

# Trading Myths and Realities: New Opportunities For Trustees to Save Money

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# Why Listen? It is Your Plan's Money

*“Everybody Likes More Cash”* Jimmy Fallon



# Saving Money is for Everyone

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*“Well, Almost Everybody”*



# Trading Has Dramatically Changed

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- ***Three Goals to This Presentation***
  - ✓ Educate on Emerging Opportunities for Trustees
  - ✓ Dispel Widely Held, But Now Obsolete, Myths About Trading
  - ✓ What You Can Do to Create Savings for Your Plan

# Saving the Plan Money in Equity Trading

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# What Happened to Performance Since 2000?

- *S& P 500 Compound Average Growth Rates (CAGR) by Decade*

✓ 1950's	19.61%
✓ 1960's	7.78%
✓ 1970's	5.80%
✓ 1980's	17.68%
✓ 1990's	18.30%
✓ <b>2000-2011</b>	<b>0.50%</b>

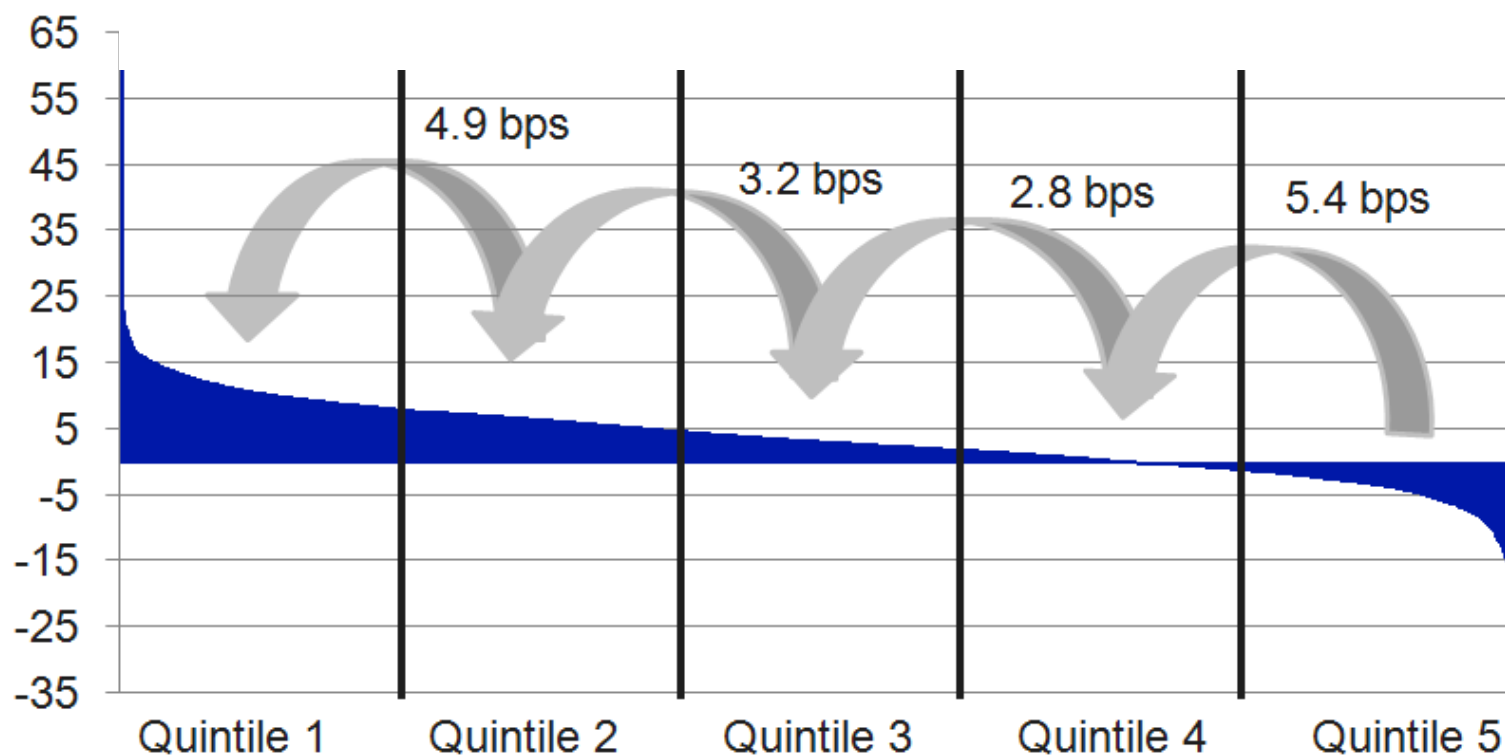
Cash Starvation of  
Equity Returns



# Low Return Environment: BPs to Jump a Quintile?

## Performance vs. S&P 500 Benchmark

Basis Points to Move from Mid Point of a Quintile to Bottom of Next Quintile

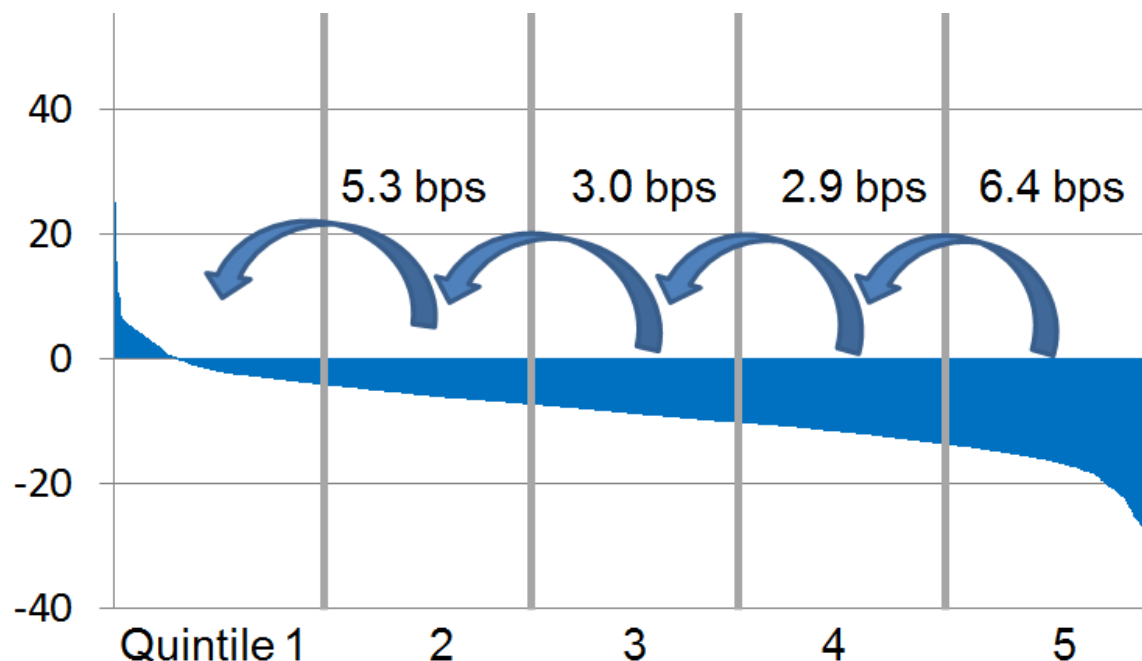


<sup>1</sup> One Year Total Return Analysis, assumes dividends reinvested back into the security 7/16/11 – 7/16/12  
Source: Analysis of 6,087 funds by Bloomberg Tradebook Analytics using **FSRC<GO>**; April 12, 2012.

# Now: “Rounding Error” Matters!!!

## Performance vs. Russell 3000 Benchmark

Basis Points to Move from Mid Point of a Quintile to Bottom of Next Quintile



<sup>1</sup> One Year Total Return Analysis, assumes dividends reinvested back into the security 7/16/11 – 7/16/12  
iShares IWW equity used as proxy for Russell 3000 index in order to incorporate dividend reinvestment in total return  
Source: Bloomberg, FSRC<Go>: Analysis of 6,032 U.S. Domiciled U.S. Equity Funds



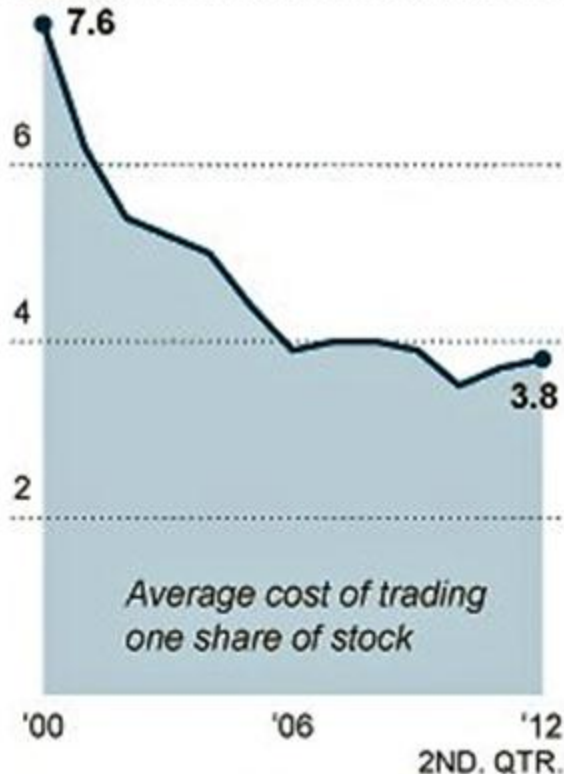
Harness The Power™



# Commissions Drop Dramatically, Then Rise

## STOCK TRADING COST

8 cents



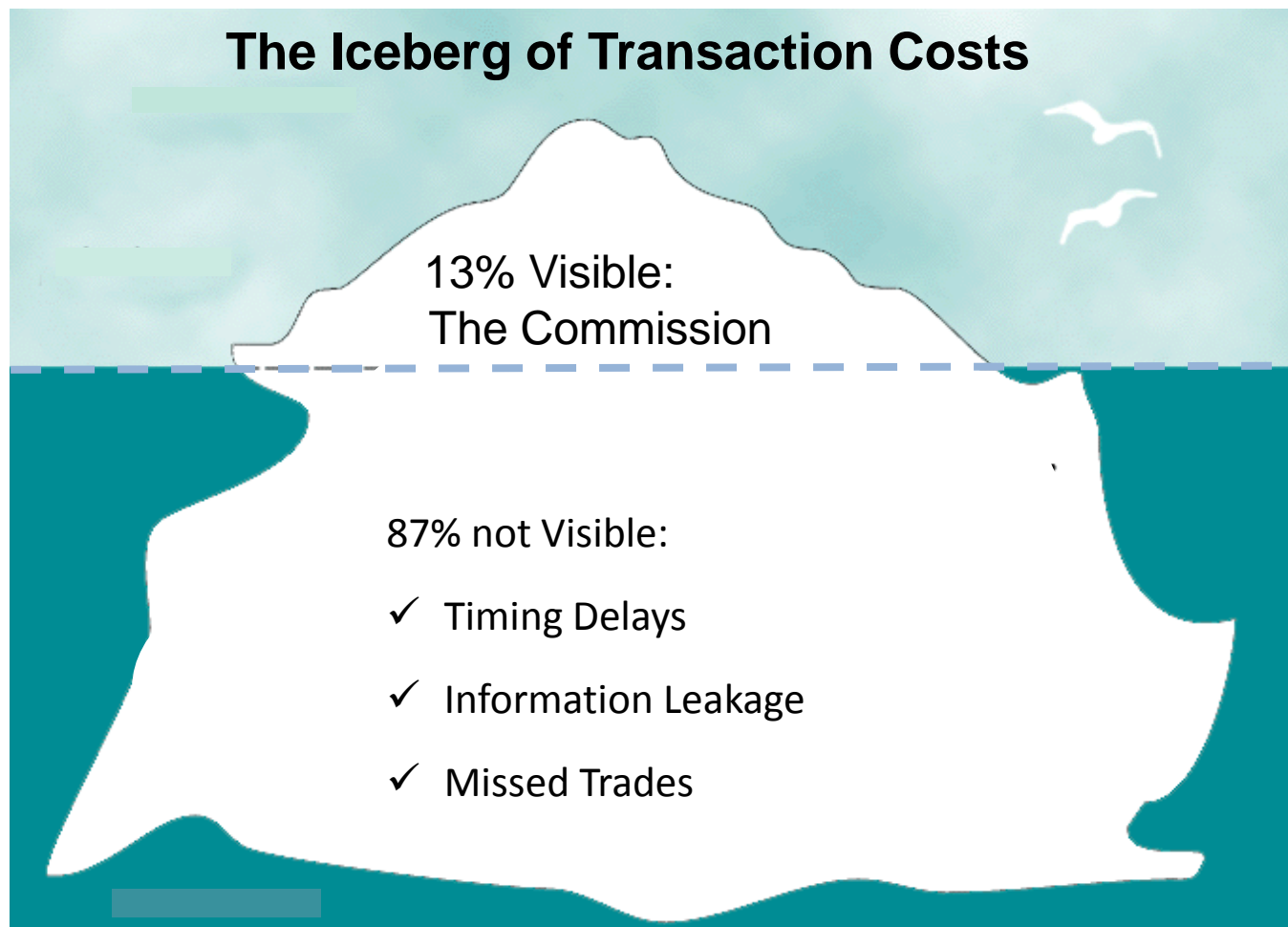
Sources: Financial Information Forum; Abel/Noser

The New York Times

## Lower Brokerage Commissions

- ✓ 1990's 12.50 Cents Per Share
- ✓ 2002 6.25 Cents Per Share
- ✓ 2010 3.5 Cents Per Share
- ✓ 2012 Average 3.8 Cents per Share
- ✓ 2012 Electronic 1.00 Cent Per Share

# What are the Two Components of Trade Cost?



» A Plan can reduce costs and help preserve alpha for trading

# Trading Reality Meets Myth: The Wizard of Oz (1939)

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# Trading: Reality Meets Myth

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- ***Two Worlds of Trading:***
  - ✓ **High Touch:** Traders Add Value - Create Individually Customized Execution Strategy for Each Order Using Multiple Trading Venues
  - ✓ **Low Touch:** No Value Added by Trader - Hit ENTER for Automated, Low Cost, Ultra Fast Electronic Execution
- ***For Externally Managed Platforms: Major Implications***
  - ✓ Let's Look at Three Trading "Myths"
  - ✓ Let's Begin with Some Historical Perspective

# Myth #1: Aggregating Orders Benefits You

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- ***Most Common and Most Dangerous Fallacy: No Longer True!***
  - ✓ **MYTH:** Money Managers Aggregate Trades to Benefit Plans Through Their Buying Power
  - ✓ **FACT:** Large Trades Are Disadvantaged in Terms of Cost and Quality
    - Fragmented Liquidity Makes Large Blocks of Shares Hard to Find
    - More Expensive Execution with Longer Execution Times
- ***REALITY: Your Trades Are Better Off with Low Cost, High Quality Electronic Execution***

# NYSE: Trading Has Dramatically Changed

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1987: 190 Million Shares per Day

NYSE Trading Floor 1987

# NYSE: What Happened?



NYSE Trading Floor 2012



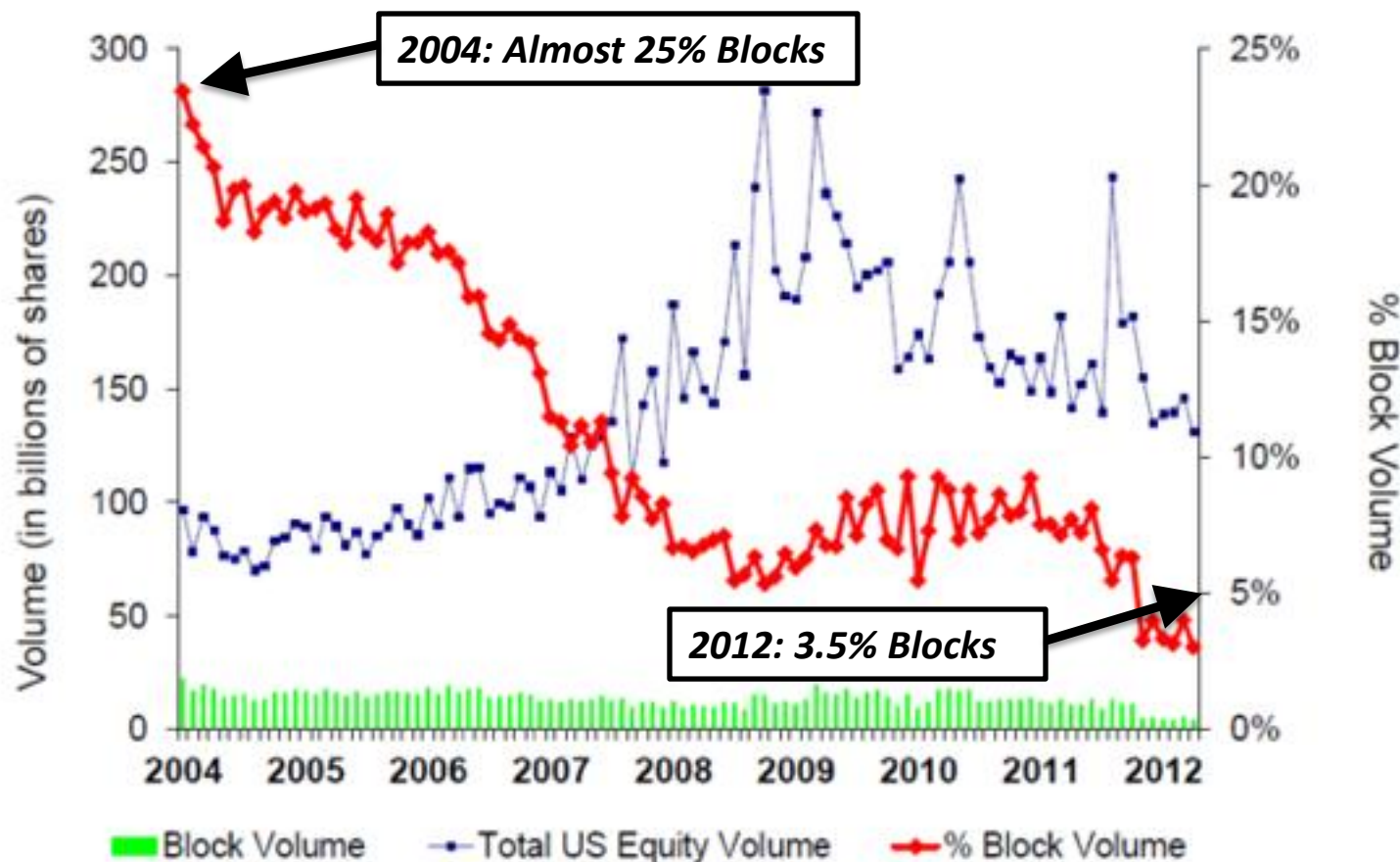
# Trading Evolves From People to Computers

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# Block Trades (>10,000 Shares) Almost Disappear

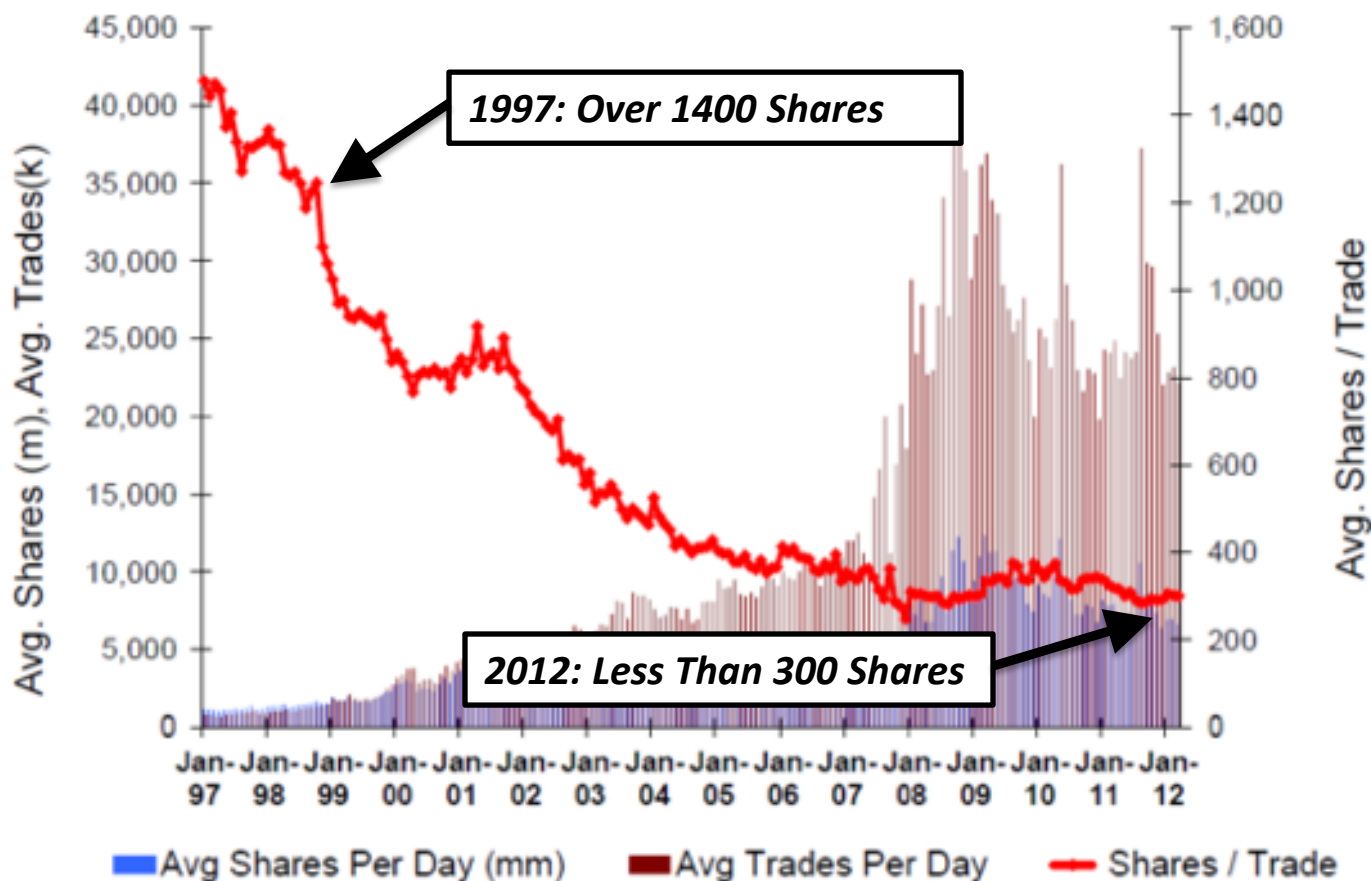
## Block Volume vs. US Total Volume: 2004 – 2012



Source: TABB Group, US Exchanges

# Shares per Trade Drops Dramatically

## US Average Trade Size: Jan 2004 – Apr 2012



Source: TABB Group. US Exchanges

## Myth #2: Relationships with Traders Are Critical

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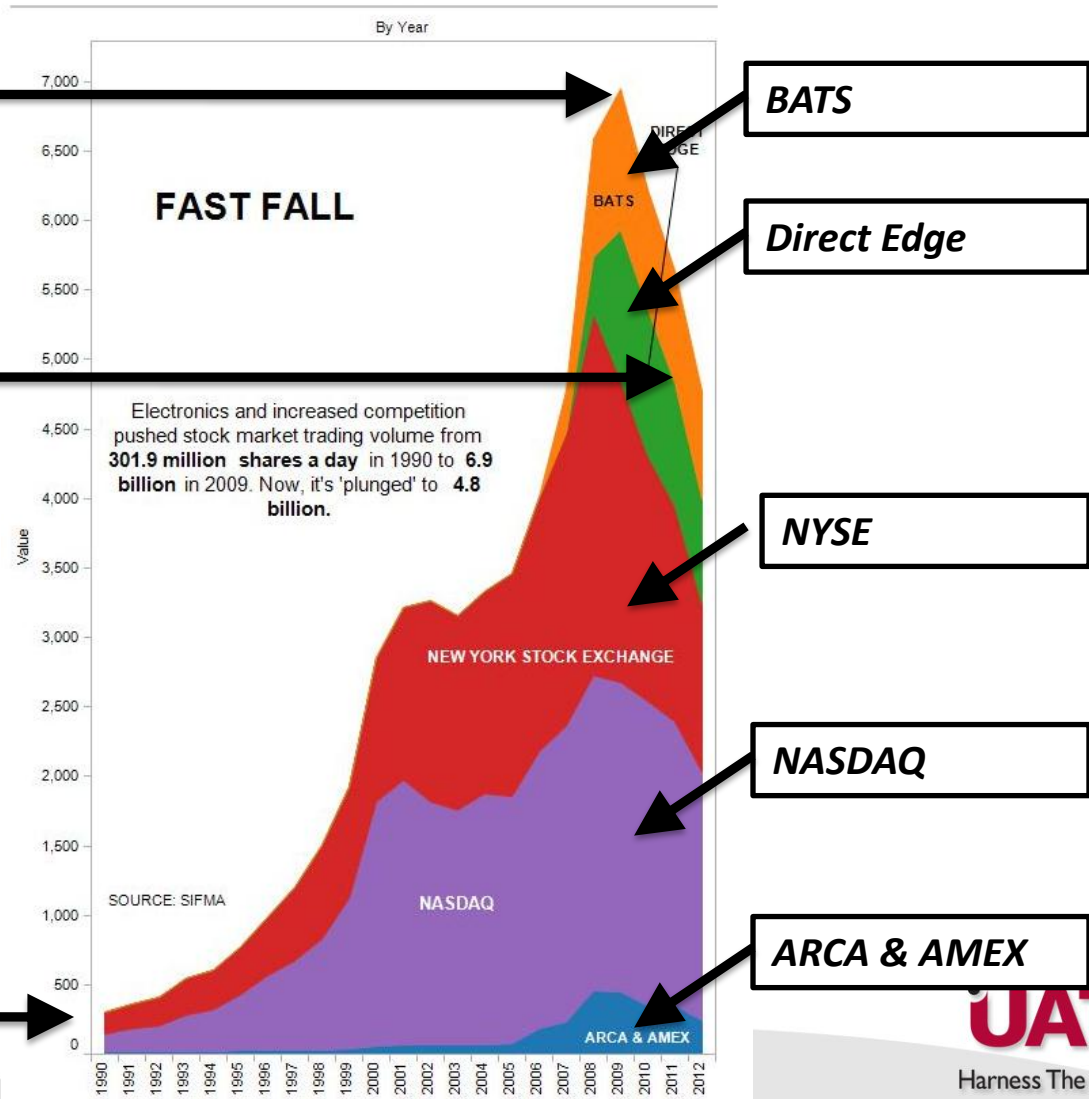
- **MYTH:** Money Manager Relationships with Traders are Critical to Success
- **FACT:** Traders are Far Fewer in Numbers and Much Less Powerful
  - ✓ Power Grew From Their Monopoly on Information
  - ✓ Electronic Systems Make Information Ubiquitous
  - ✓ Reg NMS Prohibits Favoritism on Small Orders
- ***REALITY: Traders' Hands Are Tied By Technology, Market Structure and Regulatory Oversight***

# “Liquidity Fragments” as Total Volume Explodes

2009: 6.9 Billion Shares per Day

2012: 4.8 Billion Shares per Day

1990: 300 Million Shares per Day

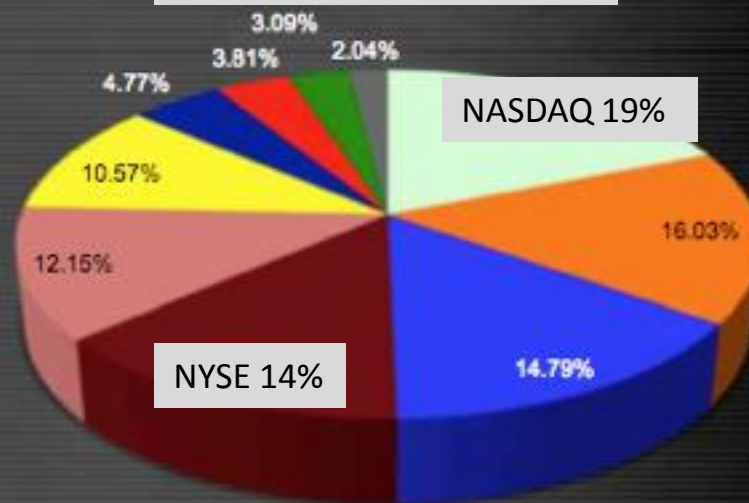
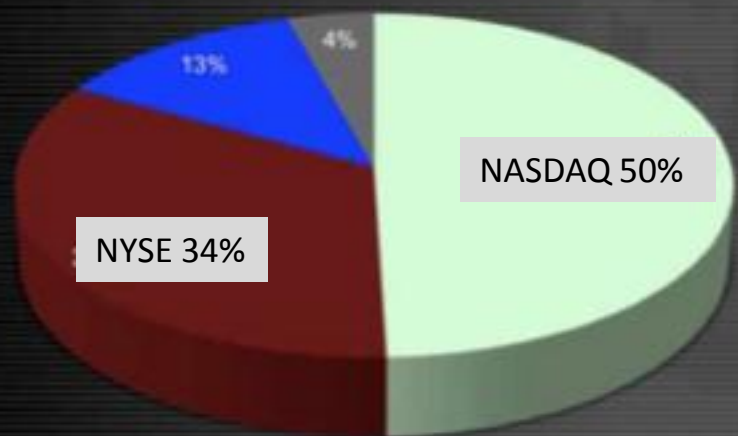


# Liquidity Fragments Quickly: 2006 - 2010

## Fragmentation Has Increased Dramatically in a Short Period of Time

March 2006

August 2010



NYSE & NASDAQ  
COMBINED: 84%

NYSE & NASDAQ  
COMBINED: 33%

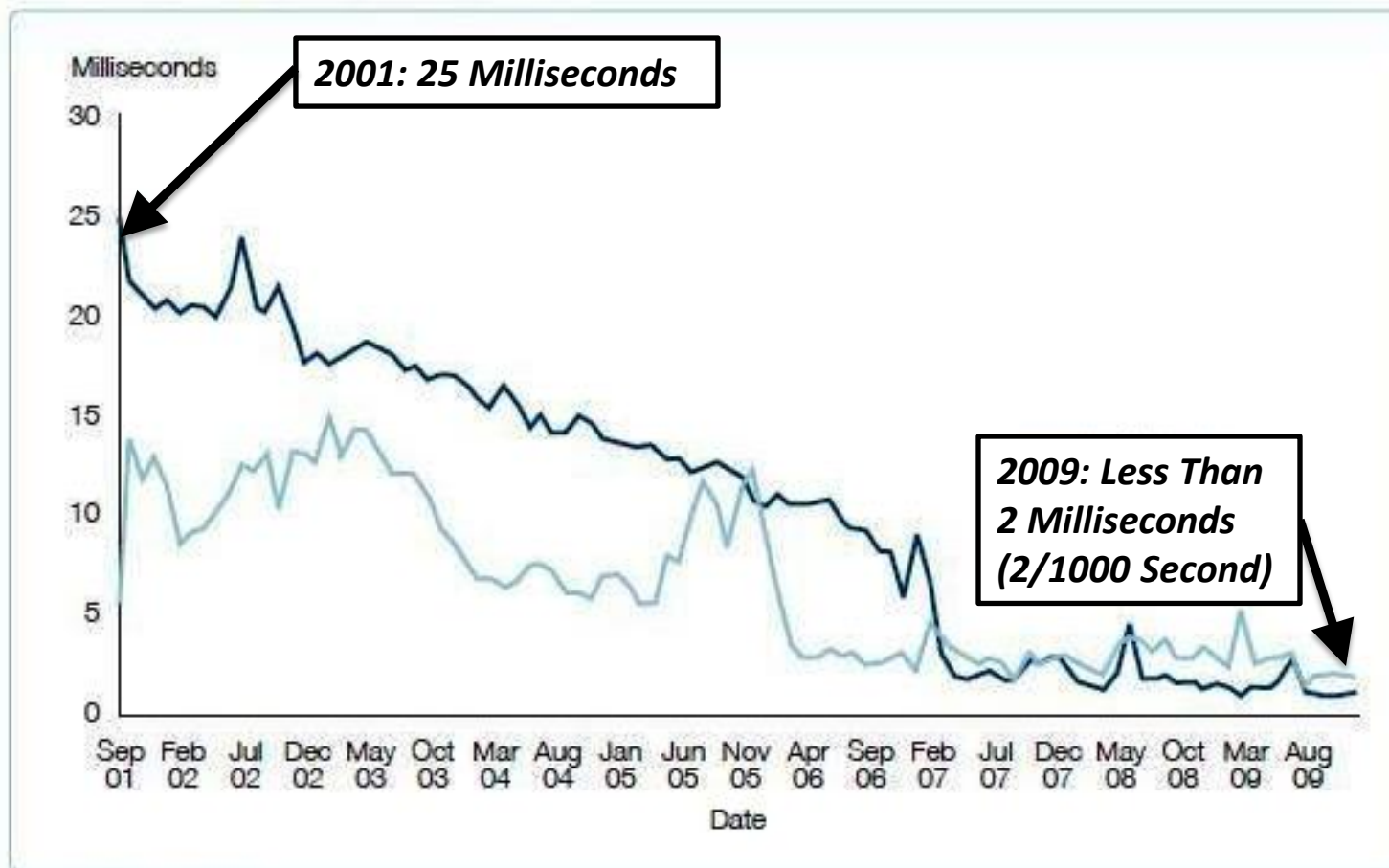
Sources: ArcaVision, Direct Edge, Rosenblatt Securities

■ Nasdaq  
 ■ NYSE Arca  
 ■ Dark Pools  
 ■ EDGX  
 ■ Nasdaq BX  
 ■ Nasdaq/NYSE TRF (Adjusted)  
 ■ Other

Sources: ArcaVision, Direct Edge, Rosenblatt Securities

# Faster Trade Execution Times

## Market Order Execution Speed



Source: NYSE/Nasdaq



Harness The Power™

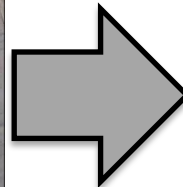
# Today's Electronic Trading: The Big Picture

- *Finding Large Numbers of Shares Is Difficult Across Multiple Venues*

1980's....



2012....



## One Major Exchange (NYSE)

Shares Offered: Thousands  
Spread: 12.5¢/Share  
Commission: 12.5¢/Share

***Very Profitable!***

## Multiple Execution Venues

Shares Offered: 100-500 per Venue  
Spread: 1¢ to 3¢/Share  
Commission: 2.5¢/Share

***Very Competitive!***



# Today: Faster, Smaller and Cheaper

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- ***Today's Trading:***
  - ✓ Faster, Cheaper Trades... Transacted at Lightning Speed... in Smaller and Smaller Share Increments... At Tighter Spreads and Lower Commissions.

***“The U.S. Marketplace Has Evolved Rapidly in the Last Decade.***

***The Advances in Speed Since 1999 Have  
Transformed the Marketplace to the Core.”***

Laurie Berke, Principal, Tabb Group

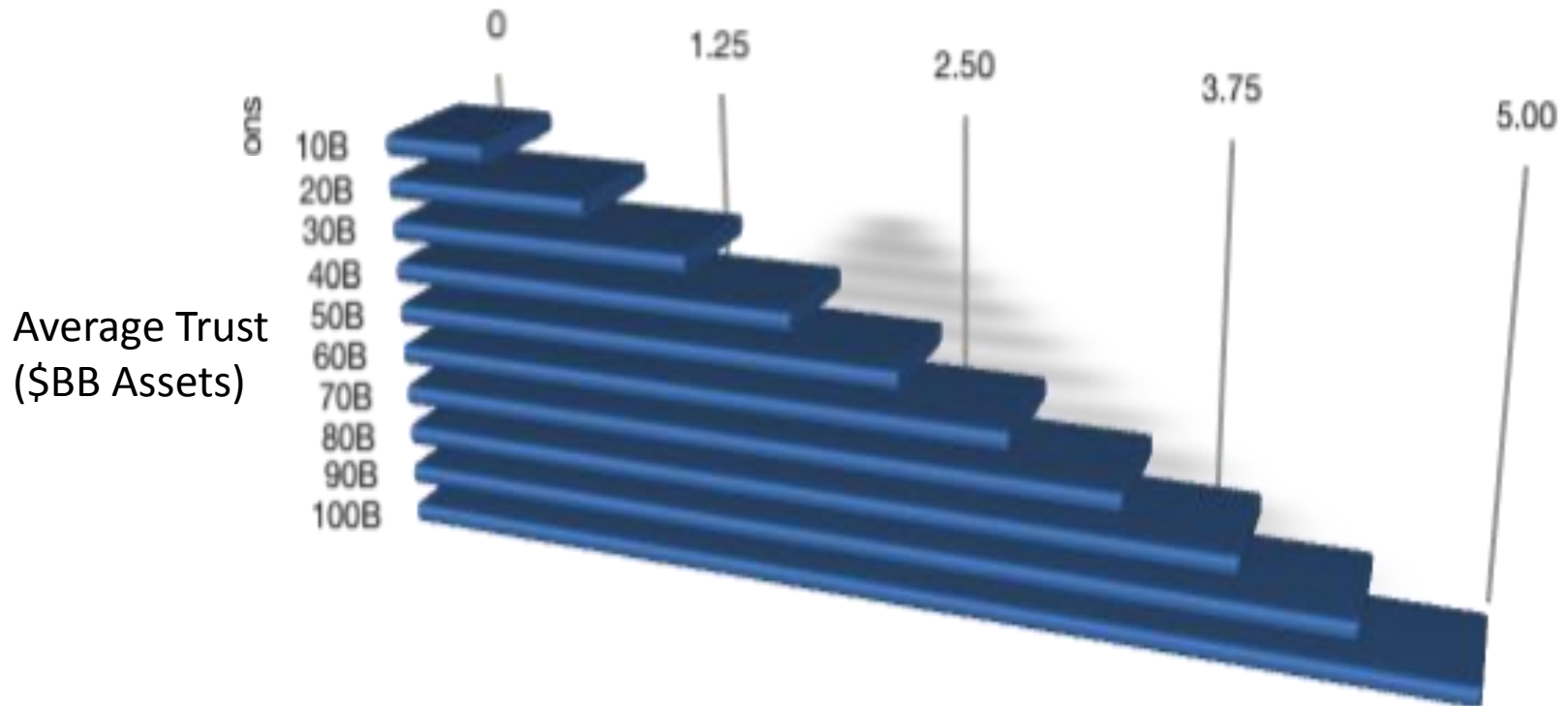


# Myth #3: You Are Powerless to Question Costs

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- **MYTH:** Trading Is Too Complicated and Plans Should Not Question Trading
- **FACT:** Trading Costs and Quality are Your Business
  - ✓ Plans have a Fiduciary Obligation to Lower Expenses
  - ✓ Goal: Minimize Trading Costs and Maximize Execution Quality
- ***REALITY: New and Improved Technology Enables Plans To Benefit from Lower Trading Costs and Higher Execution Quality***

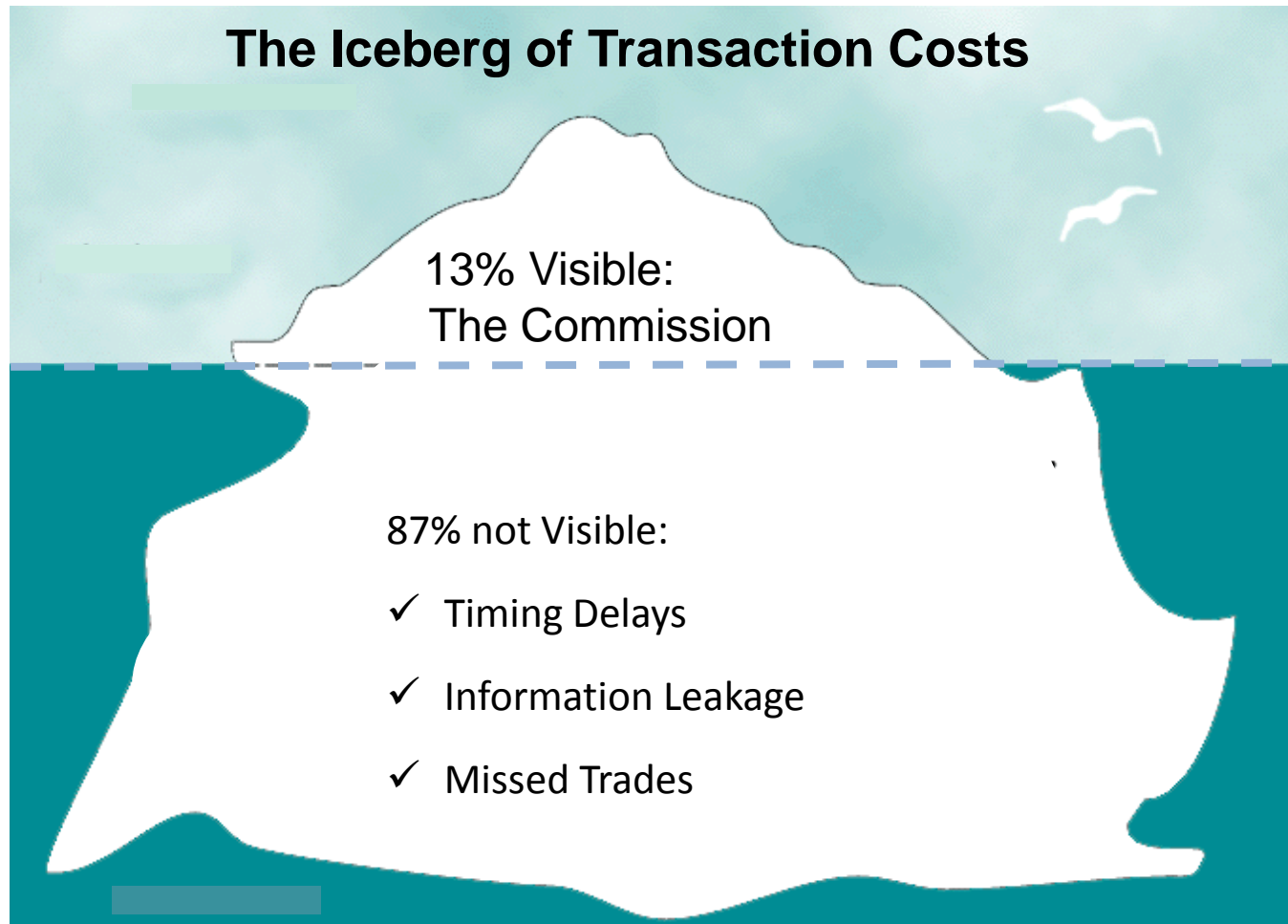
# Amazing Control and Power Opportunity



## ***Rule of Thumb:***

\$10 Billion in Active Equity Trades 500 Million Shares Annually

# What are the Two Components of Trade Cost?



» A Plan can reduce costs and help preserve alpha for trading

# Explicit and Implicit Trading Costs

- **Explicit Costs include Brokerage Commissions**
  - ✓ Commissions Drop From 12.5¢ to as Low as 1.0¢ per Share
- **Implicit Costs Consists of Price Improvement: More Favorable Stock Price**

\$42.02	National Best Offer	_____	0% = Best EX
		↓	
		Execution at MBBO (\$42.01): One Cent Price Improvement	
		↓	
\$42.01	MBBO	_____	100% Price Improvement
		↓	
\$42.00	National Best Ask	_____	0% = Best Ex

# TABB Group White Paper



## **Automated Trading Decisions:**

***Unifying The Goals of Asset Owners and Asset Managers***

***September 2012***

# Conclusion

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- ***Electronic Trading Has Replaced People With Computers***
  - ✓ Faster Trading with Less Expensive, Higher Quality Options
- ***Trading Myths Die Slowly***
  - ✓ Little or no Benefits to Aggregation of Your Plan's Trades and traders need technology
- ***Plans Have Power to Control Trading Cost and Quality***
  - ✓ Technology Enables You to Help your Money Managers Deliver Better Results for Your Plan...Come to Booth to Get a Copy of the Report



# Cost Containment

## Managers

## Custody

## Trading



# Three Step Process

**1. ASSESSMENT**

**2. EVALUATION**

**3. ACTION**