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Lawrence Harris and Joel Hasbrouck

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Market vs. Limit Orders: The SuperDOT Evidence on Order Submission Strategy

Lawrence Harris and Joel Hasbrouck*

Abstract

This paper discusses performance measures for market and limit orders. We suggest two measures: one for precommitted traders (who must trade) and another for passive traders (who are indifferent to trading). We compute these measures for a sample of NYSE SuperDOT orders. The results suggest that the limit order placement strategies most commonly used by NYSE SuperDOT traders do in fact perform best. Limit orders placed at or better than the prevailing quote perform better than do market orders, even after imputing a penalty for unexecuted orders, and after taking into account market order price improvement. Unconditional order submission strategies that use SuperDOT to offer liquidity in competition with the specialist do not appear to be profitable.

I. Introduction

Order submission decisions are among the most important choices traders make. Traders typically must decide when to use market orders (which demand execution at the best available price) and when to use limited price orders (which execute only if a counterparty meets the limit price). Market orders pay an implicit price for immediacy. Limit orders bear the risks of nonexecution and adverse selection. This paper presents an empirical analysis of the tradeoffs involved based on the execution performance of an actual sample of New York Stock Exchange (NYSE) orders.

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