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Understanding European vs US ETP market structure



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European ETPs are less liquid than US

The fact that European exchange-traded products (ETPs) are less liquid than US ETPs is, perhaps, the most frequently cited and noticeable difference between the two markets. Clients used to accessing US listed exchange-traded funds (ETFs) may be accustomed to large, visible exchange volumes, and larger sized quotes shown in order books. They will often notice that there is much less visibly traded volume, and less size on offer when gauging European order books.

While this often results in the perception of a 'less liquid' market, there are a few important things to point out:

- + ETPs are still ETPs and, as such, both US listed and European listed ETPs are at least as liquid as their underlying constituents.
- + At the end of the day, the ETP is an accessible investment wrapper, and may be created and redeemed on a daily basis at the fair value of its underlying constituents.
- + Authorised Participants (typically specialised market making firms, or market making desks of large financial institutions), which are the entities that are able to create and redeem shares directly with the ETF Issuer, are not limited by the volume of the ETP itself but, instead, will gauge the volume and relative liquidity of the underlying constituents which the ETP provides exposure to.
- + Therefore, when gauging products, investors should know that the volume of the ETP itself is typically not a limiting factor to the notional amount of the ETP that may be traded, and trading an amount that may represent a significant proportion of the average daily volume (ADV) of the ETP as a whole, or on any given exchange, does not mean that the price or fair value of the ETP will be impacted.

One concept which may be of particular use to investors trying to understand how liquid ETPs are, is 'implied liquidity'. Implied liquidity is an estimate of the notional amount of an ETP which

may be traded in a single day, before surpassing a threshold which could result in a price impact on the least liquid underlying constituent (typically measured as 25% of the 30 day ADV or turnover at the time). While by no means an exact measurement, the concept of implied liquidity can give investors a good base for understanding the liquidity of an ETP. In addition, Bloomberg users may access a function called ‘ETF implied liquidity’, or ETFL → GO, for ETPs with equity underlyings.

Figure 1: Example of ETFL functionality on Bloomberg

GGRA LN Equity		5) Export to Excel		ETF Implied Liquidity			
WISDOMTREE GLB QLY DIV GRWTH		Min Portfolio Weight		0	Variable Percentage		25
Implied Liquidity		Creation Information					
Implied Liquidity (shares)	12.099M	Creation Unit Size	60000	Open For Creations	Yes		
Implied Liquidity (USD)	410.998M	Creation Fee (USD)	N.A.	Settlement Cycle	T+2		
Liquidity Limiting Holding	SGSN SW	Creation Cutoff Time	16:30 DSI	Create/Redeem Process	In-kind/C...		
Holdings* (6/21/2023)	Ticker	IDTS (shares)↑	Weight (%)	Last (USD)	Volume	30 Day Avg Vol	
1) SGS SA	SGSN SW	12,098,853	.18	93.3586	319,196	32,058	
12) MTR Corp Ltd	66 HK	27,980,392	.32	4.6292	2,970,669	2,655,521	
13) CIE Automotive SA	CIE SM	32,179,336	.03	30.2544	28,267	44,975	
14) BOC Aviation Ltd	2588 HK	39,501,948	.07	7.9877	232,473	455,544	
15) Hang Seng Bank Ltd	11 HK	44,787,221	.28	14.7878	2,188,404	1,145,387	
16) De' Longhi SpA	DLG IM	51,862,658	.04	20.5313	60,246	153,631	
17) Fielmann AG	FIE GR	59,329,802	.06	53.5148	12,634	91,772	
18) Schindler Holding AG	SCHN SW	63,253,423	.10	210.8494	19,708	42,548	
19) Viscofan SA	VIS SM	63,462,329	.03	66.9760	13,201	33,579	
20) Industria de Diseno Textil SA	ITX SM	63,925,917	1.34	37.3573	905,527	3,119,742	
21) Strauss Group Ltd	STRS IT	66,329,025	.02	23.5132	95,696	85,487	
22) Roche Holding AG	RO SW	67,091,142	.23	327.7151	21,045	63,434	
23) Banca Mediolanum SpA	BMED IM	71,084,472	.12	9.0325	693,855	1,307,235	
24) Nordnet AB publ	SAVE SS	81,282,271	.05	13.0921	215,939	383,474	
25) Singapore Technologies Engine	STE SP	81,758,969	.12	2.6870	7,536,100	4,968,033	
26) Henkel AG & Co KGaA	HEN GR	83,996,618	.15	69.2338	22,551	255,756	
27) Gjensidige Forsikring ASA	GJF NO	88,498,923	.09	16.2019	190,142	639,405	

1) Edit Basket *Creation basket estimated from portfolio

Source: Bloomberg, June 2023. Historical performance is not an indication of future performance and any investments may go down in value.

Volumes in Europe are too low

The vast majority of ETPs listed in Europe are likely to have an official listing on more than one exchange venue. However, on top of this, they are also likely to be traded on any number of the 200+ execution venues across Europe. The effect of this is a very fractured market, with a lack of turnover being concentrated in a single venue. Overall volumes, however, are often healthy.

Another market difference, that investors used to trading US listed ETPs may not realise, is that the European market still sees the majority of volume take place ‘over the counter’ (OTC). Below is a rough breakdown of how the market typically looks:

On exchange liquidity

- + The visible layer of liquidity

- + Represents 20-30% of turnover
- + Volume is fragmented across European exchanges

OTC turnover

- + Represents 70-80% of ETF turnover
- + Mostly hidden due to lack of reporting requirements
- + Reported trades split across venues

Underlying market liquidity

- + The largest driver of liquidity for most ETPs
- + Acts as a liquidity 'backstop' for ETPs – that is, the worst case liquidity of an ETP is that of the underlying market
- + Implied liquidity function acts as an indication

Figure 2: On exchange liquidity is only the tip of the iceberg and most of Europe's volume is 'under water' in the OTC market

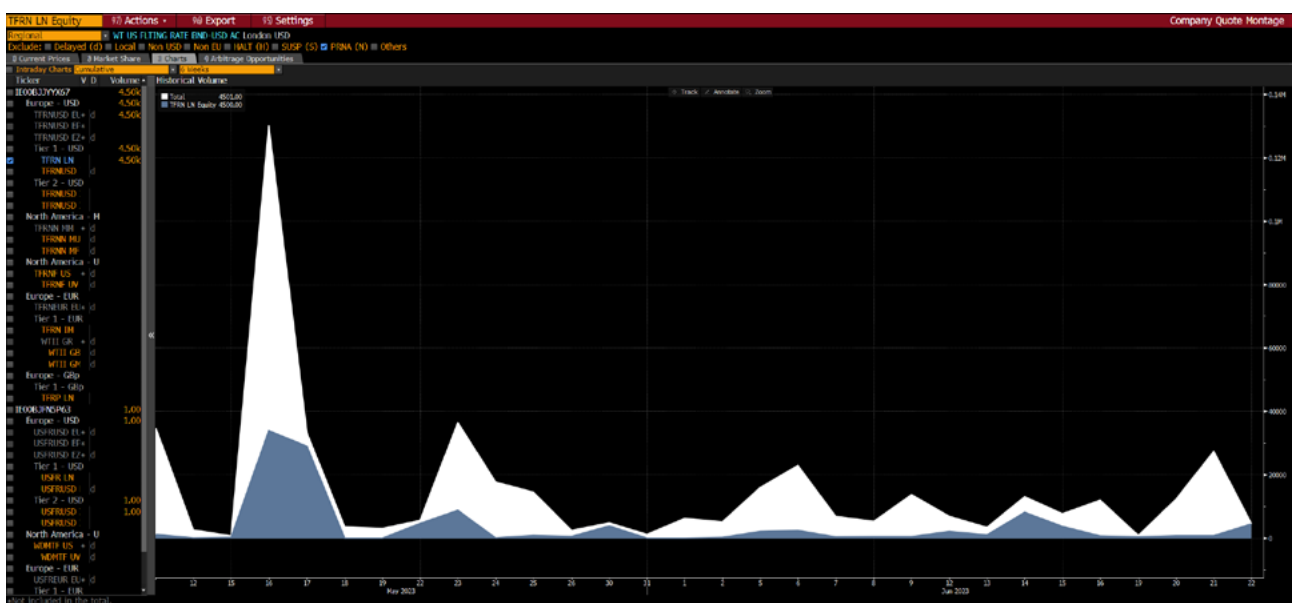


Source: WisdomTree.

Unlike the US market, Europe does not yet have a consolidated tape where trades are reported to, so gauging turnover can be challenging. One potentially useful source of information however, is a Bloomberg function known as ‘Quote Montage’ (QM) →GO.

Recent European regulation (MiFID II) requires trades that take place OTC to be reported to venues called Approved Publication Arrangement(s) (APAs). The QM function aggregates reported trades under one product on these venues and displays them on this page. So, while not a consolidated tape (and trades may be reported with delays), it does indicate that there is a greater turnover of ETPs happening in the European market than headline exchange volume figures might suggest.

Figure 3: Example of QM functionality on Bloomberg



Source: Bloomberg, data as of 14 June 2023. **Historical performance is not an indication of future performance and any investments may go down in value.**

The European market is confusing

One obvious difference between the US and Europe is the prevalence within Europe of many different countries with distinct cultures, languages, and currencies, and yet also tightly intertwined financial markets. The ETP industry in Europe typically tries to serve all of these unique and diverse investor groups. This has, unsurprisingly, led to a prevalence of not only cross listing and trading of ETPs across markets in Europe (and in fact overseas as well), but also offering ETPs in different listing currencies, and also having unique share classes which may have differing base currencies, may or may not be currency hedged, and also may or may not be distributing or accumulating share classes.

It goes without saying that investors should, of course, take due care when selecting products and understand the impact of currency movement on their investments. From a trading

perspective, however, share classes and listings in currencies such as Euro or Pound Sterling typically represent the exact same underlying exposure and benefit from the same underlying liquidity. Trading costs are also very close as foreign exchange (FX) markets are extremely liquid, allowing market makers to convert and hedge positions with very little cost and effort.

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