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# FIXED INCOME

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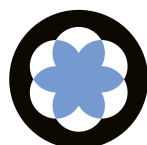


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## Fixing Fixed Income

With the world still recovering from a drawn-out financial crisis, it's easy to forget that the initial catalyst for this economic collapse was the credit crunch, and that the inability to accurately value and price fixed income assets was a major contributor to the resulting chaos, which also led to the shattering of fragile sovereign debt issues and downgrades of the credit ratings of countries previously thought untouchable.

Part of the solution was to press for improved transparency in the fixed income and derivatives markets, by proposing to move swathes of previously over-the-counter instruments onto exchanges—or at least, centrally-cleared, exchange-like venues—to generate more accurate and transparent pricing and eliminate counterparty risk. Not only does this help investors better price assess the risk of potentially riskier instruments, but it also helps them determine which are actually risky—there's always talk of a flight to quality when markets look fragile, but first you have to figure out which assets are quality and which aren't.

Another component of the solution—in part a result of the above move to exchange-like venues—is the availability of more data. As the “electronification” of fixed income markets continues, it naturally begets a more structured and safer trading environment, encouraging more liquidity, more trading, and more data as a result. The upshot is that if you have more data that is more timely, and delivered at a higher frequency, the more accurate your pricing will be as a result.

However, this increased liquidity and availability of data has an unintended consequence, making the fixed income markets more attractive to algorithmic and high-frequency traders seeking alternative sources of alpha from their algorithms outside the equities markets. But are the still-convalescing credit markets ready for the inevitable disruption of HFTs, or is fixed income still too fragile for high-frequency? And should algos with the power to create Flash Crashes even be allowed to trade the debt issued by the government that regulates them. Either way, any HFT involvement would also open the fixed income markets to the same regulatory scrutiny that HFT has attracted in other asset classes. But considering credit's role in precipitating the financial crisis, perhaps even more regulatory scrutiny of the fixed income markets isn't a bad thing after all. ■



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## MarketAxess to Expand Xtrakter Data, Post-Acquisition

New York-based fixed-income marketplace operator MarketAxess plans to expand the market data services offered by Xtrakter, the data and reporting arm of clearing and settlement utility Euroclear, after agreeing to acquire the company in a deal worth £26 million (\$42 million), ostensibly to expand its trade reporting capabilities.

James Rucker, credit and risk officer at MarketAxess, says the trading platform operator has no plans to integrate Xtrakter's market data directly into its own data services, though he confirms that MarketAxess will seek to expand Xtrakter's market data services following the acquisition.

"Xtrakter already provides a number of market data services, but we think there's scope to expand those. They do have a

premier set of end-of-day pricing data, and we certainly think there is opportunity to expand the historic data that is used, and to provide products that would be of value to market participants," he says.

Xtrakter currently offers a range of market data services, including the XVOL fixed income volume and liquidity data service, and the XNAV contributor-based pricing service, which integrates over-the-counter trade data with closing bid and offer quotes from a network of dealers, to assist financial firms in performing net asset valuations. Both XVOL and XNAV are delivered as daily CSV or XML files.

Meanwhile, MarketAxess distributes trade data for corporate bonds from FINRA (the Financial Industry Regulatory Authority), combined with proprie-

tary information such as estimated spread-to-Treasuries and asset swap spreads, as well as trade prices and market depth for trades executed on MarketAxess' trading system via its web-based BondTicker datafeed.

MarketAxess expects to complete the acquisition, subject to approval from UK regulator the Financial Services Authority, in the first quarter of 2013. Rucker says the primary driver for the acquisition is Xtrakter's position as a provider of regulatory trade reporting to the FSA, which is particularly attractive to MarketAxess because of the European Commission's efforts to reduce trade settlement risk and increase market transparency under the review of the Markets in Financial Instruments Directive, dubbed MiFID 2. ■

## MSCI Adds Bonds to ESG Research

Index provider and risk management tools supplier MSCI has expanded its ESG (environmental, social and governance) Research service to include fixed income assets, enabling clients to use the vendor's research and analysis tools to incorporate ESG factors and monitor ESG risk in their fixed income portfolios.

The offering includes ratings, scores, profiles and reports covering more than 9,000 issuers and 260,000 individual corporate, sovereign, supnationals, agencies and covered bonds, and is available via a monthly datafeed and the vendor's BarraOne investment risk and portfolio attribution tool. ■

## Intex Adds IDC Evaluations

Needham, Mass.-based Intex Solutions, a provider of structured fixed income cash flow models and analytics, has incorporated evaluated prices from Interactive Data into its IntexCalc bond and deal analysis solution, as inputs for single-security and portfolio-level analytics reports.

The evaluated prices cover a range of asset-backed securities and residential and commercial mortgage-backed securities, and will help IntexCalc users run comparative scenario analyses and improve their portfolio and risk management practices. ■

## BlackRock, TR Ally for 'Derived' Bond Analytics

Thomson Reuters has launched Fixed Income Derived Analytics, a new risk analysis service to help institutional asset managers, hedge funds, banks and sovereign wealth funds manage risk in their fixed income portfolios by utilizing calculations from asset manager BlackRock's risk analytics, investment systems and advisory services division, BlackRock Solutions, rather than running costly data collection and analytics in-house.

The vendor provides price data and the underlying factors used to value a security, which BlackRock Solutions uses to calculate analytics using the same models

and infrastructure that support its Aladdin trading and risk management platform—which is used internally by BlackRock, as well as by its clients—before returning the resulting derived analytics to Thomson Reuters for distribution via its DataScope Select and DataScope Onsite platforms.

The analytics distributed by Thomson Reuters comprise the key security-level market risk parameters—such as nominal yield, nominal spread, option-adjusted spread and modified duration—for US mortgage pools, convertible debt and US commercial mortgage-backed securities, as well as government, agency and corporate

bonds. The calculations for these instruments—a subset of the analytics available via Aladdin, which also provides a broader range of analytics over a wider array of fixed income assets—are updated daily, as markets close around the world.

"We recognize that there's a whole segment in the marketplace that doesn't want an entire platform and the whole suite of analytics we provide, but still needs certain basic analytics metrics and risk metrics," says Robert Goldstein, senior managing director and head of BlackRock's institutional business and BlackRock Solutions. ■



## Data Explorers Vets Found Ratings Analysis Firm

Credit Benchmark, a new startup that will provide aggregated analysis of trading firms' proprietary credit ratings and risk assessments, has begun enlisting 10 early-stage contributors for a proof-of-concept phase, ahead of a production launch slated for the first quarter of 2013.

The vendor will collect proprietary credit rating data produced in-house by financial firms, such as probability of default, aggregate it, and provide participating contributors with a spread that shows their position against an anonymous cross-section of their peers, to give fixed income traders a more comprehensive view of the marketplace and provide greater transparency.

"All banks are using their own credit

ratings, as well as those from ratings agencies... and we want to help them leverage that intellectual property. Globally, there are around 10,000 analysts performing credit ratings within financial firms—that's double the number at the ratings agencies," says Donal Smith, co-founder of Credit Benchmark. "We think credit and risk are fundamental issues in the markets today. Banks want as many sources of insight into credit as they can get... and they realize they need to sweat those that they already have."

Smith, former chief executive of Thomson Financial in Europe and most recently CEO of securities lending data vendor Data Explorers—acquired by Markit earlier this year—set up Credit Bench-

mark with Data Explorers founder Mark Faulkner, enlisting Elly Hardwick, former head of strategy for Thomson Reuters' Investment & Advisory division as CEO, to address the perceived shortfalls of traditional credit ratings with additional, complementary sources of insight.

Participating companies will provide default probability estimates for specific companies across a broad range of credit assets to Credit Benchmark, which will provide a consensus view of the spread of opinions, where each firm sits within that spread, and how the positions change over time. In addition, the vendor will collect firms' historical ratings and default estimates, to provide a historical time-series of default probability scores. ■

## US Treasury Taps OneTick for Auction Support

The US Treasury Department's Office of Debt Management is rolling out New York-based data technology vendor OneMarketData's OneTick tick database and complex event processing system—as part of a broader data technology deal with NYSE Technologies, an authorized reseller of OneTick—to support its setting of borrowing rates and the timing of Treasury auctions.

The Treasury is using NYSE Technologies' feed handlers to capture trade and full-depth order book data from Icap's BrokerTec electronic bond trading platform, then stores it in the OneTick database, where it can easily write and run queries and analyses on the data to detect patterns around trading activity—for example, when the market is active, liquidity trends, or how the market reacts to certain news or geopolitical events, says Richard Chmiel, senior vice president of global sales at OneMarketData.

"It's not too dissimilar to what a quant fund would do. A quant fund does this to try and identify predictability and repeatable patterns because if you can identify something that repeats, you've got alpha opportunities," Chmiel says. "The Treasury is not looking to generate alpha, but it is looking to understand the market. There's an enormous amount of debt out there, and it trades very actively. There are many facets that the Treasury wants to evaluate."

For example, an understanding of how Treasury securities are currently being traded can impact the Treasury's borrowing, including the rates at which it borrows and the timing of its auctions, Chmiel says. "By running these analyses, the Treasury is trying to optimize its borrowing," he adds. ■

## Morningstar Adds Fitch Ratings to Custom Client Tools

Chicago-based data and investment research provider Morningstar has integrated credit ratings from Fitch Solutions, the data and product arm of global ratings agency Fitch, into bespoke web-based data displays and datafeeds that it creates for clients to support their credit risk analysis and assessments of the credit quality of their investment portfolios.

Fitch delivers the ratings for all of its global sectors—including banks, corporates, insurance companies and sovereigns—to Morningstar as a daily end-of-day file via its Integrated Data Service (IDS), matched via ISIN identifiers to Morningstar's data universe.

Connor Sloman, chief operating officer of Morningstar UK, says the ratings will be available in all bespoke services that the vendor provides to institutions, and that clients will be able to customize the ratings they receive. "Institutional customers might want an on-screen display of bonds over a certain credit quality, or they may want to view a specific list of bonds with credit quality shown. They can then filter, search or sort based on Fitch's credit quality or other analytics," Sloman says.

Morningstar's institutional clients can also use the ratings with its existing analysis tools—for example, in tools that compare bond metrics such as yield, maturity, duration, as well as now Fitch's credit quality. "So we are really integrating the Fitch ratings alongside our other dataset to allow investors to perform that research," Sloman adds.

Ian Rothery, global head of third-party distribution and strategic partnerships at Fitch Solutions, says a number of clients had asked the vendor to integrate its ratings into Morningstar's bespoke tools. ■



## Ticking Transformation: Fixed Income Focuses on Data Quality, Timeliness, Granularity

With the destructive impact of the credit crunch still visible on the global financial markets, the financial industry expects higher quality and timely fixed income data, with more accurate evaluated prices and transparency equivalent to exchange-traded assets, which—for better or worse—could create a fertile ground for high-frequency trading to take root in the fixed income markets.

**IMD: How has better use of market data and other forms of information created a more stable fixed income trading environment since the credit crunch? How can data contribute to ensuring a stable and profitable fixed income marketplace in future?**

**Paul Rowady, senior analyst, Tabb Group:** In the post-credit crisis era, enhanced transparency has been a primary focus of the global capital markets ecosystem, from regulators to service providers and market participants. In particular, the fixed income markets have been at the center of these efforts—no wonder, since fixed income accounts for 80 percent of the notional values outstanding in swaps, for example.

As these improved transparency initiatives take place in fixed income and other markets, cleaner, more accurate, more timely, more granular and more comprehensive data will—and has already—become a primary by-product. It remains to be seen whether this new paradigm will lend itself to more profitable opportunities in fixed income and rates products going

forward—as the profit potential may simply shift from one subset of strategies to another, rather than growing the overall capacity—but data improvement initiatives certainly increase the likelihood of more efficient markets.

**Alex Sedgwick, head of research, MarketAxess:** For fixed income investors looking to increase portfolio returns, market data has become a more important tool to evaluate best execution for both liquid and harder-to-price bonds. Although transaction cost analysis is still relatively new in over-the-counter markets like corporate bonds, we have found new ways to evaluate execution strategies and find pockets of liquidity in the market.

For the sell-side, access to more extensive market data and the growth of electronic trading have reduced the barriers to entry for regional and specialist dealers to provide liquidity to institutional clients. Greater post-trade transparency allows smaller dealers to more accurately determine the market for



less liquid bonds and helps make them more competitive in on-the-run issues. This trend has created a more diverse dealer group from which investors can source liquidity, resulting in a deeper and more stable liquidity pool for buy-side traders.



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**Simon Linwood, data manager, MTS:** Quite simply, there has been a widespread flight to quality across the industry, much in the same way that investors usually react in periods of high volatility and uncertainty.

As more trading shifts to electronic platforms, more and more market data has become available. This rise has been mirrored by an increase in questions about how data is produced—something that depends on the execution venue from which the data is sourced. For example, market participants are asking whether they are looking at firm prices, indicative request-for-quote prices or composite. They are therefore placing particular emphasis on prioritizing the quality of data, and this is ultimately dependent on the quality of the execution venue from which it is sourced. MTS benchmark data is taken directly from the MTS trading platform with prices covering the European government, quasi-government and covered bond market. Its quality is assured through the number of participants from which it is sourced, the large trading volumes on the platform, and the fact that all prices are executable.

Market data has an integral role to play in securing an efficient, transparent fixed income market for the future, but it is essential that vendors continuously invest in creating new datasets and innovative products—both real-time and historical. To this end, we have developed MTS Live, an ultra-low-latency, tick-by-tick data service that is the first of its kind in European electronic fixed income trading, and represents a significant step forward for the asset class in terms of the depth, quality and quantity of data it delivers. It gives participants access to an un-netted tick-by-tick datafeed, comprising every price available in the market. This development provides more granular data—greater transparency, but also more flexibility to our participants in what they can do with this data. This is all backed up with over a year of historical tick-by-tick data, enabling participants to back-test strategies to analyse their performance against real market conditions, as well as for research purposes.

**Patrick Morris, chief executive, Hagin Investment Management:** The real issue with data is that the more you have, the more likely it is that you will favor an automated system, decrease headcount, and ultimately compress margins. Just as in the equity markets, the proliferation of automated systems can have the unintended effect of increasing anomalous or bogus trades that temporarily shock the market. Additionally, the data that is most important is sometimes the most difficult to get. For example, true transparency in the underlying credit quality of certain vehicles has not increased. The muni market is an excellent example of this. What the increase in data does do is allow a much larger number of players to participate. This diversification of active investors should help temper volatility, as it is a way of diversifying opinions. What we have seen in the government bond market is the effect of active and large-scale intervention creating a headline-driven marketplace. Both European and US bonds, as well as some emerging market bonds, now react almost exclusively to US Federal Reserve and European Central Bank minutes, since these two buyers are “non-rational” in terms of fundamental valuation. This has migrated down to corporate bonds and other fixed income securities, and has increased interest in contextual and linguistic analysis of data—effectively high-speed headline and social media analysis—to determine the mood or attitude of policy-makers. As a stabilizing agent, the ECB and Fed have both tried to smooth out headline risk by more completely communicating policy decisions and the forecasted duration of action. This, more than any other “data” feed, acts to stabilize fixed income markets. This is an anomaly historically—as private profits are the mandate of either agency—but for the time being, it is the key driver.

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**“As improved transparency initiatives take place in fixed income and other markets, cleaner, more accurate, more timely, more granular and more comprehensive data will—and has already—become a primary by-product... [and] data improvement initiatives certainly increase the likelihood of more efficient markets.”**

*Paul Rowady, senior analyst, Tabb Group*

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**IMD: What are some new ways that people are using data to support fixed income trading—or additional datasets and contextual information that provides indicators of the fixed income market? How is this contributing to demand for fixed income and related data overall?**

**Linwood:** Participants’ use of market data in the fixed income markets has, until recently, largely remained unchanged. However, with the introduction of new regulations and further electronification of the bond markets, all

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institutions—whether buy-side or sell-side—are hungrier than ever for market data, and their expectations on financial services firms to provide this is high.

Real-time, pre-trade price data remains essential for buy-side price discovery in fixed income. This has always been the case, but we have seen a significant uptick in demand for this type of data during the last year as the eurozone crisis reached its peak.

MTS and other technology providers are developing new, innovative solutions to meet the demand for more, quality data. Our MTS Prime platform is an excellent example of a regulated, orderly electronic all-to-all market for credit, including corporate, financial, covered and SSA bonds. More electronic trading on new platforms such as MTS Prime will begin to produce more market data, and—providing the focus is placed firmly on quality and accuracy when sourcing the data—this in turn this will drive more profitable trading opportunities for market participants.



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**Sedgwick:** TRACE (the Trade Reporting and Compliance Engine) data from FINRA (the Financial Industry Regulatory Authority) has been around for almost a decade, but in many ways remains an underutilized resource. One example of how we can use the trade-level data provided by TRACE is to evaluate the bid-offer spread for bonds on a daily basis. At MarketAxess, we aggregate this data to provide a daily indication of market liquidity, which is expressed as an index value for our proprietary Bid-Ask Spread Index (BASI).

We can then determine how the liquidity and trading costs vary for different parts of the market, including different trade sizes, sectors and asset classes at a specific moment in time. Since we track all of these values daily, we can also monitor how liquidity or trading costs change over time relative to other parts of the market. This sort of insight is invaluable for investors looking for trading opportunities and trying to determine the trading costs associated with a particular trading strategy.

**Morris:** The data-driven approach is not a new one in fixed income. In fact, way back in 1990 a group of six investment banks created the “Electronic Joint Venture” to improve

data communications with buy-side clients. Previously, fixed income research was generally an in-house affair at most banks, with communication of “ideas” generated from the research. As firms gained increased access to computer technology, the demand for data increased and the generation of “rocket scientists” on Wall Street really kicked into high gear.

The big innovations will all come from the risk management side of the business moving forward. Once data is readily available, the alpha (or talent) contribution declines as market participants arbitrage away excess return through competitive bids, lose differentiated return profiles, and begin to manage to beta or benchmark returns. We have seen this trend across both fixed income and equity products. However, as the failure of Long-Term Capital Management showed so clearly, the ability to build robust models that generate positive returns must involve a risk management and liquidity context that prevents catastrophic failures and near-100 percent losses. Fixed income returns tend to be fairly low in the current environment, so leverage is a key component of outside performance. In this environment, the data demands increase dramatically as real-time risk management and stop-loss scenarios begin to dominate the internal thought process at buy-side and sell-side firms. Complex cash flow modeling is another area of demand, since it is a very complicated topic and also a key valuation metric.

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**“The data that is most important is sometimes the most difficult to get. For example, true transparency in the underlying credit quality of certain vehicles has not increased. The muni market is an excellent example of this. What the increase in data does do is allow a much larger number of players to participate. This diversification of active investors should help temper volatility, as it is a way of diversifying opinions.”**

*Patrick Morris, chief executive, Hagin Investment Management*

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**Rowady:** Greater automation of a workflow process and standardization of datasets in any market lends itself to more timely and accurate analysis. Moreover, couple this with the incorporation of traditionally unstructured and semi-structured data across all products, asset classes and strategy types, and the appetite for all kinds of data becomes unprecedented.

Specifically, the heightened use of fixed income-oriented data has relative and absolute applications. It can be used to enhance non-fixed income applications as well as directly for new fixed income applications. It is this breadth of use cases that makes the increasing demand for fixed income data so noticeable.





**IMD: Where do you see opportunities to adapt strategies and technologies from the high-frequency equities markets for fixed income trading, such as trading algorithms and low-latency data delivery? Are the fixed income markets and data even suitable for these strategies, and how would this affect data requirements where some assets remain illiquid and depend on end-of-day valuations?**

**Morris:** This is an issue that I think will increasingly become of interest to regulators and the general public. As the high-frequency trading players move away from the tight margins in equities, we will see a surge in bizarre and potentially disruptive trade activity in fixed income. The largest market is in treasuries, but there are certainly opportunities across many of the other markets for HFTs to have their fun. HFTs rely on price discovery inefficiencies and exploit these by “creating” and withdrawing liquidity based on the behavior of the non-HFT counterparty. In effect, it is a very rapid calculation of the exact price and size of an order in almost real time. The argument is that the HFT takes the place of a specialist, and that in doing so creates greater liquidity and transparency in the market, so that there is no one player that dominates the order flow, and so the spreads tighten on every trade. These trades happen in less time than it takes for a human or non-HFT system to even enter an order or cancel a trade.

As the HFT “arms race” intensified in the US equity markets, the need for speed eventually hit certain impenetrable laws of physics, and all of the players converged, slugging it out on a “fair,” but significantly less profitable playing field. In fixed income, the race has just begun, so we will need to see a few key tests, the first of which will be a fixed income “Flash Crash.” It is not clear to me that Federal regulators will be pleased with a locked or Flash-Crashed treasury market, so if HFTs are not careful, they might get kicked out of the market before they really get in. In addition, the equity markets have deep liquidity in both directions proved by over 100 years of serious price shocks and recoveries, the most recent being 2008. Fixed income markets are less robust in declines, certainly steep declines, and the markets can lock up—a condition of zero liquidity. Also, small issuers or issuers of less liquid instruments may not be that happy with a heavy HFT presence, since smaller issues have wider spreads, fewer participants, and are susceptible to price shock. Although this may not be immediately alarming, issuers that go back to the market when their last issuance has gone through a mini-Flash Crash or liquidity squeeze might find themselves locked out of public markets due to a reluctance to invest in a volatile security.



**Patrick Morris**  
Hagin Investment Management

All concerns aside, HFTs are in the fixed income markets, and will continue to push ahead. The size of the market is compelling, it is significantly less efficient than equities, and a strong argument can be made that fixed income markets need to be more transparent. Those providing low-latency data and server co-location—as well as in the strategies themselves—will make fortunes quickly. How each type of algorithm might operate is for the algo writers, but I would warn them to tread lightly around the 80 percent of the market volume that is in rates products and MBS pass-through, since any disruptions would attack core policies of the Fed, the Treasury and the current administration, and could actually stall or impair an economic recovery by shaking confidence.

**Linwood:** Fixed income markets are definitely ready for low-latency data, and banks are embracing algorithmic trading for fixed income. Our MTS Live product was developed directly as a result of demand for low-latency data.

We predict that the move to a more equities-like market will be a staged approach—it has already happened in European government bonds, and MTS Live has been very well received, with a number of banks signed up. SSA (Social Security Administration) bonds and covered bonds will be next, followed by the larger bonds of frequent issuers in the industrial, auto, chemical and technology, media and telecom sectors.

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**“With the introduction of new regulations and further electrification of the bond markets, all institutions are hungrier than ever for market data.... Real-time, pre-trade price data remains essential for buy-side price discovery in fixed income. This has always been the case, but we have seen a significant uptick in demand for this type of data during the last year as the eurozone crisis reached its peak.”**

*Simon Linwood, data manager, MTS*

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**Sedgwick:** Given the current fractured state of the fixed income market, I think we are probably a long way from seeing bonds migrate to an exchange-traded model suitable for HFT strategies. That said, we are very cognizant of equity market developments, and an important element of HFT trading algorithms is accurately estimating trading costs given the high turnover rates.

Fixed income currently lacks a market-standard approach to evaluating trading costs. However, we’re looking to change that. MarketAxess Research has developed a proprietary approach to measuring the cost of execution in the corporate bond markets. We can quantify the difference

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between where a trade is executed and the prevailing market price, according to TRACE, by using prints from similar trades as well as our own estimates of the transaction costs associated with the characteristics of a particular trade. We can then use this dataset to estimate the value of trading with a larger number of counterparties via an ECN such as MarketAxess or the trading costs associated with different trade sizes and maturities.

**Rowady:** For starters, highly automated and/or high-turnover trading strategies have numerous and specific needs before they can be successfully deployed in any product or asset class. These include—but are not necessarily limited to—a highly automated execution paradigm, clean and comprehensive real-time and historical datasets, and a diverse composition of end-user demographics.



**Paul Rowady**  
Tabb Group

The first of these are fairly well understood, though the last of these appears not to be well appreciated—after all, it is the “friction” caused by the variance in end-user strategies that makes a certain market the most ripe for high-frequency trading. If all market participants in a product or asset class were deploying the same or similar strategies, this friction would likely not be sufficient to allow HFT strategies to thrive. Of course, liquidity fragmentation, small average trade sizes, and a prevalence of index products (for index arbitrage-type strategies) are also factors that allow high-frequency strategies to be profitable.

Assuming all or many of these factors become common in fixed income markets, then highly automated and high-turnover strategies could become attractive here. However, this is a level of transformation that could take time or never fully materialize. While the eagerness to find new sources of short-term alpha is at all-time highs (given the maturation and competition among such strategies in equity markets), just because certain players want the landscape to evolve in their direction doesn’t necessarily mean it will happen on the desired timeline or in the preferred manner at all. Now that high-frequency strategies in equities and futures markets have found avid critics, particularly among some regulators, future market structure transformations are likely to be conducted in a manner that attempts to avoid the impacts of high-frequency trading.

So while it is plausible that fixed income markets could become the next bastion of HFT, the probability of such a transformation in the immediate future is not overwhelming, in my opinion.

**IMD: How are marketplaces, data vendors and evaluated pricing providers meeting the needs of traders, investors and risk managers with more timely, accurate fixed income data—especially for less liquid, harder-to-price assets?**

**Sedgwick:** In many cases, marketplaces and data providers are indeed not meeting their trading customers’ needs, and there is a large amount of frustration among market participants about the poor quality of marks from providers of evaluated prices. This demand for better pricing in less liquid markets like corporate bonds has driven our development of new tools to provide greater context for our investor clients.

Some of these approaches include better pre-trade analytics and trade cost analysis to enable fund managers to use best-execution data to inform their execution and trading strategy. Ultimately, they are trying to figure out how to trade better. For example, we work with large asset managers and investors in both the US and Europe to evaluate how they handle different sized trades and manage their trading order flow, based on their estimates of trading costs. For harder-to-price securities, the approach might not necessarily be as specific as looking at a given trade and estimating the corresponding cost, but may involve looking at generalized trading costs for all trades.

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**“Many marketplaces and data providers are not meeting their trading customers’ needs, and there is a large amount of frustration among market participants about the poor quality of marks from providers of evaluated prices. This demand for better pricing in less liquid markets has driven our development of new tools to provide greater context for our investor clients.”**

*Alex Sedgwick, head of research, MarketAxess*

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**Rowady:** The demand for third-party pricing and valuation solutions is greater than at any point in history. This is due primarily to the heightened post-credit crisis needs for more accurate and timely risk measurement functionality. By making pricing and valuations engines easier to use and integrate—in many cases through various alliances and partnerships with broader platform vendors—these specialist solutions can be well-positioned to deliver the greatest value to market participants. Of course, enhanced data quality and more comprehensive data makes all downstream applications much more impactful.

**Morris:** Just looking at hard-to-value assets, FASB 157 has created a need for market-based valuation. What is uncertain is not so much the availability of models and data—insurance companies have been doing this for more than 100 years—but the accuracy and utility of the data that is produced. Many valuation models change dramatically when certain inputs change nominally, so there should always be a healthy amount of skepticism concerning



the accuracy of data and pricing for less liquid assets. It is certain that any trading of assets based on models that have potentially incorrect data can become quite volatile and unstable—such as in the case of LTCM, for example.

**Linwood:** In fixed income, if an asset is illiquid and harder to price, it generally means it is a small issue, sub-investment grade, a structured note, or from an issuer that does not have naturally comparable peers. Evaluated pricing will always be needed for these bonds. With the pace of evolution in the fixed income market increasing all the time, real-time pricing data is now needed more than ever. Evaluated pricing must move to real time in order to keep pace with client demand. This means businesses need real-time, high quality data throughout the trading day. This is one of our core data offerings, and a service that we are continuously developing and refining to meet the changing needs of the market. Evaluated price providers take data from numerous sources, and sell-side trading desks are a major contributor of information. However, trading platforms like MTS Prime for credit instruments will open up exchange-type, order-driven trading to the buy side, which in turn will produce new liquidity and unique market data.

**IMD:** As fixed income trading becomes more transparent, liquid and commoditized, spreads and margins tighten, while industry headcount declines, will demand for fixed income data increase or decline overall—and how can data providers, brokers and marketplaces leverage data as a competitive differentiator?

**Sedgwick:** I believe these trends signify a longer-term shift, and in the near-term we won't be moving to a radically different market dynamic. That said, we definitely see a growing level of importance for fixed income market data. Typically, when we talk about market data for credit, what immediately comes to mind is post-trade TRACE data. However, dealer runs, quotes from ECNs, and even data about the depth of the market are particularly valuable when trying to evaluate market movements and, ultimately, one's ability to transact. Regardless of which way the market moves in terms of margins and commoditization, there will be an increasing demand for fixed income data as investors find new ways to leverage the information to inform their trading strategy.

**Morris:** In a computer-driven world, data is king. Personnel is costly, whereas technology is considered a "cheap" alternative and an investment with a clear payoff. Data analysis is the differentiator: Clearly identifying value-added algorithms that can spot pricing anomalies in both the short and long term. The time decay on these opportunities can be pretty short, since the access to data will allow all players to use the same information and, ultimately, the market players arbitrage away excess returns from significant anomalies in the market. In addition, since the Fed has taken such a proactive position in the market, directional players and exotic products that produce very high returns will dominate

the market until the quantitative easing program comes to an end, when more traditional valuation-based systems take the lead. The market leaders will be the firms that have the dry powder to put money to work quickly across a large number of systematic, data-driven products. For brokers, just as in the HFT market, the key is speed, speed and more speed. Heavy investments in trading infrastructure will be the determining factor in the brokerage community, as in equities, where any desk that did not commit heavily to technology lost market share.

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**"In a computer-driven world, data is king. Data analysis is the differentiator: Clearly identifying value-added algorithms that can spot pricing anomalies in both the short and long term.... The key is speed, speed and more speed. Heavy investments in trading infrastructure will be the determining factor in the brokerage community, as in equities, where any desk that did not commit heavily to technology lost market share."**

Patrick Morris, chief executive, Hagin Investment Management

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**Linwood:** Without doubt, there is only one way the demand for data will go—up. Fixed income trading will move onto exchange or MTF platforms, in the same way as equities, foreign exchange and commodities. By its very nature, electronic trading is driven by automated trading algorithms, and these are fueled by pre- and post-trade market data.

It is vital for the future of the market that electronic facilitators of fixed income trading such as MTS continue to work with the buy side and sell side and introduce new markets and new products, such as we have done with MTS Live for our participants, and MTS Prime for credit and the buy side.

**Rowady:** Fixed income, in general, is most likely to see the greatest expansion of new strategy deployment than any other asset class (with commodities also likely to see significant growth). This is because fixed income has remained the largest market, overall, that has yet to see the level of trading automation seen in other asset classes. Though I don't believe it's a foregone conclusion that fixed income markets will necessarily become more liquid—they might not, due to the mass transformation going on among large dealers—I do believe that demand for fixed income market data and related datasets will be strong in any case. Traditionally, these markets have not been as transparent as other markets. Now, and in large part due to the mass transformation of market structure going on in the swaps markets, demand for fixed income data globally will reach new all-time highs as market participants embark on new alpha discovery adventures in a large market with new levels of transparency. Those data and service providers that can provide access to unique datasets are most likely to benefit from current market drivers. ■

SPONSOR'S STATEMENT

## Of MiFID 2 and Market Data

The latest raft of European financial regulations will undoubtedly increase the data management burden for fixed income market participants, but will spur demand for services that provide granular, accurate and reliable market data, says Roger Barton, regulatory consultant at European fixed income marketplace MTS.

As the final details of the long-awaited financial regulatory reforms begin to take shape in Brussels, it is at last becoming clear what impact they will have on the fixed income markets in Europe and on the market data requirements of market participants. Regulations will undoubtedly increase the need for market data, but with an influx of electronic trading volumes creating more and more data, how can participants be sure that they can access accurate, comprehensive data?

The most important direct regulation relating to market data is contained in the review of the European Commission's Markets in Financial Instruments Directive (MiFID). While the specific details are still being thrashed out, there are a number of clear intentions, including a significant focus on increasing levels of pre- and post-trade transparency, which regulators believe can be achieved largely by shifting more participants towards trading on electronic platforms.

Among its major updates, MiFID 2 is expected to propose a large extension in the regulation of all trading venues that are not regulated as exchanges. This will create two new categories of trading venues—Organized Trading Facilities (OTFs) for multilateral platforms, and Systematic Internalizers (SIs) for bilateral platforms.

While moving to electronic platforms is not mandatory, there will be an inevitable shift towards electronic platforms for a wider range of fixed income products. The European Commission has stated that it does not believe that the regulatory objectives can be achieved through the use of pure voice trading.

Therefore, platforms that already operate as regulated, electronic and transpar-

ent platforms—such as MTS—are in the right place, and there is likely to be a rising tide of business to these platforms, which in turn will produce an increasing amount of market data.

The new regulations will also place a strong emphasis on best execution, which means that accurate and reliable market data will assume an even more critical role than currently. Inevitably, all platforms offering best execution will need connectivity to sources of reliable market data.

### New Challenges

While the influx of electronic trading volumes will introduce new data sourcing and management challenges, the idea is that, eventually, the introduction of a consolidated tape and best execution will protect the market. Whether or not this will work is an open question, and will depend crucially on the wide distribution and use of accurate market data.

In the equities market, the original MiFID did not account for the cost of aggregating market data from multiple venues trading the same security. The lack of any standardized reporting model also made it difficult for buy-side firms to make like-for-like comparisons of the execution quality provided by brokers. The introduction of a consolidated tape would overcome this challenge in the European fixed income market, in the same way that TRACE has in the US, though it remains to be seen whether the regulations will mandate a consolidated tape of fixed income data.

In response both to regulations and client demand, banks have started to move from end-of-day valuations to intra-day or even real-time checks to drive accurate



Roger Barton  
MTS

analysis, pricing and risk management decisions. This requires very rich market data, delivered with minimal latency.

MTS has always put client demand at the forefront of its technology development and innovation, and with the market asking for low-latency fixed income data, the company has developed MTS Live, a new ultra-low-latency data distribution facility offering comprehensive, un-aggregated order information for the most liquid bonds traded on the MTS Cash market.

Data is based on the constant tradable pricing for the bonds traded on the platform, giving participants access to the full range of information between ticks. We expect this kind of service to see significant uptake in the near future to meet the demands of market participants requiring ever-increasing levels of data granularity to be as transparent as possible.

While in principle, an increase in transparency will undoubtedly be beneficial to the fixed income market overall, the danger is that the regulators overcook the transparency requirements, which could negatively impact liquidity and create greater market data challenges. The proof will be in the final calibrations, but the indications so far are that regulators are taking a careful approach and recognize that the bond markets work differently from the equities markets, so there is hope that the worst excesses will be avoided. Only once we have the final rulebook will we know exactly what kind of impact this will have on market data requirements. ■

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