Carpe diem

Investor appetite for emerging markets remained buoyant during 2012 and technology enhancements aiding access to a number of developing markets will be continue to be key themes during 2013, writes Roger Aitken.

Emerging markets, which as a term was first brought into fashion in the 1980s by then World Bank economist Antoine van Agtmael, is sometimes loosely used as a replacement for emerging economies. Today the seven largest emerging and developing economies by GDP today are China, Brazil, Russia, India, Mexico, Indonesia, and Turkey.

Investment across emerging markets has been robust of late, as evidenced by emerging market hedge fund capital reaching US$127.8bn during Q3 2012. According to Morgan Stanley Capital International (MSCI), which launched the first Emerging Markets Index covering 21 countries in 1988, the global equity opportunity set had risen to 14% in 2010 (1988 = 1%).

Per Lovén, Head of Corporate Strategy, EMEA, Liquidnet, a global institutional trading network, says: "There is a growing desire from institutional investors in the western world, who hold 85% of all investable assets, to increase exposure towards equity markets of fast-growing economies which, historically, have been under-invested."

Some emerging markets have even started to become hubs for other markets and a new generation of algorithms based on liquidity seeking strategies well suited to emerging market environments is helping matters.

Russian market interest has been propelled by the success of London Stock Exchange's International Order Book (IOB), where today 34 Russian companies have their GDR's (Global Depository Receipts) traded through an IOB universe of 127 companies. Stocks like Russia's Gazprom recorded over US$6bn in trade value in November 2012 on the IOB.

Ben Wood, Managing Director, Head of International DMA at Otkritie Capital based in London, an FSA regulated broker, says: "Interest from investors in the Russian markets is definitely improving. With the merger of RTS Forts and Micex to form the Moscow Exchange, all asset classes – futures, derivatives, FX and equities – are now under one banner."

The combination of Russia's two exchanges (RTS Forts/Micex) into Moscow Exchange, originally announced in December 2011, benefits market participants by creating a single platform for issuers, traders and investors. It will reduce transaction costs, make trading easier and facilitate product innovation.

The move comes as technology access to Moscow Exchange was beefed up through its new M1 datacentre following an upgrade and relocation of its exchange matching engines in November 2012.

Otkritie's brokerage division has diverse client base trading Russian securities spanning traditional asset managers, high frequency trading (HFT) firms and broker dealers. "All these players are trading across all asset classes in Russia," says Wood. Firms can be engaged in arbitrage opportunities between stocks on Micex and the LSE's IOB or be pursuing certain cross-asset strategies.

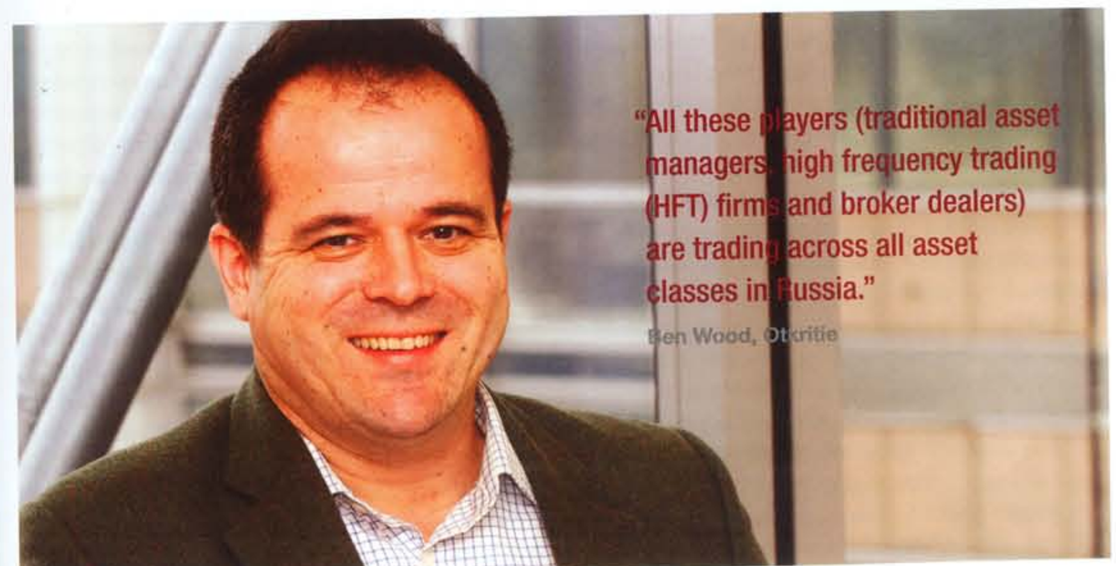
"Traditional asset managers typically require a FIX connection to route orders to a desk or algorithm engine which Otkritie is first to offer on the Moscow Exchange, while broker dealers need Direct Market Access (DMA) due to their latency sensitivity, and hedge funds and HFT houses with extreme latency sensitivity require co-location services that Otkritie provides."

While trading volumes for Russian equities are down this year over 2011, Wood says that the "exciting stories" in 2012 have been the growth of the RTS index futures, plus the expansion of the FX segment on the exchange. As the ninth largest futures contract traded by volume globally (c.1.5m daily contracts), the RTS index contract is one of only two index contracts where volumes increased in 2012 over the previous year.

Russian market reforms

In one of the latest reforms designed to increase accessibility of the local markets for foreign investors, Euroclear Bank was granted by access to Russia's central securities depository (CSD) on 3 October 2012.

This development, which allows Euroclear to offer post-trade settlement services in Russia and supports market stability, opened the channel for



a significant uptick in foreign investor participation the country's domestic bond market. Until this point non-resident holdings of domestic Russian government bonds (OFZs) had been at below 10% – lagging emerging world peers.

The merged exchange will act as a catalyst for continued improvements in Russia's financial infrastructure, including settlement in T+N." ('N' denoting number of days).

"Additionally a project for T+2 settlement has commenced, with a loose timetable for Q2 2013," reveals Wood. "They intend to test run the top 20 liquid stocks." The settlement period in Russia currently is T0, which requires investors to have pre-deposit in place.

"Clearly T0 is a barrier as having the stock [in Moscow] at exchange or the money to exchange means it's difficult for non-domestic investors to have that infrastructure in place," notes Wood. To that end Otkritie has an appetite for either lending assets or money and to brokerage the client base.

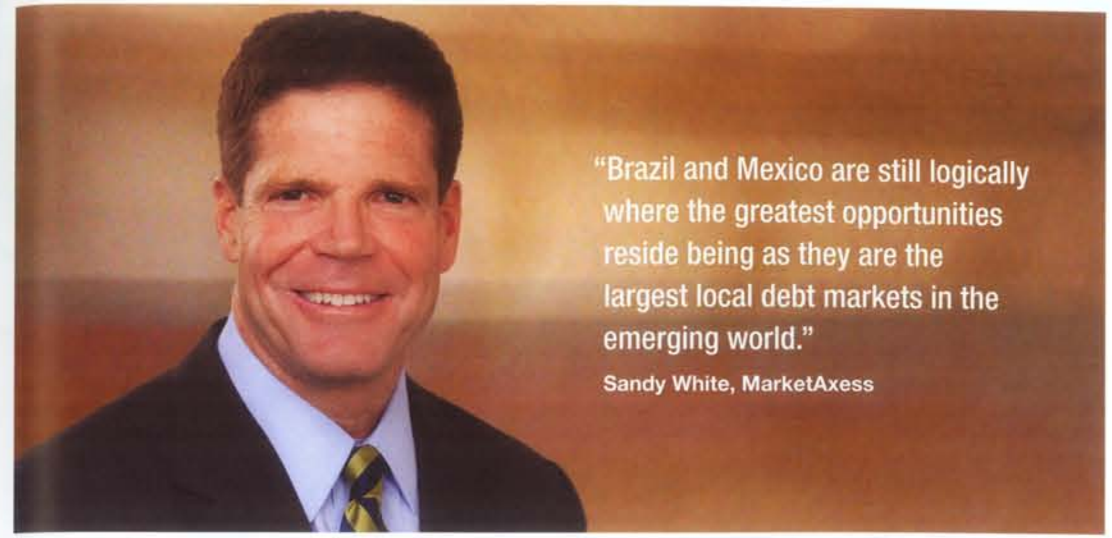
He adds: "We're also taking it further to provide a 'T+N' US$-settled transaction on Micex, so market participants will be able to choose their settlement cycle. That should appeal to the wide range of investors interested in this market." Otkritie's acquisition of Russia's Nomos Bank will likely provide a boost on the lending front as it ranks them number two in the country's non-state owned private lending market.

Peter van Wely, Head of InfoReach Europe, an independent provider of multi- and cross-asset, broker-neutral solutions for electronic, algorithmic and HFT analysis and execution of global equities, derivatives and FX, says: "We're seeing interest from US and European buy- and sell-side institutions looking increasingly at emerging markets generally and Russia in particular."

Back in April the Chicago-headquartered software vendor announced it had expanded its global footprint with connectivity to Russian markets through Micex/RTS. As such their clients were able to route equities, options and futures trade orders directly to the exchange using InfoReach's electronic platform (the InfoReach FIX Network).

He stresses: "The importance of Russia and Moscow as a financial centre – not just in and out, but also long term – because the growth of the financial sector there will grow proportionately more than an average market in western Europe. There is also nascent interest from among Russian institutions to invest in technology and trade markets outside their country."

Van Wely also notes a "big problem" centres on pre-trade risk controls, where not all the checks and balances are necessarily always in place to prevent mishaps at the front end. In this regard the vendor has undertaken significant recent work in this area and counts Russian firm Nord Capital among its clients.



More markets, more asset classes

Liquidnet, which today operates in 41 markets globally has in recent years increased the pace of its expansion into emerging markets to include Turkey, the Philippines, Indonesia and Malaysia. On 23 July 2012 Liquidnet announced that institutional investors were now able to trade Turkish listed securities through its platform.

Liquidnet's Lovén says: "Institutional investors looking to unlock value in Turkish growth companies will now be able to source large-scale liquidity in those equities, with minimal market impact, through our trading network."

Sandy White, Emerging Markets and High-Yield Product Manager, MarketAxess, in New York commenting on fixed-income landscape in Latin America, says: "For three years in a row we have witnessed overall growth in the 30%-40% range in terms of trading volumes for our emerging market fixed-income products – both for external and local trade debt [sovereign and corporate]." For 2012 White anticipates emerging growth for the firm will end c.35% higher than 2011 volumes.

MarketAxess' Emerging Market trading platform provides liquidity from thirty leading emerging markets dealers on sovereign and corporate debt offering dynamic trade inquiry routing to dealer trading desks based in New York and London as well as the likes of São Paulo, Mexico City, Hong Kong, Moscow and Istanbul. MarketAxess' Request For Quote (RFQ) model has also been enhanced to offer investors a 'Click-to-Trade' facility.

"Brazil and Mexico are still logically where the greatest opportunities reside being as they are the largest local debt markets in the emerging world. It's also where we have gained the most traction," says White. "Local debt is definitely a growing part of the story and accelerating. Close to 10% of our business now, a year ago it was below 5%."

One impediment currently facing foreign investors in Brazil is an upfront 6% tax (IOF) on money coming into the country to investing in fixed-income securities. White says: "It's definitely slowing down the growth of foreign investment in the local [Brazilian] debt market. However, we believe this to be a temporary situation."

Investors can also access fixed-income products in Argentina, Colombia, Chile, Peru and Uruguay through MarketAxess, though presently only for the global debt denominated in local currency and settled in US dollars. ■