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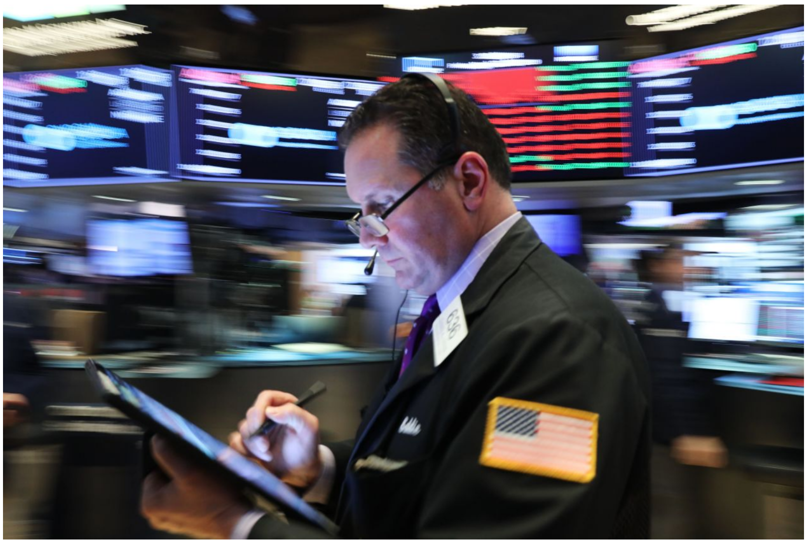
MARKETS

Thinning Liquidity in Key Futures Market Worries Traders

E-mini S&P 500 futures have gotten harder to trade since volatility shook U.S. stocks last year



E-mini S&P 500 futures are widely used on Wall Street to bet on market moves. Above, a trader at the NYSE on Friday. **PHOTO:** SPENCER PLATT/GETTY IMAGES

By Alexander Osipovich

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A retreat by traders from an important corner of the U.S. financial system has some worried it could make the stock market more susceptible to shocks.

E-mini S&P 500 futures, a huge market where over $200 billion changes hands on average daily, are widely used on Wall Street to bet on market moves or protect against adverse stock swings. The futures have gotten harder to trade since volatility shook U.S. stocks last year, according to trading data and market participants.

The futures track the S&P 500 index. When fresh economic news comes out, it is typically felt in E-mini futures first before affecting the stock market itself.

That is why any sign of diminished liquidity in E-minis concerns traders—an issue that has taken on added importance after the sudden moves in the stock and bond markets last week. Liquidity refers to the ability to buy or sell large quantities of an asset without pushing its price up or down.

> "Particularly if the market goes one way, that impact is going to be exacerbated in either an up move or a down move," said Hallie Martin, a strategist with Deutsche Bank in New York.

One way to measure liquidity is to look at the number of price quotes publicly displayed on an exchange. This reflects the willingness of firms to buy or sell in a market and to broadcast that readiness.

By that measure—called order-book depth—liquidity in E-minis hit its lowest level in over a decade during December's market turmoil, and remains near levels seen during the 2008 financial crisis, according to research from JPMorgan Chase & Co.

It is typical for E-mini liquidity to thin during periods of market stress. But in past episodes of volatility, liquidity quickly returned to E-minis after markets stabilized. So far in 2019, the depth of the E-mini order book has recovered slowly and hasn't returned to where it stood in September, before a sharp downturn began in the stock market, JPMorgan's data shows.

"The weird thing is that markets haven't been that volatile this quarter, but order-book depth hasn't really recovered," said Hovannes Jagaspanyan, an algorithmic trader in the Chicago office of Quantlab, a high-speed trading firm.

In 2017, it was often possible to buy or sell hundreds of E-mini contracts without affecting the price, but those days are long gone, said Darren Smith, a U.K.-based derivatives trader with UBS .

"During the London session, liquidity has fallen dramatically in the last few months," he said.

Market experts suggested different theories behind the retreat in E-mini liquidity. Rick Lane, chief executive of Chicago-based financial software firm Trading Technologies, linked it to a broader shift away from transparent, on-exchange trading in recent years.

"Firms that need to do large-size trades just don't feel as comfortable doing them on lit exchanges like they did in the past," said Mr. Lane, whose firm's technology is widely used in futures trading. "I think that's part and parcel of what we're seeing here."

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