Trader TV Marketplace - Show 1 - Lee and Angus

Jo Gallagher Welcome to Trader TV Marketplace: Exclusive insights from market operators. Today I'm joined by Lee Bartholomew and Angus McDiarmid of Tradeweb to analyze how traders are tackling a variable interest rate environment. Lee Angus, welcome to the show.

Lee Bartholomew and Angus McDiarmid Thank you for having me.

Jo Gallagher Set scene for us. What is driving trading and investment flows?

Lee Bartholomew I think there are several factors. Growing risk of central bank divergence right, between US and Europe. I think that's something that is driving flows to Europe. You've got the Bank of Japan change of policy. I think that's playing into some of the periphery European markets. I think you've got different credit risk profiles within Europe, and then you've also got the overarching factor of data is coming in sticky. It's not about will inflation come back to 2%. It's can it be maintained at 2%. And we're definitely seeing that in our flow. I think some of the surprising things that we're seeing is, you know, OAT volumes are still double digit up. Quarter one was a record quarter for us around workflows. You know, basis is becoming much more prevalent, whether that's cash versus the futures or whether that's IRS versus futures. You know we're working along with Tradeweb on some of these solutions. And I think that helps access to the markets and liquidity, [making it] much more appealing. And therefore you're seeing as a second order effect volumes increase, on the back of that.

Angus McDiarmid We've seen heightened growth in Q1 this year, up about 25% in our core developed markets compared to Q1 last year. The inflation story that Lee mentioned is obviously key to that. Yes, inflation has come down, but not to the extent that I think the central banks thought and the market thought. So we have meeting day policy swaps on the platform and where we had a number of cuts priced in at the start of the year. We've now at a position where there's probably only 1 or 2 priced in for US, UK and for the ECB as well. And that uncertainty brings volatility and brings more trading opportunities on the platform.

Jo Gallagher Now how are these dynamics also affecting instrument selection?

Lee Bartholomew The sell side has got much more comfortable that listed products coexist alongside OTC markets. And I know I've been on previous shows and discussed credit specific markets and I sound a little bit like a broken record, but I do think you are seeing a transition whereby fixed income will never go fully equity but there are markets within fixed income which will go equity like. And I think credit is one of those markets, I think FX is one of those markets. And then also rates have made quite a lot of progress. So what you're seeing is more of a diverse liquidity provision pool in credit. For example, you bring in the ETF providers. You look at the cash guys. They're looking at kind of package trades on Tradeweb where they want to combine those package trades with derivatives. And therefore you get a much healthier ecosystem. And people are looking to kind of reduce their market impact. For the buy side, what that means is what instruments do I use and when and what's the best combination of those instruments and how do I express my view short term, medium term and long term.

Angus McDiarmid Tradeweb operate a SEF and MTFs. Two MTFs, one in Europe and one in the U.K. It's not exactly the same as Lee was saying, but very similar. People want to access different markets and link those markets as well. So not only if we worked with Eurex with the swaps versus futures, and we're working on cash versus future basis trading, which are contingent on the platform, which means that many dealers give one price for the spread of the two products. We're also seeing people wanting to link OTC and cash markets and OTC versus OTC markets, and they're looking at different ways to do that as well. You know, Tradeweb has been operating swaps for 20 years now. So as the home of swaps, we're uniquely place to be able to bring those markets together. And we're seeing increased activity in cross market trading on the platform as a general rule.

Jo Gallagher How is that reflected in the way people trade?

Angus McDiarmid On some products? Contingency is key. So exchange traded versus an OTC or exchange versus cash. That contingency is key because of exchange rules protocols we built on the platform in that we can cross those products and send the cross to your ex to be processed on the exchange in a timely manner, which is part of the sort of rules of executing those types of packages. But when you look at asset swaps, where it's cash versus swaps, we find that our client base are looking for finding the best liquidity in the cash product and the best liquidity in the derivative product simultaneously, but from different pools. So crossing them up on the trade with a simple execution protocol that mix between contingent, non contingent then brings into play asking for two way pricing which is also key to our client base. So where two way is available they'll want to limit their market impact by trading that way as well.

Lee Bartholomew I think for me it's all about interoperability across the exchanges. Right. And. Platforms. And I think with technology going where it is, every business is a network business and it's how do you enhance the value chain across the networks in order for clients to achieve what they want. I think the buy side asset managers are under pressure on an active front from passive. Right. You've then got macro hedge funds versus systematic of how much of it's automated, how much of its voice. And I think what we're seeing is one: What products can I do to replicate my risk and what's the best way to express that view, whether that's short term, long term combination thereof. And then it's the second point, which is how can I strategically and long term enhance my workflow enhancements? Right. So I then optimize my model between kind of low touch, high touch. And then that way it gives me much more kind of control over which products I'm using. So that's why I think you see kind of credit and FX growing from here. I think what is interesting from a sell side perspective is there are a lot more engaged now in the technology so that the traders can focus on the bigger ticket, higher value business and therefore looking to kind of increase what they do on the smaller ticket flow side, low touch versus high touch, and therefore then they can focus on kind of monetizing the bigger flow.

Jo Gallagher And ultimately, how does this impact the risk on their return profiles?

Angus McDiarmid We've seen an increase in automation as well. Some of the lighter touch trades can be put through an automated program to be executed under certain rules, at certain times or with certain liquidity providers, distance from mid, etc.. And we've seen an increase in low touch business being done through an automated workflow that the dealers are more than happy to provide liquidity for, and then the higher touch, more structured products, taking a little bit more time and still remaining on a buy side sort of desktop and having a trader execute those portfolios.

Lee Bartholomew You're getting dislocation in the market, so that gives a lot of opportunity. You then seeing kind of the pod structures, guys that are looking at kind of the basis in a much more automated fashion or big size using more leverage. So therefore their workflow enhancements are much more sensitive to that. It's also much more sensitive to changes in protocol, both at the exchange and the Tradeweb layer. Right. Because ultimately for them, they want to focus on generating the alpha. How do you combine that access versus cost and who's providing the liquidity. And I think you can see it on a micro-level. And you can also see on a macro level, and you're definitely getting much more connectivity because there's so heavily focused on how do I create X return over. And if I'm building a new system, how much does that shave off my performance? And do I do that short term versus long term gains? And that for me, is much more in focus now in Europe than it has been, because you're getting that dislocated right environment.

Jo Gallagher I'd like to thank Lee and Angus for their insights today, and of course, you for watching to catch up on our other shows, including Trader TV This week, go to tradertv.net.