Market Chronicles

Riding the storm:

Where volatility, liquidity, and opportunity collide

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The market has entered a phase of profound transition. Market conditions are quickly shifting the sources of liquidity into the marketplace.Much attention was paid to off-exchange volumes consistently ringing north of 50%, and as would be expected with volatility, that reading quickly moves in the opposite direction. The rush to offer 24-hour trading is gaining momentum, but with the US "exceptionalism" trade fading, the all-important demand of late-night retail demand can drop significantly. Correlations have been at historic lows for a significant amount of time now, which signals building risk, and the current uncertainty threatens to ding what had been a favorable fundamental money-manager environment.

With 2024 quickly fading away, institutional traders, market makers and investors are bracing for a more volatile, more fragmented and potentially shifting sources of market volume. Strong, continuous institutional volumes, created a healthier market in terms of depth, spread, and execution cost, however that is now under threat. Trepidation has settled in, and could be a lasting fog until certainty on US growth is regained.

Valuation, concentrated exposure, and over-deployment of cash set the US markets up for a reckoning, which has come due.The question now isn't just where the market is headed, but how shifting market sentiment causes a shift in liquidity dynamics, and the overall health of trading conditions.

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March roared in, but where is the lamb?

March is supposed to come in like a lion and go out like a lamb, but if recent market moves are any indication, the lamb may have been devoured. The 18.8 billion shares traded on March 10 did not quite have the feel of a capitulation, but the conviction was very strong in a rare 2-to-3 standard deviation move on all the major indexes—typically a once-a-year phenomenon. The type of conviction to get the attention of momentum strategies and traders.

What made the day particularly striking was how trading unfolded against an explosion in volatility. Typically, when markets become this turbulent, certain patterns emerge: dark trading drops off significantly, a sign that market makers are skipping the dark to get to the market directly, average trade sizes shrink as traders avoid blocks to dodge adverse selection and spreads widen as market makers need to get compensated for risk. But on March 10, Liquidnet's strategy usage, execution urgency, and willingness to finish off orders in block size was combustible. But that was the eye of the storm and not atypical.

Now, as the storm clouds begin to break, the landscape looks anything but peaceful. There is a long cleanup ahead, an ubiquitous shift in sentiment and a recalibration of risk appetite. Real price volatility has landed with a thud, unsettling traders and portfolio managers alike. Only the most battle-tested will keep their risk/block appetite at 2024 levels.

The shift in sources of market liquidity was an easy prediction going into 2024 as the euphoria surrounding Trump's victory gave way for policy-driven unease. Now, after three straight weeks of lackluster economic data, we're reckoning on all things growth. The prevailing mood? Total uncertainty.

If there is any adjective that best describes the past three weeks of trading, it's "choppy." While we are still a long ways off from the price fickleness of 2022, which was one of the worst years of the past decade for continuous institutional volume, whether the proverbial lamb ever arrives will pivot on highly scrutinized economic data releases, and expectations on 1st quarter earnings are already starting to waver.

Where's this market volume coming from?

The dominance of off-exchange trading has been a hot topic since the fall of 2024, when FINRA TRF-reported volumes consistently held above 50% of total market volumes. This surge wasn't surprising, when US equities lead global performance, retail trading tends to follow suit. Historically, when the market is reeling, retail's share of total consolidated volumes hovers in the low teens. However, when the market is outperforming, that figure climbs closer to 20%.

By the end of 2024, the retail and wholesaler-driven trading made up 37% of the FINRA TRF-reported volumes, followed by ATSs accounting for 25.5% and Capital Commitment/Upstairs Blocks contributing 23.5%. Off-exchange volumes were firmly in the driver's seat but leadership can be fleeting.

Over the past three weeks, off-exchange volumes have taken a sharp dive. In a low-variance category, a 400-to-500 bps drops in two weeks is notable. As off-exchange activity cedes ground, the question now is whether this is just a temporary pullback—or the start of a cyclical shift in market structure.

Trading around the clock

With Nasdaq announcing its entry into the 24-hour trading arena, the number of exchanges and ATSs operating in this space has been climbing fast. Some are in operation currently while others, like Nasdaq, are timing their mid-2026 launch to coincide with DTCC's planned platform adjustments which will provide clearing in that 8pm-to-4am EST, "black hole," window. While counterparty risk remains a factor given the lack of clearing, that isn't stopping certain players from getting involved. The recent outage of an ATS exposed some fragility to the system. More importantly, off-hours trading volumes are hitting new highs, and with that, bringing new business opportunity.

This is a familiar pattern. The post-Reg NMS days saw a wave of fragmentation in the US marketplace as competition surged to meet demand. Although 24-hour trading isn't an exact parallel, the rush into the space feels eerily familiar. The key question is how ATSs will fit into the evolving market structure. Unlike the PFOF model during regular hours where retail brokers face off with wholesalers who guarantee execution, overnight trading presents a different dynamic. In this scenario, driven largely by Asian retail demand for access to US markets, wholesalers have the discretion to take in the order or pass. If accepted, the order is placed

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on an exchange or ATS for execution in a riskless transaction. This is much different during daytime trading where wholesalers guarantee execution regardless of volatility, volumes, or order attractiveness. Overnight, ATSs effectively function like an exchange, with resting orders.

The broader question now is what this means for Asian retail demand as the once-dominant all-roads-lead-to-the-US trade loses its grip. Some wholesalers and market makers are already involved and the thought of missing out on overnight drift in prices is catching the attention of the institutional participant as well. If this movement continues to gain legitimacy, an influx of new players could bring volumes higher, improving spreads and liquidity while bringing margin opportunities into sharper focus.

The real test will be whether the flood of participatory announcements continue hot and heavy, particularly in light of Monday's market action which signaled, loud and clear, that a major shift in tone around US markets is underway.

How low can these correlations go?

For some time now, correlations have been at depressed levels—a major contributor to the 2024 run on US markets. With price volatility out of the way, strong continuous institutional volumes created the healthiest market seen in the past decade, not necessarily in terms of market performance but in depth, spread, and impact costs.

Low correlations, however, signal elevated risk in the market. For a traditional stock-picking money manager, they offer a great backdrop to put fundamental analysis to work. Market concentration over the past two years has been unhealthy, but we are seeing signs of cracks, not only through the epic sell-offs in the Mag 7 or Nasdaq 100 being the first to the "correction" race, but also in the widening disconnect between the equal-weighted and the traditional market-cap weighted S&P 500. A day like Monday demonstrates the obvious defensive rotation, but the equal-weighed outperformed the cap-weighted by 130 bps, underscoring the trend that's been brewing for the past few months: a healthy broadening of market participation, despite headline index performance.

It will be interesting to see how this evolving landscape manifests in correlations. As mentioned, correlations have been at historical lows for some-time now, which equates to elevated risk despite healthy market performance. Those lows very often indicate a market reckoning is due and it seems like we are seeing it now. With earnings season still a long ways off, the road ahead is filled with landmines—closely scrutinized economic data releases that will shape investor sentiment. We are poised for a holistic risk on/risk off trading days and plenty of room for correlations to shift dramatically.

One thing is certain: when real price volatility rises, risk variance in trades rises more. And when volatility spreads across the market, execution becomes more challenging. At the moment, every catalyst seems negative, and implied volatility around economic headlines is surging. If this patterns of turbulence persists, the choppiness will hurt continuous traditional institutional flows and the depth and the health it provides.

When volatility spikes, three constant metrics emerge:

1. Dark trading declines
2. Average trade sizes shrink
3. Average spreads widen

If these signals continue flashing, it's a clear warning that market conditions are shifting in a way we haven't seen in years. The reckoning may just be getting started.

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Buckle up

With 2024 quickly fading in the rear-view mirror, the landscape for market volumes is changing just as fast. Urgency in trading will force broker algorithmic models to adjust the sources of liquidity they tap into, and force buyside traders to interact with contra liquidity in ways that are much different than what was enjoyed in '24.

Volatility is raising variance, which rises even more when spreading out a trade in a turbulent market. The catalysts all seem negative, and even slight positive signals, aren't bringing in the buy-on-dip behavior this market has enjoyed for some time.Not everyday is going to be turbulent but understanding the constant presence of choppy trading, what that does to liquidity sources and expected trade impact, becomes very important.

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