Equity Markets and Products

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Agenda

- Cash Equities and Delta One
- Stock Exchanges
- The Order Book
- Initial Public Offerings
- Role of ECM versus Trading Desk
- Trading Desk Functions
- Convertible Securities
- Exchange Traded Funds

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Cash Equities and Delta One

Cash Equities

Cash equities trading refers to the trading of an individual company's stock.	The term 'cash' is used since an investor has to pay cash now to buy such securities. Derivatives are non-cash products.
Large proportion of cash equities trading is automated, with a bank's internal systems automatically finding the best trading outcome for a client's specific needs	Advice and high quality execution of trades valued by clients more than price.

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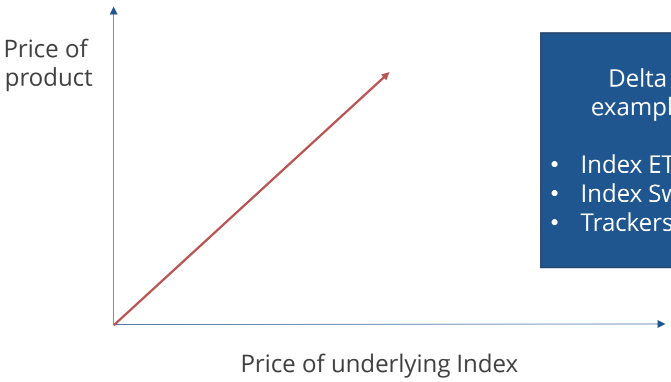
Delta One

A delta one product gives the same market exposure as “owning the index”



Delta 1 examples:

- Index ETF
- Index Swap
- Trackers

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Stock Exchanges

Stock exchanges

Quote driven	Order driven
Market makers quote prices (both bid and offer) that they are willing to trade at	Orders placed by market participants are matched by the exchange
Must maintain a price quote for a specified minimum number of shares	If a trade cannot be matched, it is added to a log of unmatched trades, called the order book
If a client requests to trade at a quoted price, the market maker is obligated to trade at that price	At the end of the day, any unmatched trades are deleted from the order book
Market makers profit via the bid-ask spread	The order book visible by all exchange members
NASDAQ	NYSE, LSE, TSE

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Main Stock Exchanges

Stock exchange	Country	Market cap (Jan 2015 USD trillions)
New York Stock Exchange	USA	19.2
NASDAQ	USA	6.8
London Stock Exchange	United Kingdom	6.2
Tokyo Stock Exchange	Japan	4.4
Shanghai Stock Exchange	China	4.0
Hong Kong Stock Exchange	Hong Kong	3.3
Euronext	European Union	3.3
Deutsche Börse	Germany	1.7

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The Order Book

The Order Book

Buy orders ranked from highest to lowest price

Company A			
Size	Price	Price	Size
5,000	105	~~107~~	~~2,500~~
1,000	104	109	~~3,000~~ 500
4,500	103	109	4,000
		110	1,000

Sell orders ranked from lowest to highest

Orders of equal price are ranked by time

A limit order to buy 5000 shares at 109 would be executed by matching 2,500 shares at 107 and the remaining 2,500 of the order at 109.

The first trade at the top of the sell side of the order book would be the remaining 500 shares of the first order with a price of 109 which has not yet been matched

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Initial Public Offerings

What is an Initial Public Offering (IPO)?

- Previously privately held shares are sold, for the first time, to the public
- The shares are listed on a securities exchange for the first time
- Existing shareholder may sell some or all of their shares
- Company may or may not raise new capital in the process
- This is referred to as the "primary market"

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IPO Process

Valuation and preparing the company (management team etc.)	ECM bankers
Due diligence	ECM bankers, accountants and lawyers
Preparation of prospectus	ECM bankers, accountants and lawyers
Application for listing on exchange	ECM bankers and lawyers
Management presentation preparation and pre-marketing to select institutions	ECM bankers and sales team
Roadshow / book building	ECM bankers and sales team
Final pricing and listing and support	ECM bankers, sales team and traders

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Role of ECM versus Trading Desk

Role of ECM vs Trading Desk

	ECM	Trading Desk
Services	Provide advice on equity (or equity based) products Identify investors for IBD transactions	Execute trade with or on behalf of clients Advice on market trends Market making
Market focus	Primary markets	Secondary markets
Access to inside information	Yes	No
Income	Advisory fees	Commission Bid-ask spread

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Trading Desk Functions

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Trading Desk Functions

Trading Desk Activities	
Principal trading	The bank itself is one of the parties of a trade requested by a client or initiated for risk management purposes
Agency trading	The bank acts as the client's agent, entering into a trade on behalf of the client
Market making	Providing liquidity on a stock by quoting bid and offer prices. Trades are executed on a principal basis.

Trade Types	
Block trade	Short notice large volume transaction, executed as a principal trade
Program trade	Large transaction involving many stocks being traded simultaneously. Also referred to a basket or portfolio trade. Can be executed on a principal or agency basis

Block Trades

Block trades are short notice trades whereby a selling stockholder sells a large volume of stock in one transaction

Selling large volumes of stock on the open market would unbalance supply and demand and materially move the price

Dribbling out a large volume slowly to avoid placing negative pressure on price would be impractical

Block trades typically generate low margins but boost trading volumes, helping the bank to climb the league table

Winning a block trade at a very low bid it risks generating a loss on the trade or holding the stock on its balance sheet

An investment bank may "sound out" investors before being appointed to manage a block trade. ECM bankers will often predict block trades

Convertible Securities

Convertible Debt

Convertible bonds may be converted into a predetermined quantity of the issuer's equity, typically at the discretion of the bondholder. This upside benefit to the investor enables the issuer to reduce its borrowing costs.

- The indenture will specify a conversion rate, giving the number of shares of common stock that may be issued per bond
- The existence of a call provision allows the issuer to call the bond if the stock price rises above a given level

Converting debt to equity reduces the issuer's post tax interest expense

Converting debt to equity increases the issuer's shares outstanding

$$\text{Market conversion price} = \frac{\text{Convertible bond price}}{\text{Conversion ratio}}$$

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Other Convertible Products

Warrants	Allows holder to purchase newly issued shares of the underlying company at a fixed (exercise) price. Typically issued in conjunction with a corporate bond. Economically identical to a convertible bond, but the bond and warrant can be separately traded
Convertible Preferred Stock	Preferred stock which may be converted into predetermined number of common stock of the issuer.

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Exchange Traded Funds

Exchange Traded Funds (ETFs)

- Open ended funds which typically track an index.
- Objective is to match the performance of an index whilst minimizing costs
- Price is quoted on an exchange and trading can take place intra day
- New ETF shares are paid for with a portfolio of shares (matching the index being tracked), not with cash
- ETF stock price typically trades very close to NAV
- Tax advantages as sale of ETF shares on exchange does not require disposal of underlying securities in the fund

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