

THE ETF TRADER INTERVIEW SERIES: KEN DOLAN, JEFFERIES & COMPANY

David Abner — Head of Europe

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Welcome to the fourth installment of the [ETF Trader Interview Series](#). In this edition, Dave Abner, Head of Capital Markets at WisdomTree, speaks with Ken Dolan, Senior Vice President on the ETF trading desk at Jefferies & Company, Inc. Ken joined the desk in 2011 after spending nine years at LaBranche & Co. as a Managing Director and Head of ETF Trading. In addition to his ETF trading experience, Ken has nine years of trading experience across equities, fixed income and emerging markets at Deutsche Bank, Credit Suisse and Lehman Brothers. He received a BS from Providence College and is a Chartered Financial Analyst. **David Abner: Tell us a little about yourself and your business. Let's start off by explaining your firm.**

Ken Dolan: Jefferies is a global investment banking firm focused on serving our clients for over 50 years. Our full-service platform provides a full range of investment banking, sales, trading, research and strategy across the spectrum of equity and fixed income securities, as well as commodities, across the Americas, Europe and Asia.

DA: What services do you provide? **KD:** Jefferies has a full-service ETF sales and trading platform. Our main goal is to provide consistent pricing to our clients. Our team provides clients with consistent and aggressive pricing, not only during the day, but also outside of market hours. We use proprietary risk and trading systems to best provide prices and [liquidity](#) to our clients. Our pricing reflects our ability to trade baskets, ETFs, options and, on certain ETFs, futures. Our partnership with the fixed income group to source underlying bonds helps us be more competitive for our clients. **DA:**

Describe your client base and your experience. **KD:** We provide insight, expertise to investors, companies and governments from all over the world. Together our team of ETF traders has over 25 years of experience trading the ETF product. The team is well known in the market for its expertise in trading fixed income and international ETFs. **DA: Give**

an example of a trading/execution strategy you have developed with a client. **KD:** We like to discuss with clients where an ETF is currently trading relative to its [arbitrage](#) band to determine the best course of execution. The arbitrage band stretches from the redemption price to the creation price, and incorporates the underlying bid/ask spreads, all associated transaction costs and any taxes or stamp duties. If an ETF is trading near its creation price, trade impact decreases for buy orders as the arbitrage opportunity adds supply to the market. Sell orders wouldn't have the benefit of the arbitrage liquidity, so we might advise a trading strategy that would reduce potential impact and maximize the midband liquidity. **DA: What mistakes do you see clients making in their execution process?** **KD:** Many times we see clients using a standardized process and not adjusting based on intricacies of products (i.e., U.S. equity ETF versus International equity ETF versus Fixed income ETF). **DA: What do you wish clients would do better?** **KD:** It would be nice to see clients show more flexibility with regard to clearing trades. **DA: How do you think ETF issuers could help**

the process of client execution and education? **KD:** ETF issuers could help better educate smaller funds about the benefits of trading directly with the liquidity providers. **DA: The ETF managed portfolio segment is one of the fastest growing segments of the ETF market. Is there anything in particular that group should be focused on**

when transitioning its portfolio holdings? **KD:** We've been successful when we've partnered with ETF managed portfolios to pair any additions against correlated deletions. This allows us to reduce market impacts and [hedging](#) costs. This also reduces the market risk to the [dealer](#) and, ultimately, the trading costs to the portfolio. **DA: Discuss the**

growth of the Fixed Income ETF segment and what you believe its effect on the bond market could be for individual bonds. **KD:** We are seeing some impact to individual bond issues in cases where a particular ETF has large assets under management (AUM). This happens because many of the ETF strategies are [passive](#) and target specific [CUSIPS](#), rather than relative value in any given corporate credit. But ultimately, an ETF is just a wrapper—a way to gain access to an asset class. So most effects on individual bonds are a function of the aggregate demand for that class of assets. **DA: What is the best way to assess the potential liquidity of a fixed income ETF?** **KD:** Very generally,

liquidity in fixed income markets and hence fixed income ETFs will correlate with [duration](#) and [credit quality](#). The further out the [duration curve](#) you go, the less liquid the underlying bonds are. And the lower you are in the credit spectrum, the

less liquid you would expect those bonds/ETFs to be. The structure of the creation and redemption process also impacts the liquidity in Fixed Income ETFs. This varies from issuer to issuer and even product to product. This is where it helps to work with a trading desk that is actively involved in the fixed income ETF space. **DA: What should clients be thinking about/asking when getting ready to execute an ETF block trade in a lower-volume ETF? KD:** The focus here should be on the liquidity profile of the underlying securities, round-trip trading costs and how to best manage the impact. It's possible to minimize your trade impact by expanding the trading window, but that increases your market risk. Clients should understand and quantify this trade-off to help pick the optimal trading strategy. **DA: What are the most typical concerns you hear from clients regarding the ETF market? KD:** Liquidity during stressed market times. **DA: Do you think the [Bid/Ask Spread](#), the difference between the best price you can buy and sell an ETF electronically, really matters when judging an ETF for investment candidacy? What do you think is the best way an investor should judge liquidity and execution cost of an ETF? KD:** Round-trip execution costs, including bid/ask spread, commissions, fees, stamp taxes, etc. **DA: Explain the significance of a [creation unit](#). Do investors need to be aware of how many shares equal a creation unit for an ETF? KD:** Not really. Any discussions around optimal creation unit size are usually had by the ETF issuers and their [authorized participants \(APs\)](#). The only time this may be a factor for an investor is in the scenario of an ETF with low shares outstanding (three or fewer units), low [average daily volume \(ADV\)](#), and small trade size. In this case, whether a dealer has inventory or not can affect the pricing. **DA: Thank you very much for participating in this series.**

Important Risks Related to this Article

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Liquidity : The degree to which an asset or security can be bought or sold in the market without affecting the asset's price. Liquidity is characterized by a high level of trading activity. Assets that can be easily bought or sold are known as liquid asset.

Arbitrage Mechanism : The ability to compare the price of an ETF and its underlying basket and exchange one for the other utilizing the creation and redemption process.

Currency hedging : Strategies designed to mitigate the impact of currency performance on investment returns.

Dealer : A person or firm in the business of buying and selling securities for their own account, whether through a broker or otherwise.

Passive : Indexes that take a rules-based approach with regular rebalancing schedules that are not changed due to market conditions.

Duration : A measure of a bond's sensitivity to changes in interest rates. The weighted average accounts for the various durations of the bonds purchased as well as the proportion of the total government bond portfolio that they make up.

Credit quality : A measure of a borrower's potential risk of default.

Duration Curve : The graphical representation of the trend in interest rates as it relates to length of loan. The plots on the graph will have an interest rate for a specific loan time period, usually 2,5,10,30 year.

Creation Unit (CU) : A specified number of shares issued by an exchange-traded fund (ETF) in large blocks, generally between 25,000 and 200,000 shares. The authorized participants that buy creation units either keep the ETF shares that make up the creation unit or sell all or part of them on a stock exchange.

Authorized Participant (AP) : An entity, usually an institutional investor, that submits orders to the ETF for the creation and redemption of ETF creation units.

Average daily volume : Average dollar amount traded over the course of a single trading day.