



February 13, 2012

# Trading Talk

## Market Structure Analysis & Trading Strategy

### Rosenblatt's Monthly ETP Review: January

#### Notable ETP News

#### [PIMCO: Total Return ETF Will List on March 1](#)

—Securities Technology Monitor

The long awaited launch of an exchange-traded fund by a certifiable investing rock star is nigh. The Total Return Exchange-Traded Fund (ticker TRXT) is scheduled to list on March 1, according to Pacific Investment Management Co., best known as PIMCO.

***Our Take:** The launch of an ETF based on the world's biggest mutual fund is significant for several reasons. For one, there has been much talk about active ETFs claiming a larger piece of the pie but index-based products still constitute the vast majority of AUM. This launch could begin to change that. Secondly, and more relevant for those of us whose primary concern is the trading markets, a successful launch of TRXT and similar products could both provide a little boost to exchange volumes and further increase the percentage of consolidated US equities volume that is executed through ETFs. As we detailed in our year-end US Securities Volumes [report](#), this figure hit a record-high 14.93% in 2011.*

#### [BlackRock to List Eight ETFs on BATS Market](#)

—Securities Technology Monitor

The world's largest asset management firm will be the first company to list securities on a BATS Global Markets electronic venue that now competes for listings on the New York Stock Exchange and Nasdaq Stock Market.

***Our Take:** A third exchange enters the ETF listings fray. BATS' free listings program, announced earlier this week, should cause issuers of actively traded ETFs to take a closer look.*

#### [Exchange Traded Funds: FT Special Report](#)

—Financial Times

The exchange traded funds industry gathered strength in adversity in 2011, the most difficult year in its history. It encountered a ferociously challenging combination of weakness in stock markets worldwide, unprecedented criticisms from regulators and often hostile media coverage.

#### [NASDAQ Introduces Take Fee Incentives in Tape B Securities](#)

—Press Release

Effective Wednesday, February 1, 2012, NASDAQ will introduce two volume tier discounts for removing liquidity in Tape B securities. Member MPIDs can qualify for one of two discounted Tape B take rates by meeting both an add and remove monthly volume requirement.

***Our Take:** Nasdaq's fee changes for Tape B (Arca/Amex-listed — the vast majority of US ETPs) could affect venue market shares and broker routing decisions.*

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**CBOE Futures Exchange to Launch Security Futures Trading in Emerging Markets Volatility Index**

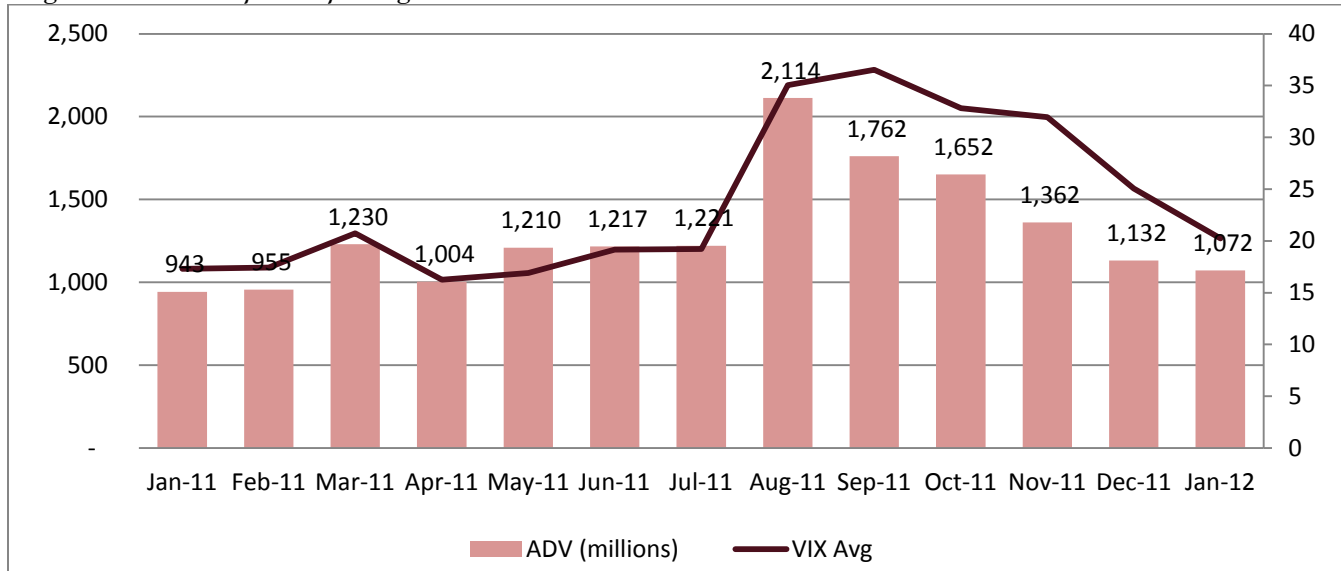
—Press Release

CBOE Futures Exchange announced today that it will launch trading in security futures on the CBOE Emerging Markets ETF Volatility Index (Index ticker: VXEEM; futures symbol: VXEM) on Monday, January 9, pending regulatory approval.

**ETP Volume, Value Traded, Market Share & Fragmentation Data**

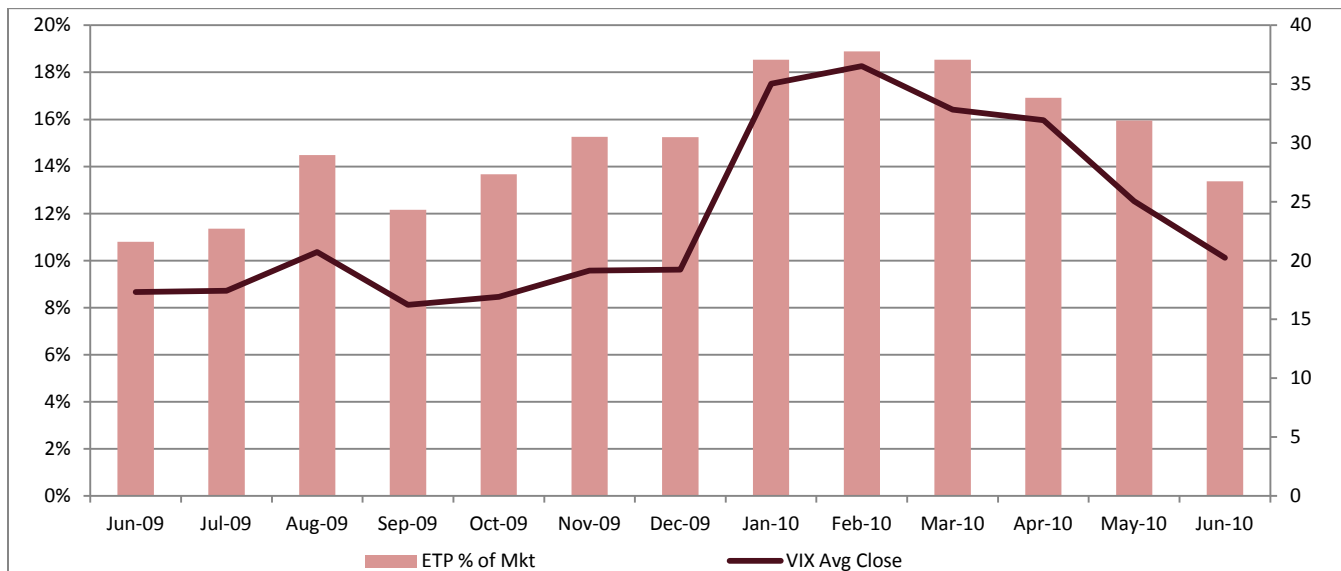
**US Exchange Traded Products ADV**

*ETP volume appears closely correlated with volatility, perhaps because traders in volatile markets eschew single-stock risk in favor of using ETFs to make shorter-term bets*



Source: Arcavision, CBOE

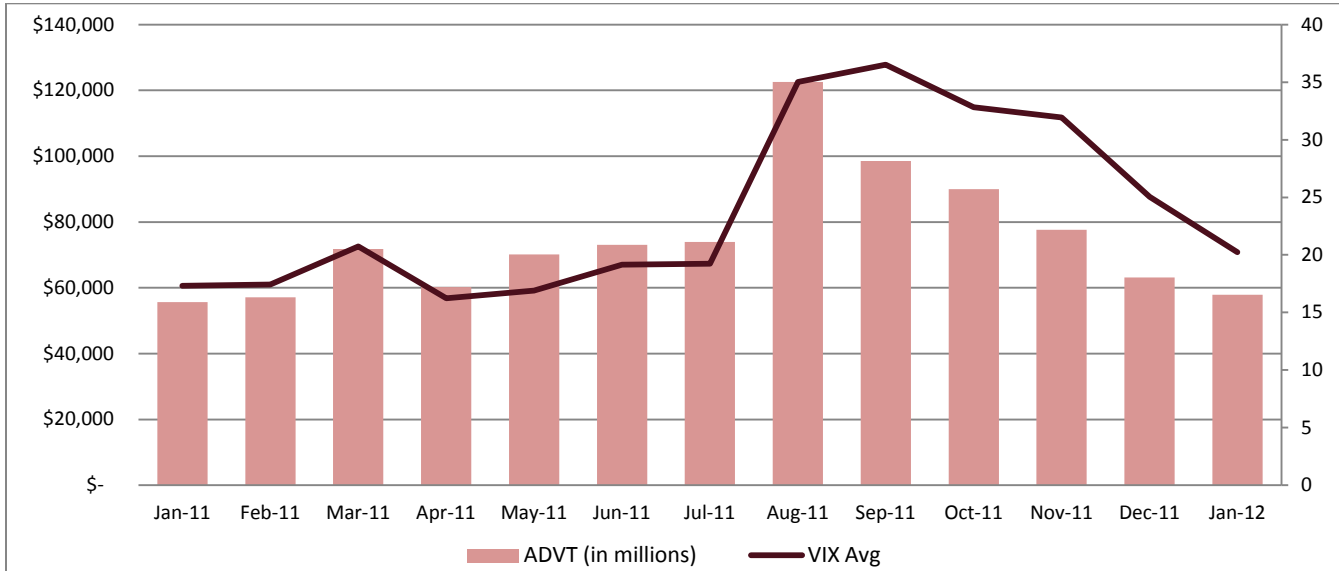
**US Exchange Traded Products % of Consolidated Equity Volume**



Source: Arcavision, CBOE

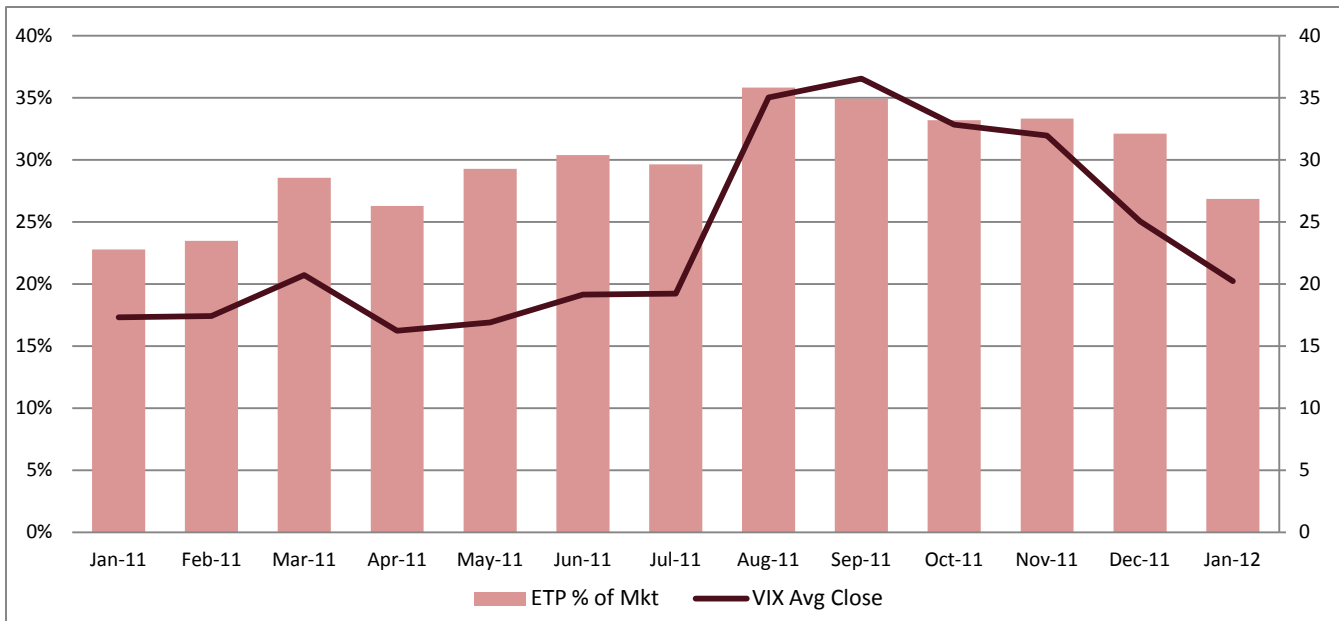
**US Exchange Traded Products Average Daily Value Traded**

For ETPs, value traded matters. The 5 most active ETFs (SPY, XLF, EEM, IWM and QQQ) have a much higher volume weighted average price (\$72.92<sup>a</sup>) than the stocks in S&P 500 (\$33.70<sup>a</sup>) and all NYSE-listed stocks (\$28.58<sup>a</sup>). ETFs thus make up a greater portion of the equity market's value traded than share volume — often by as much as 10 percentage points — and have claimed more than 25% of dollar value since March 2011.



Source: Arcavision, CBOE

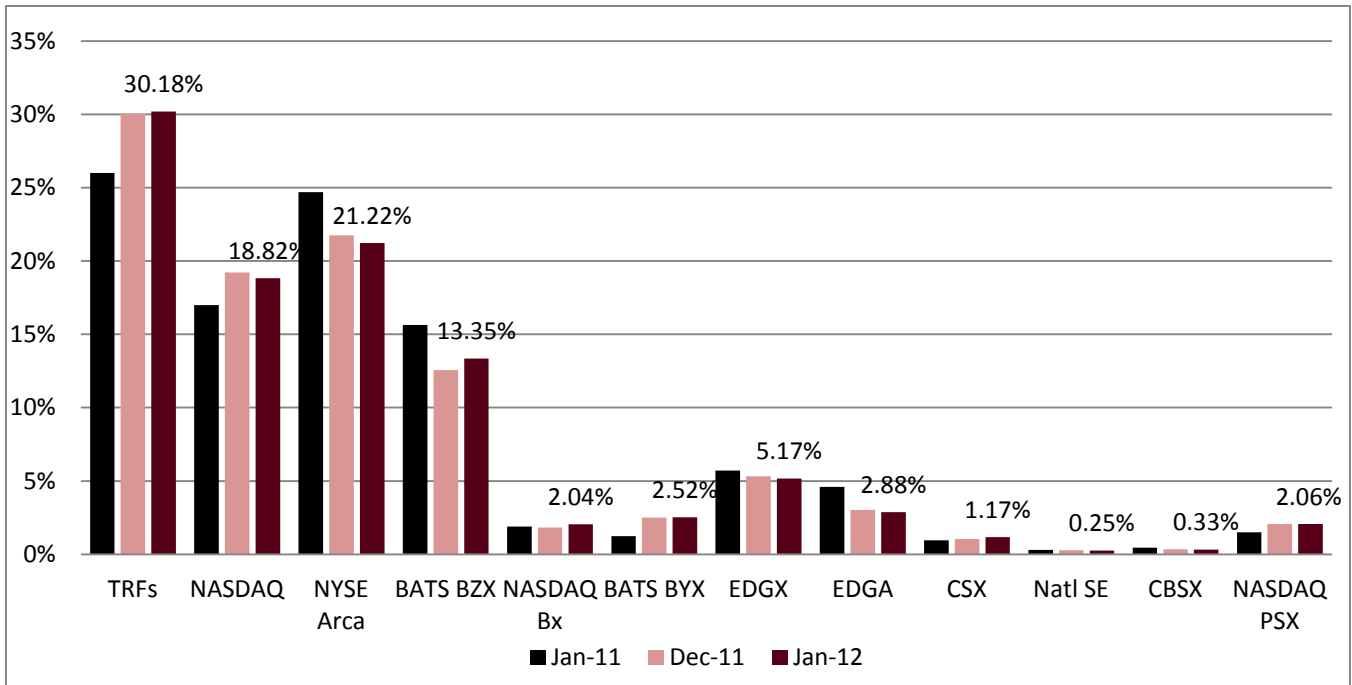
**US Exchange Traded Products: % of Consolidated Equity Value Traded**



Source: Arcavision, CBOE

<sup>a</sup> Source: Bloomberg

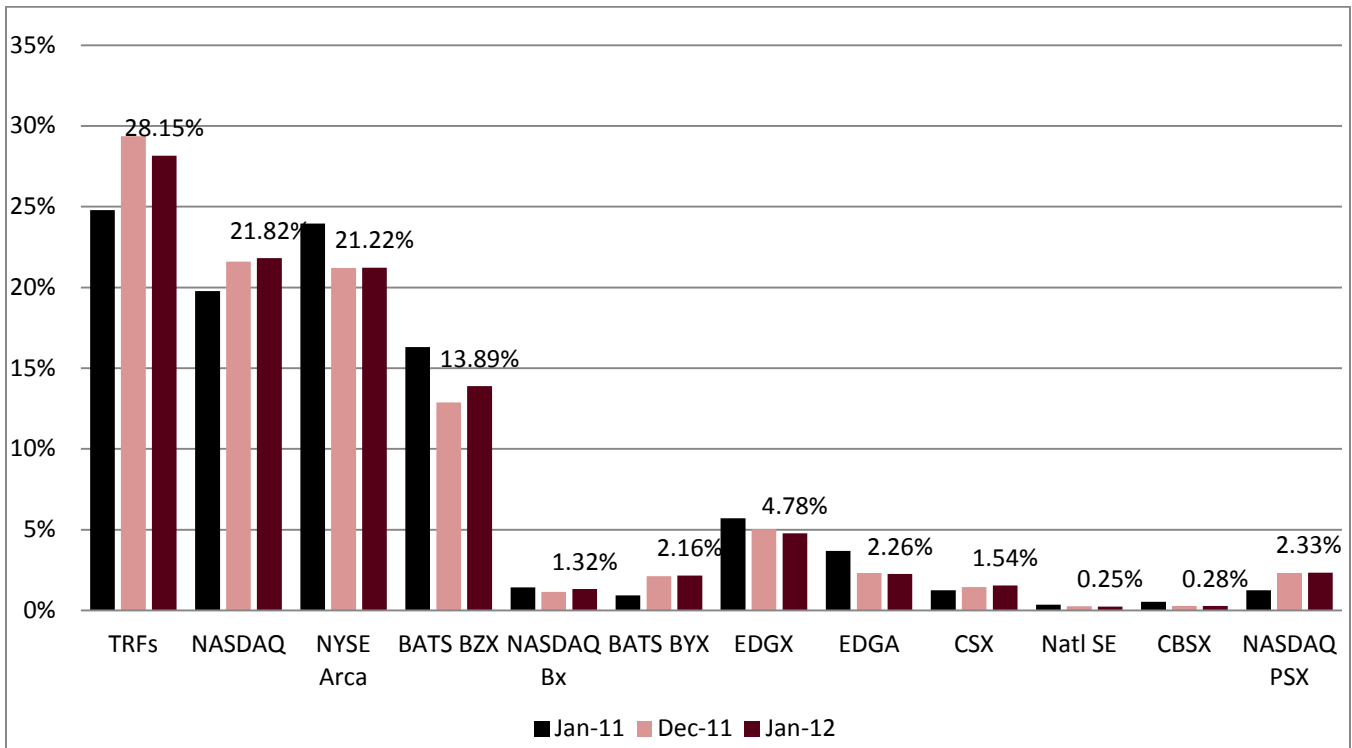
**US Exchange Traded Products: Market Share by Venue**



Source: Arcavision; percentages shown are for most-recent month

**US Exchange Traded Products: Market Share of Value Traded by Venue**

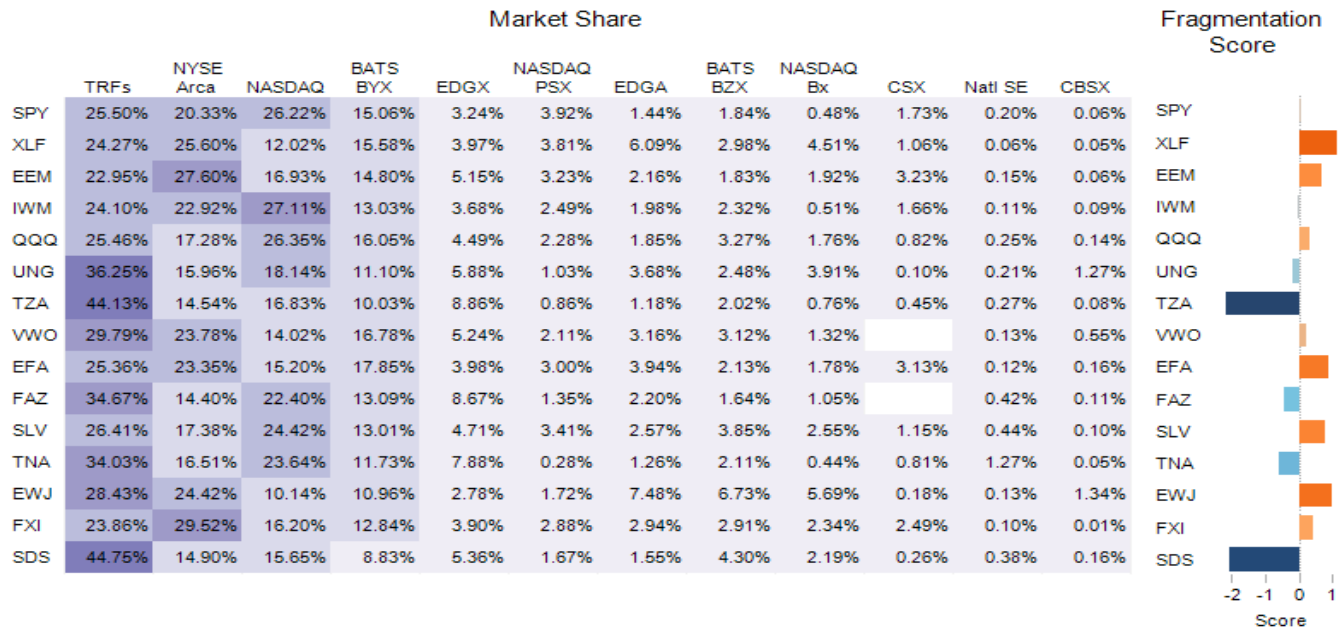
Nasdaq's share of value traded likely is greater than that of its shares traded because it is the listing market for the high-priced QQQQ.



Source: Arcavision; percentages shown are for most-recent month

**Market Share and Fragmentation for Most-Active ETPs**

The table on the left shows market shares, with darker shading for venues with a higher share of that symbol than of consolidated trading. The fragmentation scores depicted on the right use the normalized Herfindahl-Hirschman index, a measure of industry consolidation, and standardizes it to determine if a security is trading on its primary exchange. Higher scores mean more optimization is required to access liquidity in other venues. XLF was the most fragmented of the group in January and SDS the least. We score the top 100 ETPs by volume in the Appendix of this report.



Source: Rosenblatt Securities, Bloomberg

**Difference From All ETPs Market Share: Most-Active ETPs**

This heat map shows how much more or less of a particular ETP's share volume is executed on each venue, compared with those venues' share of volume for all ETPs; A high value and green shading means the venue has a greater market share in that ETP than it does for all ETP volume (such as Nasdaq in SPY); A low value and red shading means the opposite (like Nasdaq in XLF).

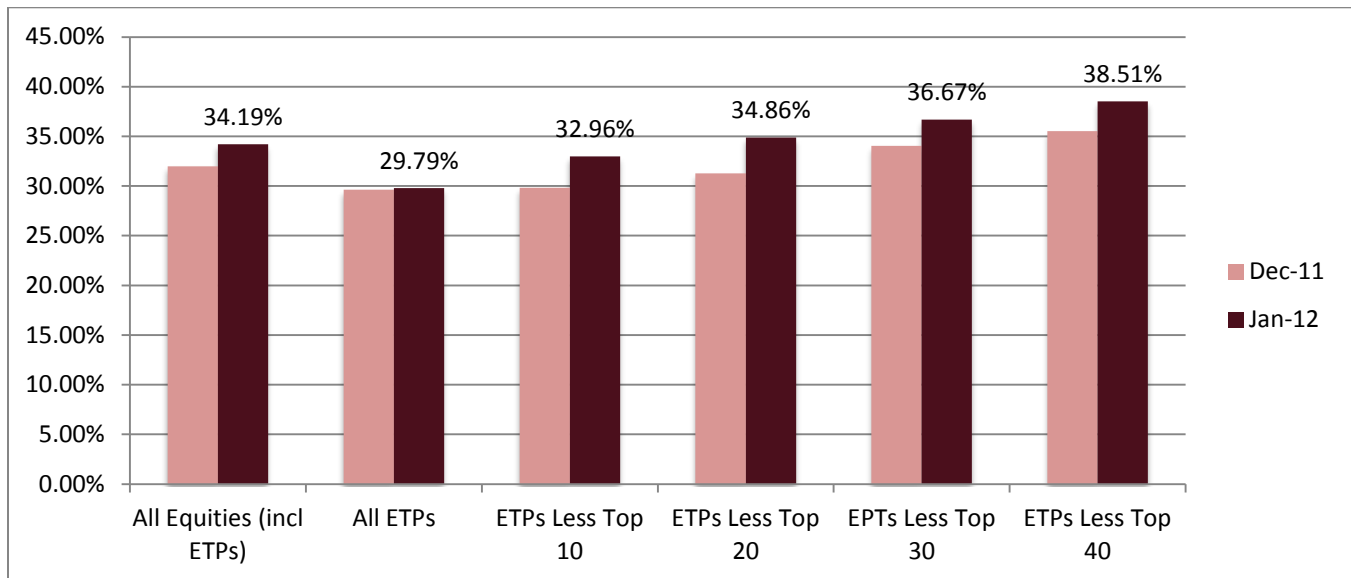
	SPY	XLF	EEM	IWM	QQQ	UNG	TZA	VWO	EFA	FAZ
TRFs	-4.68%	-5.89%	-7.22%	-6.08%	-4.74%	6.06%	13.95%	-0.38%	-4.82%	4.50%
NASDAQ	7.39%	-6.80%	-1.89%	8.29%	7.54%	-0.69%	-1.99%	-4.80%	-3.62%	3.58%
NYSE Arca	-0.89%	4.36%	6.37%	1.71%	-3.96%	-5.26%	-6.69%	2.55%	2.14%	-6.83%
BATS BZX	1.70%	2.20%	1.44%	-0.33%	2.69%	-2.25%	-3.34%	3.42%	4.49%	-0.27%
NASDAQ Bx	-1.56%	2.47%	-0.12%	-1.54%	-0.29%	1.87%	-1.29%	-0.72%	-0.26%	-0.99%
BATS BYX	-0.68%	0.46%	-0.69%	-0.20%	0.75%	-0.04%	-0.50%	0.60%	-0.39%	-0.87%
EDGX	-1.93%	-1.19%	-0.02%	-1.49%	-0.68%	0.71%	3.69%	0.07%	-1.19%	3.50%
EDGA	-1.44%	3.22%	-0.72%	-0.90%	-1.03%	0.80%	-1.69%	0.28%	1.06%	-0.68%
CSX	0.57%	-0.11%	2.07%	0.50%	-0.34%	-1.06%	-0.72%	-1.17%	1.96%	-1.17%
Amex	0.00%	0.00%	0.00%	0.00%	0.04%	0.00%	0.00%	0.00%	0.00%	0.00%
Natl SE	-0.06%	-0.19%	-0.11%	-0.15%	-0.01%	-0.04%	0.02%	-0.13%	-0.13%	0.17%
CBSX	-0.27%	-0.28%	-0.27%	-0.24%	-0.19%	0.94%	-0.25%	0.23%	-0.17%	-0.22%
NASDAQ PSX	1.86%	1.75%	1.17%	0.43%	0.22%	-1.03%	-1.20%	0.05%	0.94%	-0.71%

Source: Arcavision

### Off-Exchange Trading

*ETPs as a group trade more on exchanges than do all equities. However, the further one looks down the liquidity continuum, the more volume trades off-exchange. We believe this is due in large part to market makers who are willing to quote size off-screen in seemingly illiquid issues.*

#### Percentage of ETPs Traded Off-Exchange



Source: Arcavision

### Fund-Flow Data

*ETPs in January saw the highest influx of funds since December 2008. Currency-based ETPs were the only asset class to experience outflows. The biggest inflows went to US equity ETPs, with a jump of \$11.6 billion, accounting for more than a third of all inflows. The US large-caps subgroup had the highest inflows, followed by emerging-market and high-yield-bond ETPs. Meanwhile, the US consumer staples subgroup suffered the largest outflows. Total assets among ETPs also ticked up 8.4%, totaling \$1.2 trillion, and the total number of active ETPs reached 1,376.*

#### ETF Group Flow of Funds - January 2012

	Assets (\$, MM)	FoF (\$, MM)					
		Jan-12	Dec-11	Nov-11	Oct-11	Sep-11	Aug-11
<b>US</b>	514,400	11,677	9,125	-7,296	9,629	-6,720	-1,825
<b>Bond</b>	187,417	7,427	6,492	5,178	4,775	6,039	4,737
<b>Emerging Markets</b>	133,715	4,995	431	-895	3,542	-221	-3,338
<b>Commodity</b>	118,682	1,609	-2,660	2,782	-520	-339	-1,558
<b>Foreign</b>	93,106	1,283	-75	-726	1,147	2,391	-1,617
<b>Income/Dividends</b>	41,209	2,193	2,244	1,796	2,457	1,319	2,104
<b>Global</b>	30,129	244	1,093	26	302	852	1,562
<b>Short</b>	19,505	1,187	-718	-1,208	933	1,245	-328
<b>Specialty</b>	7,691	659	164	275	181	-96	-812
<b>Currency</b>	7,309	-519	40	-11	114	41	-245
<b>Total</b>	<b>\$1,153,163</b>	<b>\$30,755</b>	<b>\$16,135</b>	<b>-\$79</b>	<b>\$22,561</b>	<b>\$4,511</b>	<b>\$1,322</b>

Source: Birinyi Associates

**Largest Inflows by Subgroup - January 2012**

Category	Assets (\$, MM)	FoF (\$, MM)					
		Jan-12	Dec-11	Nov-11	Oct-11	Sep-11	Aug-11
US - Large Cap	222,311	5,814	12,044	-6,554	4,966	-5,067	530
Emerging Markets	100,299	4,597	849	-471	4,598	802	-1,467
Bond - Corporate (High Yield)	25,072	3,812	1,631	-185	1,915	1,196	-582
US - Sector (Financials)	42,243	2,013	1,006	-889	549	167	-1,689
US - Sector (Energy)	30,655	1,353	-1,556	-440	781	-1,364	560
Bond - Corp (Investment Grade)	37,643	1,303	1,376	1,796	1,835	1,112	1,216
Commodity - Gold	84,347	1,115	-2,319	3,587	813	55	-1,272
US - Mid Cap	33,527	1,083	-975	720	394	-1,034	-871
US - Sector (Health Care)	10,665	903	-1,633	69	73	657	-1,110
US - Sector (Industrials)	6,382	750	-19	-802	503	-396	-376

Source: Birinyi Associates

**Largest Outflows by Subgroup - January 2012**

Category	Assets (\$, MM)	FoF (\$, MM)					
		Jan-12	Dec-11	Nov-11	Oct-11	Sep-11	Aug-11
US - Sector (Cons Stap)	6,136	-1,016	156	-150	305	73	930
Foreign - Japan	6,043	-531	-524	-177	-345	-506	-429
US - Sector (Utilities)	9,600	-473	292	656	142	720	1,200
US - Sector (Tech)	15,972	-395	343	-4	330	146	-963
Bond - Treasury (Short Term)	12,927	-373	329	616	-192	85	2,805
Currency - US	1,646	-310	325	-105	0	721	-105
Bond - Treasury (Inter. Term)	4,016	-282	564	-25	142	397	358
Emerging Markets - Brazil	11,299	-189	-182	-113	-348	-48	-37
Global - Sector (Materials)	11,275	-183	426	44	-74	662	1,538
Currency - Europe	1,293	-169	-101	228	-84	281	29

Source: Birinyi Associates

**Largest Inflows and Outflows by ETP - January 2012**

Ticker	Category	FoF (\$,MM)	M/M
QQQ	US - Large Cap	3,245	8.42%
VWO	Emerging Markets	3,242	10.78
HYG	Bond - Corporate (High Yield)	2,274	1.46
JNK	Bond - Corporate (High Yield)	1,438	2.65
LQD	Bond - Corp (Investment Grade)	1,040	2.14
EEM	Emerging Markets	1,006	10.99
XLE	US - Sector (Energy)	989	2.26
GLD	Commodity - Gold	943	11.40
SPY	US - Large Cap	930	4.64
DIA	US - Large Cap	861	3.46

Source: Birinyi Associates

Ticker	Category	FoF (\$,MM)	M/M
XLP	US - Sector (Cons Stap)	-1,006	-1.42%
XLU	US - Sector (Utilities)	-556	-3.61
EWJ	Foreign - Japan	-539	4.77
BIL	Bond - Treasury (Short Term)	-499	-0.02
XLK	US - Sector (Tech)	-411	6.21
TNA	US - Small Cap	-384	22.15
UUP	Currency - US	-306	-1.56
IEI	Bond - Treasury (Inter. Term)	-280	0.63
EWZ	Emerging Markets - Brazil	-252	14.31
GDJ	Global - Sector (Materials)	-231	9.78

Source: Birinyi Associates

### Strategist's Corner

*"It is only prudent never to place complete confidence in that by which we have even once been deceived."*

—Rene Descartes - Mathematician, Philosopher, and Heretic

Our new Chief Derivatives & ETP Strategist, Steven Williams, in March will begin formally publishing reports on derivatives pricing and the impact of volatility on various assets. Steve will apply his expertise in complex securities pricing to highlighting pricing anomalies in the ETP & listed-options markets and explaining how to exploit them.

No actively traded asset class has challenged the efficient market hypothesis more over the past three years than the volatility market. Even though they are listed on equities exchanges, ETPs are derivatives — they literally derive their value from other securities. As is the case with all derivatives, ETPs are often mispriced in the market place.

Below is a taste of what's to come from Steve — a look at how the volatility of two actively traded ETNs affects pricing and, ultimately, performance.

#### UNG vs. GAZ

The true fair value of a vanilla option is only revealed after the contract has expired. The fair value of an ETP is the value of the trust itself. Factors including volume, availability of fungible securities and creation and redemption of outstanding shares often cause ETPs to trade above or below both fair value and/or their historical discount/premium means.

GAZ typically trades slightly above fair value (NAV), whereas UNG tends to trade near fair value (NAV). The spread is near its 2-year and all-time high. Buying an ETP that is trading at a discount or premium to NAV can result in gains or losses whether the underlying security (or securities) sits, rallies, or falls as the difference with fair value changes. Case in point: Buying GAZ on 1/06/12 (GAZ/UNG NAV spread = (.0267) would have resulted in a 20% outperformance vs. UNG.

Although we caution against shorting one ETP against a like security, we strongly suggest comparing like securities and analyzing fair value in advance of entering a trade.

#### GAZ NAV / UNG NAV Spread:

2 year high = 20.7329

2 year low = (.6976)



Mean = 3.244

2/08/12

GAZ NAV vs. UNG NAV

GAZ % Premium over NAV 20.6601

UNG % Premium over NAV (.55)

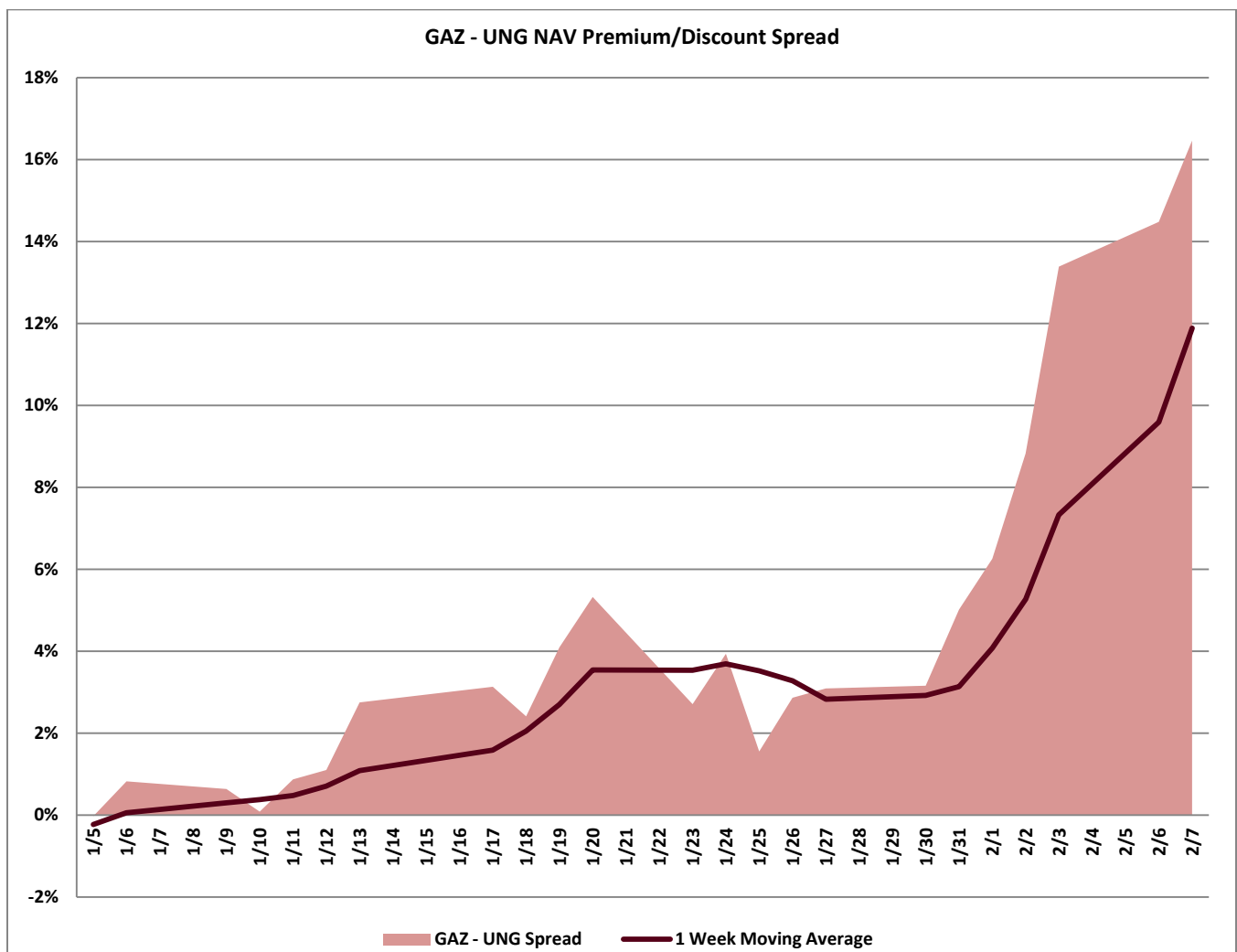
Spread = 20.1101

1/06/12

GAZ % Premium over NAV (.956)

UNG % Premium over NAV .1301

Spread (.2067)



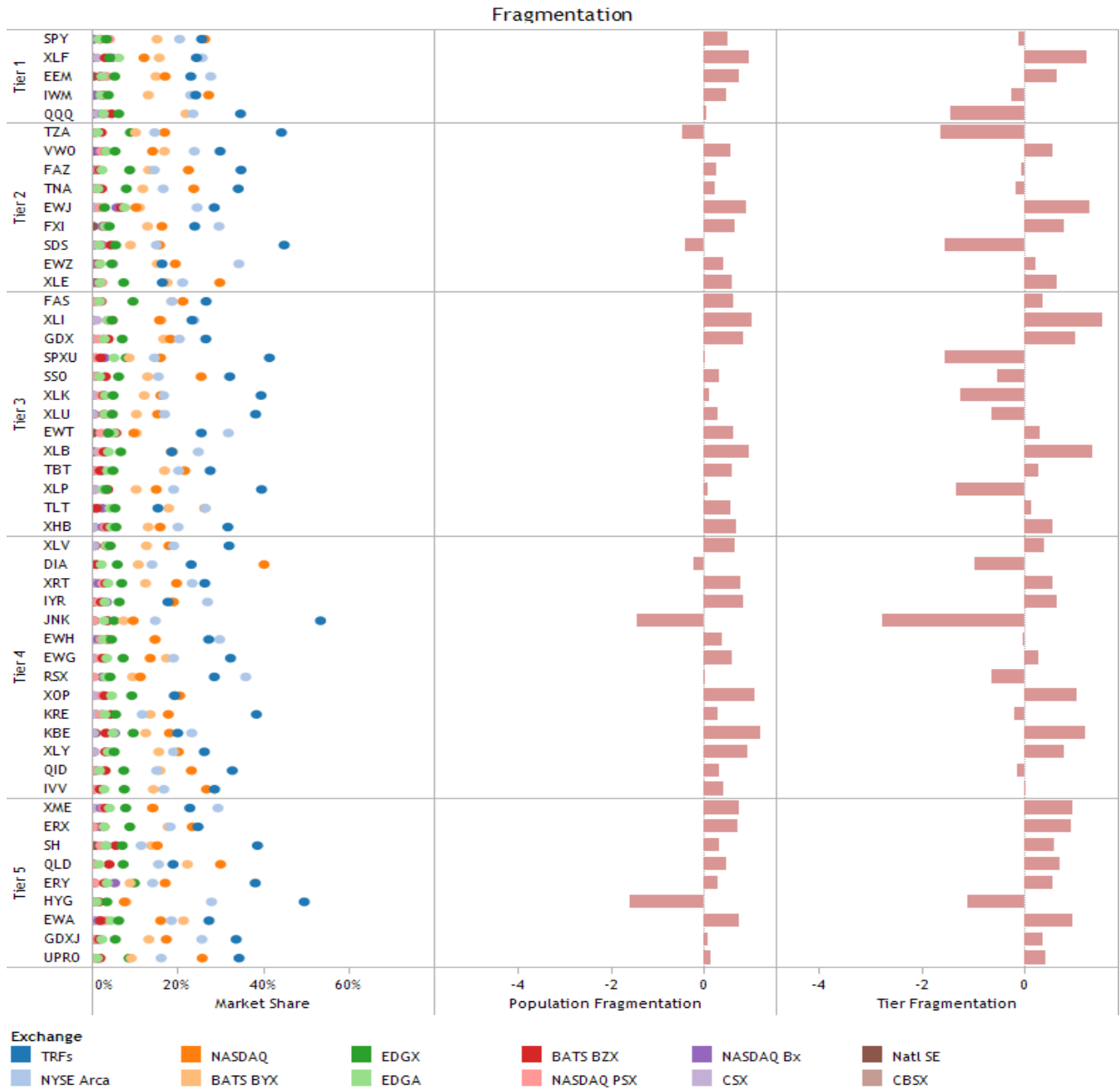
Source: Bloomberg

Please look for future notes from Steven Williams and contact him at [swilliams@rblt.com](mailto:swilliams@rblt.com) with questions or comments.

## Appendix

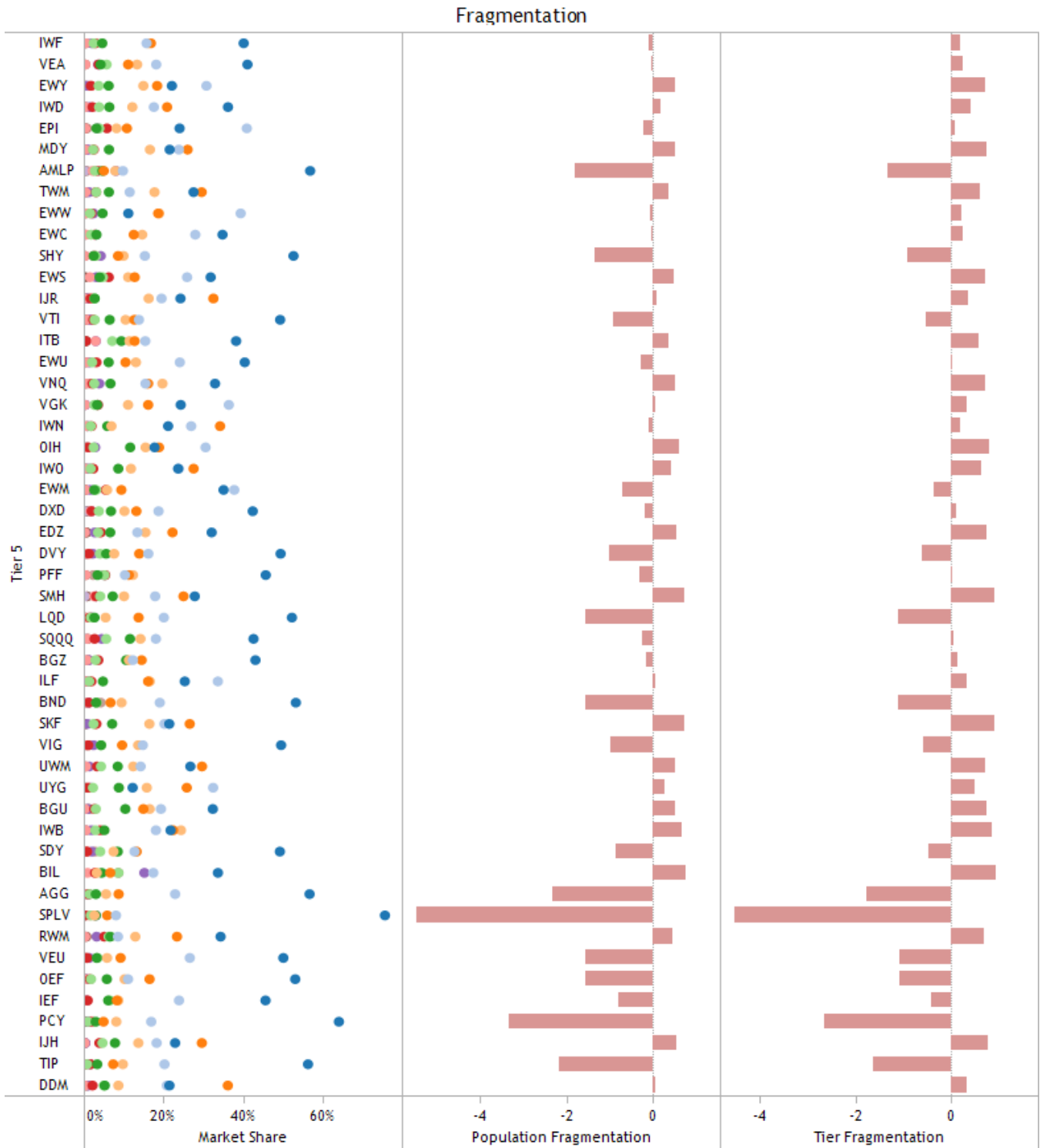
### Top 100 ETP Fragmentation Scores and Market Shares

The charts below provide an extended look at the market-share and fragmentation data we presented for the 15-most-active ETPs on page 5. We have divided the top 100 ETPs by volume into tiers according to their ADV. The position of the color-coded dot in the chart on the left indicates that venue's market share in the particular security. The bars in the second column indicate the degree of fragmentation for that security when compared with all ETPs. The third shows fragmentation compared with the tier.



Source: Bloomberg

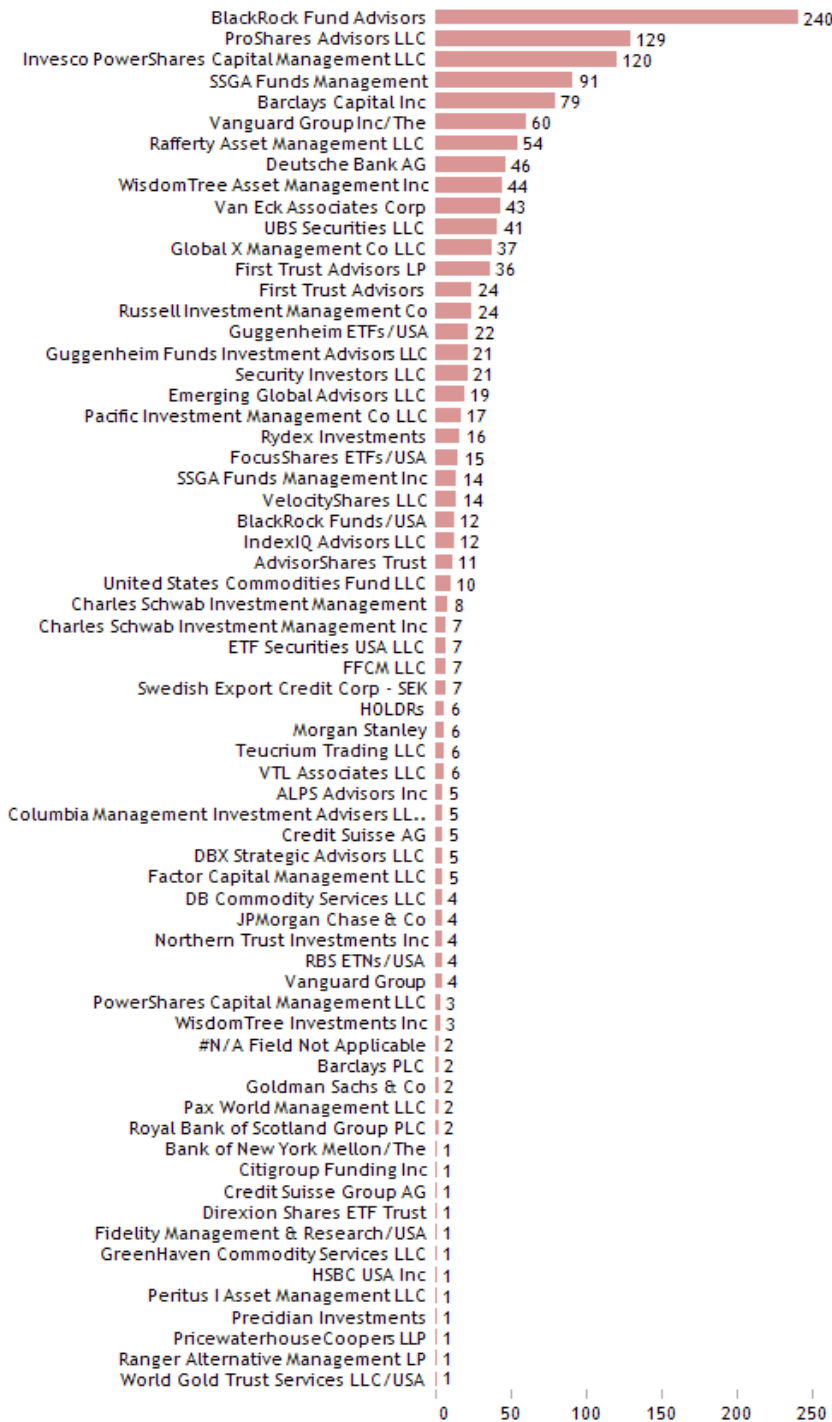
Top 100 ETP Fragmentation Scores and Market Shares (cont'd)



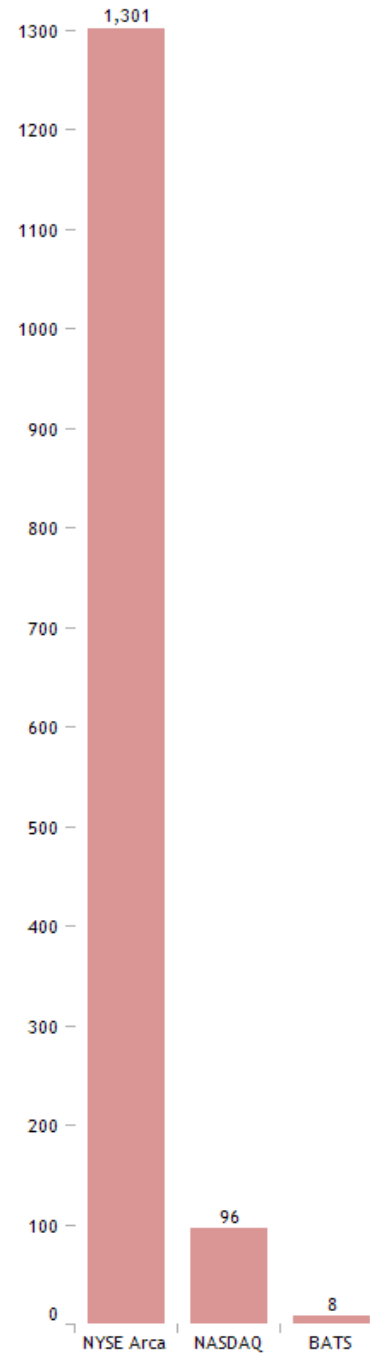
Source: Bloomberg

ETP Listing Index

Count of ETFs by Management 2/5/2012



Count of ETFs by Primary Exchange



Source: Bloomberg

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