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Opinion

The Value of Timing Requirements in Market Microstructure Research

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DESCRIPTION

The study of financial markets and how they function is known as market microstructure. The price discovery process, factors influencing spreads and quotations, intraday trading behaviour, and transaction costs are the main areas of interest in market microstructure analyze. Market microstructure is still one of the fields of financial study that is increased due to the quick development of algorithmic and electronic trading. Due to the financial markets' rapid expansion over the past ten years, there are many more trading venues and exchanges now than ever before, and trading procedures have become considerably more complex and sophisticated. Computers and electronic trading agents have exceeded traditional trading functions and participants. The traditional matching and routing of orders has given way to complicated analysis and sophisticated real-time decision-making as a result of human engagement in the trading process. Now, it is the responsibility of the market microstructure analyst to comprehend every problem relating to the dynamic marketplace. Up to this point, the majority of academic analyze has been on methods for estimating an instrument's fair market value, projections of expected returns, and methods for risk modelling. By looking at the balance sheet, fundamentals, sales data, year-over-year growth, and revenue projections of the company, analysts may use a bottom-up technique to ascertain the fair value price of a company.

In order to predict which variables, industries, or other subgroups will probably under or over perform in the future, analysts may also employ a top-down method. Although the bottom-up, top-down, and quantitative approaches are useful for understanding how the market determines fair value and which stocks are appropriate to hold in a portfolio, they are unable to explain how to measure and take into account investors' individual assessments and preferences for the securities or how the markets will respond to the arrival of "new" information. Without accounting for these preferences, portfolio managers might make transactions at disadvantageous prices, which would have a negative impact on performance and be a common cause of funds performing worse than their rivals. The role of the market microstructure analyst is to offer insight and useful information to traders and portfolio managers so that the best market prices are recorded, hence decreasing performance drag and enhancing portfolio returns, as will be a theme in this chapter. The provision of investors with a fair and transparent price discovery and liquidity snapshot is one of the primary functions of financial markets. Financial markets are not as frictionless as formal economic theory would have us believe. In fact, implementation is frequently expensive because of this inefficiency. As a result, market microstructure analysts must comprehend not only how prices are determined and the liquidity of the market, but also how prices will fluctuate in response to the introduction of fresh information and competing customer demands.

CONCLUSION

Specialists would determine the overall buy-sell imbalance, establish a fair value price based on market information and set a minimum bid/ask ratio. Stocks listed on the OTC market would trade *via* NASDAQ's dealer-based system with multiple market makers. Market makers were in charge of supplying liquidity, distributing prices, and preserving a fair and orderly market.

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