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Financial Analysts Journal ›

Volume 63, 2007 - Issue 3

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Financial Markets

Trading Volume: NASDAQ and the NYSE

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Pages 79-86 | Published online: 02 Jan 2019

Cite this article https://doi.org/10.2469/faj.v63.n3.4693

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Abstract

Historically, reported trading volume has been overstated for NASDAQ stocks relative to NYSE stocks. Because NASDAQ volume may be overcounted, many researchers use an adjustment factor to make it comparable to NYSE volumes. Today, electronic communication networks account for about 75 percent of the trading volume for NASDAQ stocks. Many believe that the increased level of trading on ECNs and changes to the order-handling rules have lessened the discrepancy between the exchanges. To investigate, this study examined the relationship between reported trading volume to shares outstanding for a matched sample of NYSE and NASDAQ companies. The evidence indicates that the discrepancy has not diminished but widened.

Historically, reported trading volume has been overstated for stocks on NASDAQ (a dealer market) vis-à-vis stocks on the NYSE (an auction market). Market practitioners know that NASDAQ volume may be double-counted, so they frequently use an adjustment factor of 50 percent or so to make it comparable to NYSE volumes. Electronic communications networks (ECNs), however, now account for about 75 percent of the trading in NASDAQ stocks, which should make the NASDAQ resemble an auction market.

Reported trading volume matters for two reasons. First, various U.S. securities regulations are based on trading volume. For example, U.S. SEC Rule 144 limits an individual's sales of restricted common stock during a three-month period to either the average weekly trading volume in the stock during the preceding four weeks or 1 percent of the shares outstanding. Second, reported trading volume matters because trading volume is an important measure, for portfolio managers and other practitioners, of a stock's liquidity. Practitioners need to know when trading volume is "real" and when it is overcounted as a result of dealer trades and, therefore, misleading. Moreover, some firms, deciding that reported volume figures in the two markets are now roughly equivalent, have already stopped adjusting for the historical difference in reported volume. We looked for evidence that the way volume is reported has indeed become equivalent in the two markets.

Thus, we examined the structure of reported trading volumes on the NYSE and NASDAQ before and after the changes that occurred from 1997 to 2002. Specifically, we compared trading during 1990–1996 with trading during 2003–2005 to determine whether any meaningful change has occurred in the relationship between reported trading volume in the two markets from the former period to the latter period.

We related reported trading volume on the NYSE and NASDAQ to the number of shares outstanding for a group of comparable companies trading on the two exchanges; we controlled for nonlinearity, stock price level, and volatility. We used the regression model to investigate the proposition that the widely acknowledged discrepancy between reported trading volumes for NYSE and NASDAQ stocks that existed before 1997 has diminished or vanished because of such recent developments as the change in order-handling rules for NASDAQ stocks and the increasing role of electronic order books in trading NASDAQ stocks. Surprisingly, we found no evidence that the discrepancy has either narrowed or vanished. On the contrary, our results suggest that the discrepancy may have widened, perhaps because of increased interdealer trading.

We also found that the association between volatility and reported trading volume has increased dramatically in recent years for both NYSE and NASDAQ stocks.

The absence of any basic change in the relative structure of reported trading volume between NASDAQ and the NYSE is a major puzzle in view of the fact that the majority of the trading in NASDAQ-listed securities has been via electronic order books in recent years. One auction market should look much like another, but we see no signs of convergence between NASDAQ and the NYSE with regard to the structure of trading volume.

Notes

[1] Newman (1990); Atkins and Dyl (1997); Anderson and Dyl (2005).

[2] The proportion of trades in which the specialist participates tends to be inversely related to the volume of trading in a stock (Madhavan and Sofianos 1998; Bondarenko and Sung 2003).

[3] We are grateful to Frank Hathaway of NASDAQ for providing this estimate.

[4] Chordia, Huh, and Subrahmanyam (forthcoming) examined the determinants of trading activity.

[5] Information about the companies during the transition period (1997–2002) has been omitted from Tables 1–3 but is available from the authors.

[6] The results of these annual regressions are available from the authors.

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Financial Analysts Journal
Published online: 2 Jan 2019

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