FINANCIAL TIMES
WEDNESDAY 28 SEPTEMBER 2016

Corporate bonds

MarketAxess muscles into US bond trading as banks retreat

Market share puts platform on par with biggest US debt dealers

JOE RENNISON – NEW YORK

Equity investors sense a winner from the upheaval transforming the business model of US corporate bond trading.

Shares in MarketAxess, the largest electronic bond trading platform, have surged more than 50 per cent so far this year as Wall Street banks retreat from their dominant role as middlemen in buying and selling corporate debt under the cosh of a tougher regulatory environment.

"There is a revolution going on," says Rick McVey, chief executive of MarketAxess, whose market capitalisation stands at $6.4bn. "The regulatory changes have been very positive for us."

As tougher capital standards weigh on the ability of banks to warehouse corporate bonds and facilitate transactions for investors such as asset managers, hedge funds and insurers, MarketAxess is encroaching on the hallowed turf of dealers — large orders known as block trades.

MarketAxess share price has risen over 50% this year

Share price ($)

Source: Thomson Reuters Datastream

MarketAxess's investment-grade block trade volume climbed to $42.5bn during the second quarter of 2016, up from $26.7bn at the start of 2014. As a percentage of the whole market, it is now running around 9 per cent. That puts it on par with the biggest bond dealers in America, according to data from the Financial Industry Regulatory Authority.

The transformation of the US market for trading debt sold by companies comes as new sales have ballooned. Buoyed by the era of ultra low interest rates, the corporate bond market has swollen from $5tn in 2008 to over $8tn today.

While Wall Street banks have reaped the benefit of underwriting debt sales from companies, regulatory changes in the wake of the financial crisis are fundamentally altering the secondary trading model, says Mr McVey.

"Most dealers welcomed technology for the smaller flow business but they very much wanted to reserve larger strategic business for themselves," he says. "Some dealers are no longer trying to hang on."

MarketAxess has grown to account for over 13 per cent of all corporate bonds traded in the US, up from just 4.5 per cent in 2010.

In an attempt to plug the gap left by banks' retreat from supporting secondary market activity, MarketAxess launched Open Trading in partnership with BlackRock, the largest asset manager in the world and a significant holder of shares in MarketAxess.

This anonymous trading venue allows investors to trade directly with others, without a bank standing in the middle of the transaction. It differs from MarketAxess's initial model, which retains the relationship structure between banks and clients, with quotes being requested by investors from a group of named dealers.

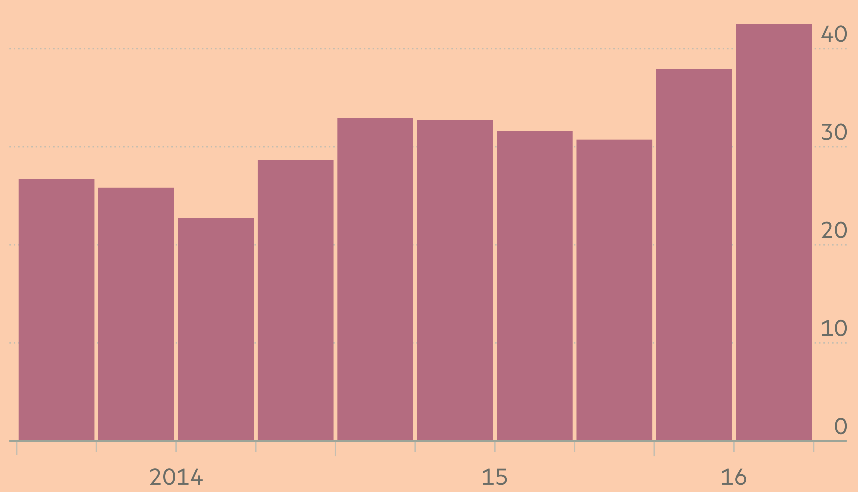
"This is where I get excited," says Mr McVey. "In the end you are going to see a much better market structure where anyone can trade with anyone. The dealers feared all-to-all trading two or three years ago. You are seeing them get a lot more comfortable."

Open Trading now accounts for 15 per cent of MarketAxess's volumes, with a third being directly between non-banks as big name institutions like AllianceBernstein have joined BlackRock on the platform.

A third of OpenTrading's volume is also driven by the growth in fixed income exchange traded funds — companies that own bonds that investors can then buy shares in on an exchange. As shares are created or redeemed, the ETF buys and sells the underlying bonds.

Record strongest quarter for MarketAxess block trades

Volumes ($bn)*



*Block defined as $5m trades and above on MarketAxess
Source: MarketAxess Research

Fixed income ETFs have grown from around $60bn in assets in 2007 to over $600bn at the end of the second quarter 2016. For junk bonds, around 35 per cent of all trades done on MarketAxess come from ETFs, says the platform.

"The ETF growth is fantastic for us," says Mr McVey. "The more those assets grow, the better we do."

MarketAxess also faces competition, both from existing venues and from new arrivals sensing a growth opportunity. While a number of startups have launched in recent years, each claiming to provide a solution to the liquidity concerns of investors, few have made much headway.

"It is impossible for anyone to show up late in the game and replicate what we have spent 16 years building," says Mr McVey. Asked whether he sees any technology that might warrant acquisition of a smaller firm, Mr McVey is dismissive and argues that the cost of an acquisition might be better spent by MarketAxess simply building the technology itself. "We don't feel like we are missing anything at the moment," he says.

One concern expressed by Mr McVey is that for all the growth seen in electronic bond trading, the market remains vulnerable to a sustained rise in yields. Thanks to regulatory changes, he says, dealers no longer have the capacity to act as a shock absorber during periods of market stress, by warehousing bonds and waiting for price volatility to ease.

"The pace of change is improving but we still see too many examples of large investors and large dealers who have not fundamentally changed," says Mr McVey. "If there is a credit shock I do not think the market is set up to handle it."