



Basket Securities - The Future of Stock Trading?

Martin Bendmann

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Seminar paper from the year 2006 in the subject Business economics - Banking, Stock Exchanges, Insurance, Accounting, grade: 2,0, European University Viadrina Frankfurt (Oder), course: Market Microstructure, 20 entries in the bibliography, language: English, abstract: Harry M. Markowitz developed the most renowned capital market theory of the last century, for which he received the Nobel Prize in 1990, the “Modern Portfolio Theory”, which can be seen as the basis for basket securities. He recommended investments in diversified portfolios in order to reduce risk.¹ Especially institutional investors started to trade large diversified bundles of shares in order to construct efficient portfolios. Soon they recognized, that they need to find an alternative with lower transaction costs and lower potential to destabilize the market than the conventional program trading.² Trading baskets that include all stocks, with narrow spreads and liquid markets, appeared to be a solution.

As a result at the beginning of the 70s the first index funds were issued in the USA, based on the assumption, that actively managed funds are not able to outperform the market in the long term.

Those funds are intended to avoid the costs of program trading that occurred every trade and meet the needs and expectations of the investors. Due to the instant success, several instruments were created. In the following pages I will point out how an ideal basket vehicle should be designed and afterwards examine some of the most popular basket securities concerning the question how good they meet their target of replicating their underlying index and at which price.

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