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Shades of Darkness: A Pecking Order of Trading Venues*

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Abstract

We characterize the dynamic fragmentation of U.S. equity markets using a unique data set that disaggregates dark transactions by venue types. The “pecking order” hypothesis of trading venues states that investors “sort” various venue types, putting low-cost-low-immediacy venues on top and high-cost-high-immediacy venues at the bottom. Hence, midpoint dark pools on top, non-midpoint dark pools in the middle, and lit markets at the bottom. As predicted, following VIX shocks, macroeconomic news, and firms’ earnings surprises, changes in venue market shares become progressively more positive (or less negative) down the pecking order. We further document heterogeneity across dark venue types and stock size groups.

Keywords: dark pool, pecking order, fragmentation

JEL Classifications: G12, G14, G18, D47

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