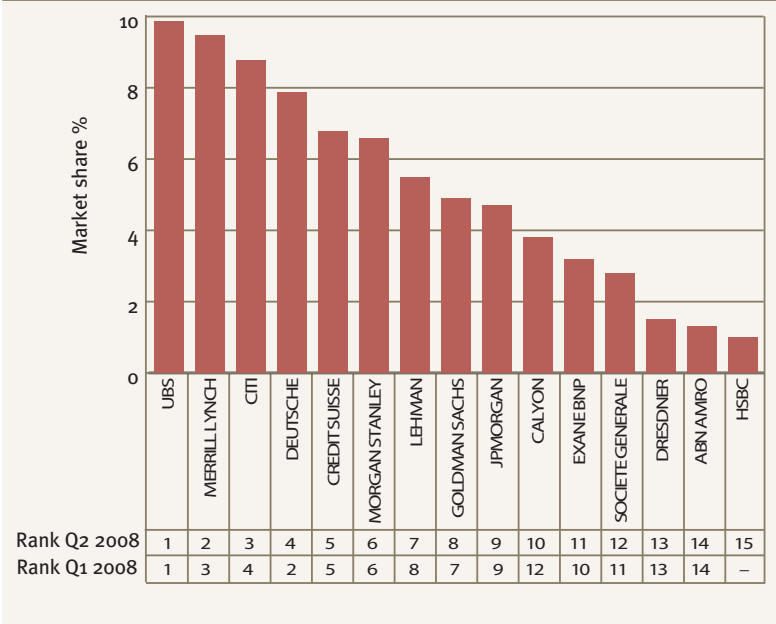
Leading brokers – Q2 2008

Equity business offers respite

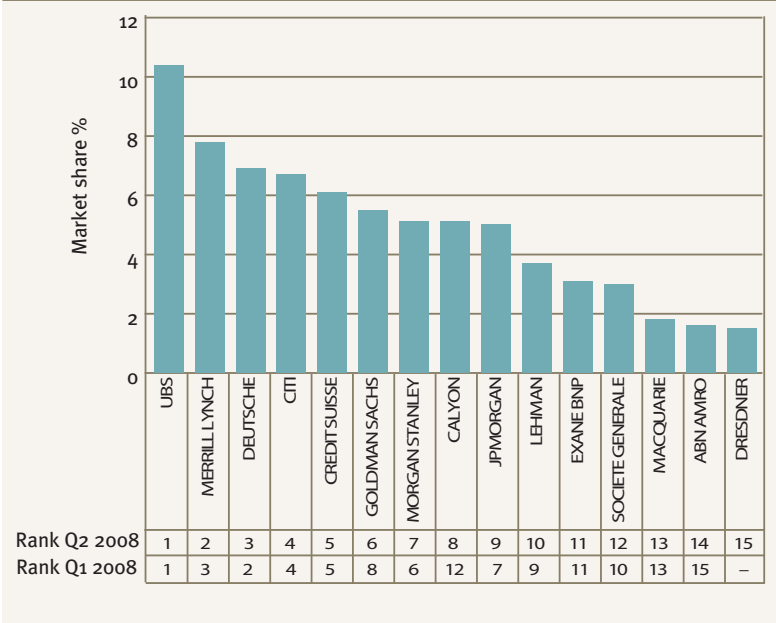
The overall business profitability of investment banks has been under considerable pressure for over a year now as a result of the general downturn in almost all securities markets. Equity trading has not been immune from these trends but, compared with many investment bank activities, has remained relatively robust and free from major problems. In such an environment, the leading brokers will no doubt be keen to maintain and, where possible, expand their market share.

The good news for the major banks that have been hit hard by credit-related losses is that this does not yet appear to have had a material impact on their ability to maintain their position in equity trading. On a global basis, UBS continued to be the largest broker, with a market share of 9.9% of commissions and 10.4% of value traded. Merrill Lynch improved its position in both categories from third to second and Citi also improved in terms of commissions, moving up to third. Among the remainder of the global top

Q2 2008 LEADING GLOBAL BROKERS – TOP 15 RANKED BY COMMISSION

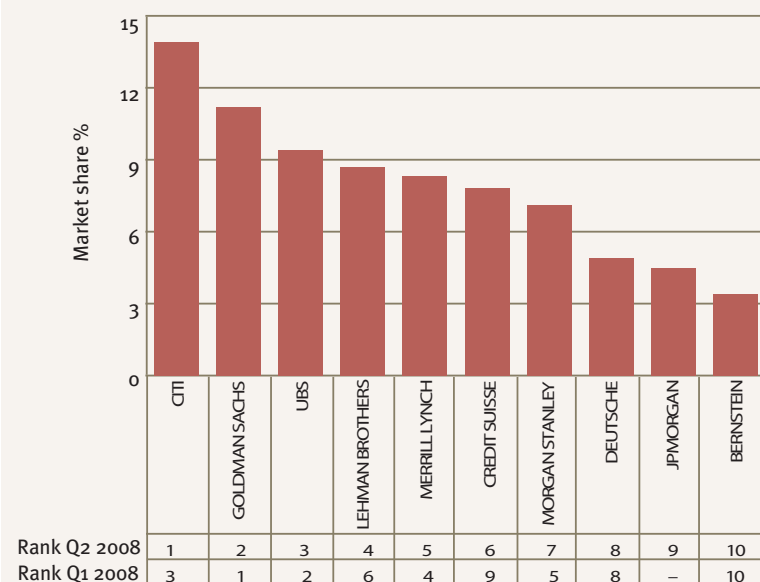


Q2 2008 LEADING GLOBAL BROKERS – TOP 15 RANKED BY VALUE TRADED



Leading brokers – Q2 2008

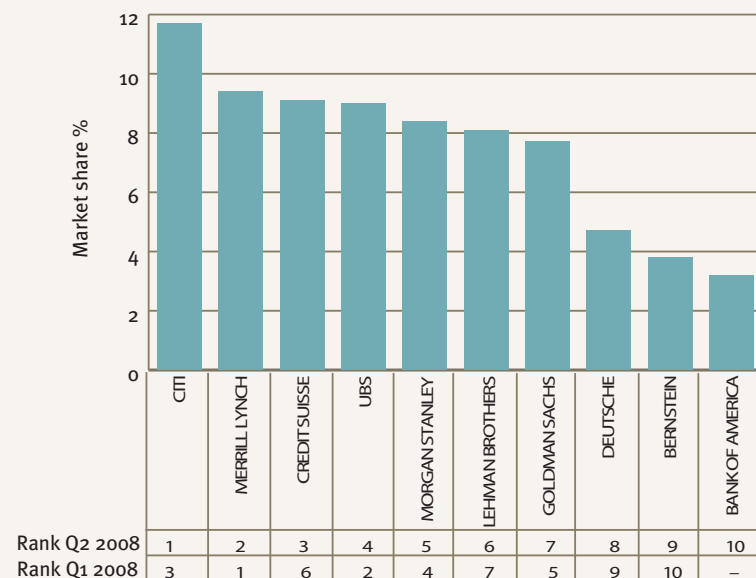
Q2 2008 LEADING US BROKERS – TOP 10 RANKED BY COMMISSION



10 the positions fluctuated slightly, as did market shares, but the overall standings were largely unchanged. It is perhaps interesting to note the ongoing emergence of BNP Paribas, which moved into the top 10 for both commissions and value traded. The performance of Calyon, entering the top 15 list in both categories is also noteworthy.

In the US market, UBS and Merrill Lynch both fell in the rankings, but maintained their position in the top four. By contrast, Citi moved up strongly to top both lists with a share of 13.9% of commissions and 11.7% of value traded. ■

Q2 2008 LEADING US BROKERS – TOP 10 RANKED BY VALUE TRADED



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 – Q2 2008

Trading gets tricky

The Momentum Index offers an important insight into the degree of difficulty associated with trading generally. The Momentum Index for sells once again was significantly higher than for buys. This suggests that portfolio managers may have had to realise cash more quickly than expected or simply reacted to volatile market movements in a somewhat costly way. The index for sells was 49.8, the highest ever recorded and well up on the 42.2 recorded in the previous quarter. Managers did better as far as buy trades were concerned, with the Momentum Index for buys averaging 18.6. Though slightly higher than in the previous period, this was

MOMENTUM TABLE

| ALL | Q2 2008 | Q1 2008 | Q4 2007 | Q3 2007 | Q2 2007 | Q1 2007 | Q4 2006 | Q3 2006 | Q2 2006 |
|-----------------------|------------|------------|------------|------------|------------|------------|------------|------------|------------|
| Very unfavourable | 16.8 | 21.9 | 17.1 | 13.9 | 7.7 | 8.5 | 8.5 | 9.7 | 13.2 |
| Quite unfavourable | 12.9 | 12.4 | 12.7 | 12.7 | 11.6 | 12.1 | 12.1 | 12.0 | 12.2 |
| Somewhat unfavourable | 18.9 | 15.7 | 19.1 | 19.8 | 25.2 | 25.9 | 25.5 | 25.8 | 21.2 |
| Neutral | 18.1 | 12.8 | 17.4 | 18.9 | 23.1 | 21.9 | 23.7 | 20.9 | 18.9 |
| Somewhat favourable | 15.2 | 13.6 | 15.7 | 16.5 | 20.4 | 19.1 | 19.0 | 19.5 | 17.4 |
| Quite favourable | 9.2 | 9.0 | 8.4 | 9.1 | 7.6 | 7.4 | 6.6 | 7.3 | 8.9 |
| Very favourable | 8.9 | 14.6 | 9.5 | 9.1 | 4.5 | 5.1 | 4.6 | 4.7 | 8.2 |
| GSCS Momentum Index | 34.9 | 30.9 | 34.7 | 25.0 | 22.4 | 26.4 | 29.1 | 30.6 | 25.6 |

“The Momentum Index was 34.9 – the highest level recorded in more than two years.”

still well below typical levels seen in 2007.

Overall the Momentum Index was 34.9 – the highest level recorded in more

than two years. This is perhaps the best measure of the challenge facing buy-side traders in the current environment. ■

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.