Trader Insights

Actionable Ideas for the Power to Trade Smarter

The Big Problem with Small Cap Liquidity

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Mr. Healy: Small cap stocks have always been harder and more expensive to trade than large caps, and liquidity issues have worsened over the last decade. Market makers tend to focus on the most liquid securities, making spreads for small caps even wider. In fact, over half of today's small caps are trading at least five cents wide.

In addition, small cap volume is concentrated at the end of the day, trading after 3.30 p.m. Queue lengths also increase nearer the close, when urgency grows and volume shifts from off- to on-exchange. Finally, small caps not only have more off-exchange volume, but also more hidden on-exchange volume. This emphasizes the need to place hidden orders at multiple price points, and to employ strategies for capturing off-exchange liquidity.

How can traders navigate this environment? It can help to utilize a smart strategy that's designed around the nuances of small caps, such as Capture from Bank of America. This liquidity-seeking algo looks to access both on- and off-exchange volume, and minimize market impact. It actively utilizes a variety of non-displayed order types across execution venues, placing orders at multiple price points within the spread. Capture also helps locate additional block liquidity using conditional orders. This allow you to look for blocks electronically while still actively working an order in the market.

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