

AERIAL VIEW

ACCESS A BROADER MARKET PERSPECTIVE



GOING BEYOND THE CALL

CORPORATE BOND BUYERS DIAL BACK THE PHONE IN FAVOR OF AUTOMATING SOME PRICE-CHECKING AND DATA-AGGREGATION TASKS

BY AERIAL VIEW STAFF

Credit investors are starting to use machines to aggregate prices and stage orders, a long-awaited development for fixed-income markets that for years have been striving to resemble exchange-traded equity markets.

For decades, fund managers have been relying on banks, software providers and technology firms to bring innovation to the bond markets. Change was elusive at first, with only incremental increases in electronic execution.

Lately, however, credit traders across the buy-side have started to embrace such technology amid shifts in volatility, reduced liquidity in the wake of the global financial crisis and regulations that require them to demonstrate best efforts to execute an order for an end client.

In the second quarter about 29% of corporate bonds changed hands electronically, according to researcher Greenwich Associates, up from 19% in early 2018. About 58% of US Treasuries traded electronically as of last year, up from 51% a decade ago, according to research firm Aite Group. That compares to 90% of equities, which primarily trade on exchanges.

Bond buying is also becoming more systematic as lower returns, and the shift from active to passive investment strategies, are spurring buy-side firms to reduce costs. Buy-side traders are starting to use auto-quoting systems and aggregators to check prices from multiple venues in one centralized place, a shift that is streamlining previously manual processes and helping to unlock more turnover in hard-to-trade securities.

Telephone negotiations for trades in

more esoteric corporate debt securities are still common, but automating trading in the more liquid securities has continued to increase. Additionally, more and more order tickets are generated with a search for prices on a platform and traders are seeking prices across whole lists of bonds at once, instead of one at a time.

Some institutions are also realizing that using technology to aggregate market information can reduce human error and the time it takes to trade.

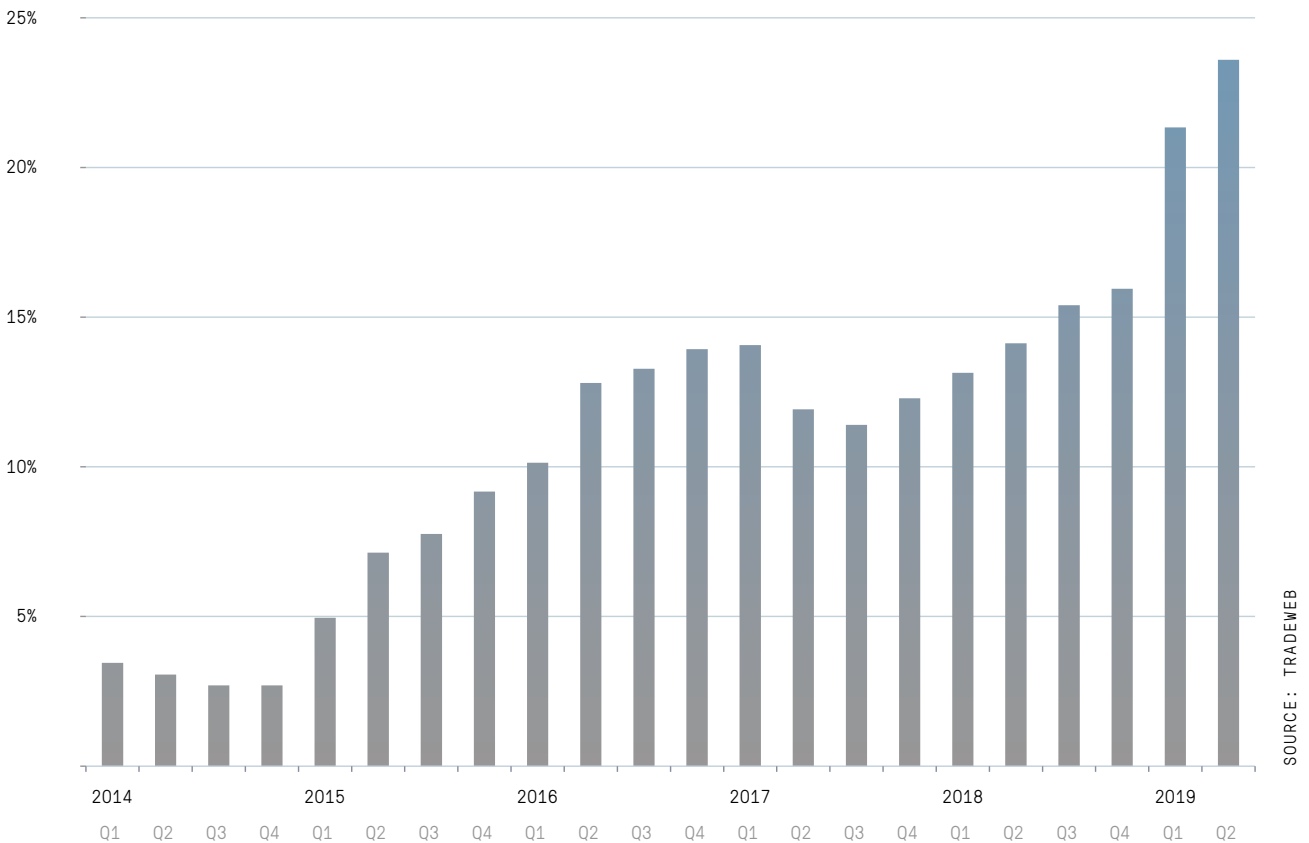
“What it’s really doing is what the desk assistant did 10 to 15 years ago, which means looking at all the pricing sheets [and] aggregating them into one place so the trader could make a decision,” says Audrey Blater, senior analyst at Aite.

One often-stated cause for the lag in electronic bond trading is structural: borrowers issue debt in many

(CHART 1)

BONDING MOMENTS

The percentage of institutional investor bond trades* on Tradeweb using its AiEX tool reached a record in the second quarter



*CORPORATE AND GOVERNMENT BONDS

different forms and maturities, unlike equities that are traded in standardized form primarily on exchanges and other electronic venues. A second factor is the disparity between high turnover in newly issued debt in today's low interest-rate environment and low liquidity in bonds that are a few weeks old.

Now, automation is making it easier and faster to trade those bonds, bringing more liquidity to the credit markets so that human traders can spend more of their time on areas where they can bring more value.

"The more turnover in the market, the fewer bonds that dealers need to hold in their inventories and the more we can focus on assisting clients in

areas like helping to source interest from other buysiders in less liquid instruments," says Michael Brown, who runs fixed-income electronic markets at BNY Mellon Capital Markets, LLC, a registered broker dealer.

The broker dealer is signed up to a host of bond platforms, including Bloomberg, Tradeweb, LiquidityEdge and MarketAxess. In August, MarketAxess said it had agreed to buy LiquidityEdge.

AllianceBernstein LP, a \$580.8 billion asset manager as of June 30, built a platform called ALFA – or Automated Liquidity Filtering & Analytics – to identify investment opportunities and suggest trades. That brought the liquidity

discussion to the forefront of the investment process rather than the end, says James Wallin, senior vice president in fixed income at the firm.

In 2017, the asset manager sold ALFA, putting the tool in the hands of a much wider swath of buy-side participants. "Algorithmic pricing has allowed for efficiencies in trading, freeing up traders to focus on the high-touch, less-liquid value add to our clients," says Wallin.

Another benefit is that, once armed with more pricing knowledge and rules-based software, traders can become part of the securities selection process earlier on in the trade negotiation process. That operational efficiency

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**JAMES WALLIN,
SENIOR VICE PRESIDENT
IN FIXED INCOME,
ALLIANCEBERNSTEIN**

A WIDER POOL

The growth in auto-quoting, price aggregation and electronic execution in corporate bonds has given buy-side traders a chance to verify prices more efficiently and make quicker decisions. But some market conventions die hard.

Broker dealers still sit on the other side of many credit trades, with about 56% of buy-side volume in the U.S. investment grade corporate bond market handled by the five largest dealers, according to researcher Greenwich Associates.

Nevertheless, portfolio managers are increasingly able to trade with their peers in a comingled pool, aided by new technologies and means of price discovery. “All-to-all [trading] has certainly moved from theory to reality” in credit markets, wrote Greenwich’s Kevin McPartland in a recent report.

MarketAxess, which has an approximately 85% share of institutional corporate bond trading on electronic platforms, has a tool it calls Open Trading serving more than 1,600 institutions. Since the platform operator is also a registered broker dealer, buyers and sellers face MarketAxess as the central counterparty, keeping flows anonymous. Open Trading saw \$2.1 billion in average daily volume in the second quarter of this year, up 48% from the year-earlier period. The number of responses grew 57% over the period (see chart 2).

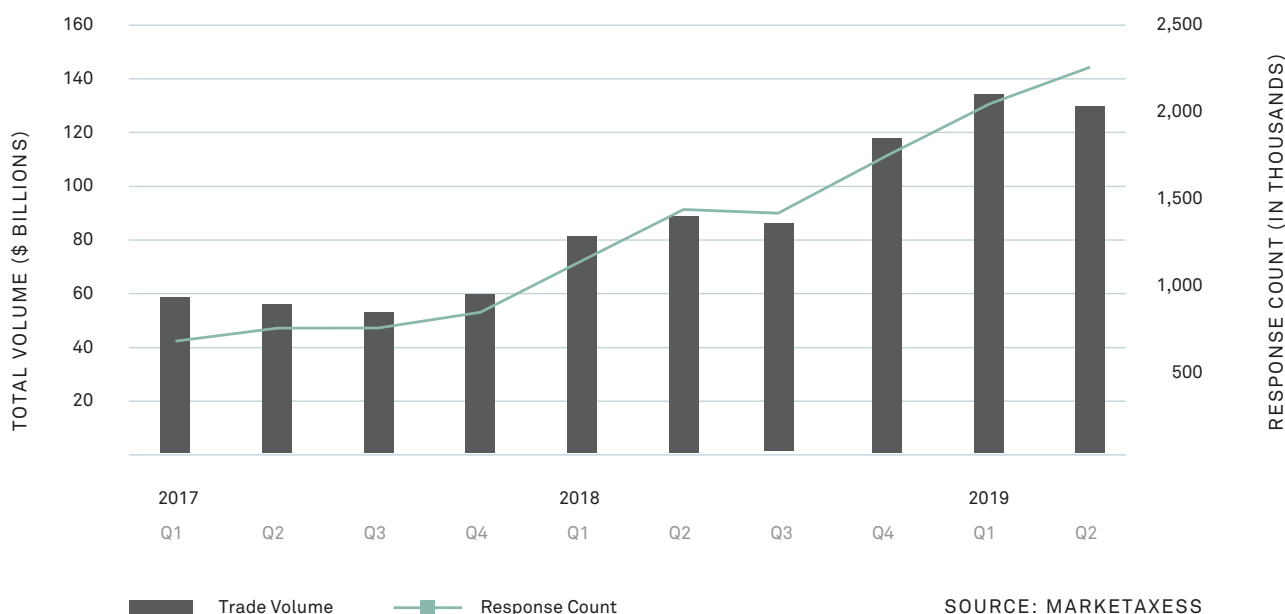
But just because customers can print trades with other customers, it doesn’t make dealers irrelevant. In certain instances, when customers can’t complete trades on such anonymous venues, their dealers will put balance sheet to work and provide the liquidity they need. While most of the negotiations behind corporate bond trades still happen by phone or by chat message, the growing use of technology shows the marketplace is changing.

BNY Mellon Capital Markets, LLC is committed to evolving with the market, supporting both innovative and traditional ways of servicing our clients’ liquidity needs.

(CHART 2)

ALL SYSTEMS GO

On the MarketAxess Open Trading system, where anyone can trade with anyone*, volumes are up 48% year over year



*Professional trading institutions signed up as counterparties to the MarketAxess broker dealer

is key now that there are so many trades needed to keep up with moves in benchmark indices and exchange-traded funds.

Of the bond investors that are auto-executing credit trades, more than 80% said that they were doing so for trades under \$1 million in size.

“If they’re seeing repetitive patterns of trading for certain securities like US Treasuries or investment-grade corporate bonds, they say, ‘Why do we need to have people keep clicking buttons when their time can be focused on more high-value efforts? Can we program a machine to do that for us?’” says Ravi Sawhney, global head of automation and analytics at Bloomberg LP, which launched an automated trading system for bonds in November.

The tool called “Rule Builder” can be used to define trading parameters without the requirement to call in experts to write personalized computer code. The system now works for fixed-income and equities trading, and will gradually support other asset classes as well, Sawhney says.

Tradeweb has a tool called Automated Intelligent Execution, or AiEX, which facilitates trading for 22 different products and more than 100 desks are now using it. Colm Murtagh, who heads up institutional rates trading for the platform operator, used to work at asset manager BlackRock and by the time he left three years ago, 40-50% of all US Treasury trades the firm did through its central execution desk involved AiEX. In the second

quarter, a record number of trades going over Tradeweb systems involved AiEX (see chart 1).

“In almost every case, highly skilled traders want to spend their day finding opportunities [for customers] as well as adding value and off-setting risk, rather than just clicking buttons,” Murtagh says. “AiEX does the latter so they can go back to doing the former.” ●

Katy Burne is Editor of Aerial View Magazine at BNY Mellon Markets. Questions or Comments? Contact MichaelDavid.Brown@bnymellon.com in BNY Mellon Markets, or reach out to your usual relationship manager.

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