

Markets

Rise of MarketAxess mirrors demise of traders on Wall Street

Electronic bond-trading platform has delivered better returns than Netflix or Amazon

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The news that MarketAxess was about to join an inner sanctum of corporate America stunned Rick McVey.

The chief executive of the electronic bond-trading platform had just returned to his office in Hudson Yards in New York after a late-afternoon meeting, to find that the company had qualified for the S&P 500 index of the biggest US companies.

“There was an email from a sales guy out in LA who had seen [the announcement] and I nearly fell out of my chair,” he told the Financial Times.

Since that day in late June the company’s market capitalisation has added another \$2.8bn, a reflection of its position right at the heart of sweeping changes on Wall Street.

The days of young men and women barking into phones to connect buyers and sellers – the kinds of scenes associated with the “masters of the universe” chronicled by Michael Lewis or Tom Wolfe – are slipping away. Instead, bonds are being traded electronically and via algorithms, sometimes without any human touches at all along the way.

These radical shifts in the \$9.3tn US corporate bond market have handed MarketAxess, the industry-leading platform, a 590 per cent rise in its share price over the past five years. That is 13 times the return of the S&P 500, and better than other much-hailed disrupters like Amazon or Netflix.

The question now is whether MarketAxess can maintain its dominance, with competitors such as Tradeweb Markets, which went public in a splashy initial public offering in April, nipping at its heels.

MarketAxess is also trying to push into new areas, such as the \$16tn market for US government debt, where Tradeweb, Bloomberg and Refinitiv – bought this month by the London Stock Exchange – are already fighting it out.

Heightened competition is likely to weigh on the company’s earnings growth over the next few years, according to Brian Bedell, an analyst at Deutsche Bank. Goldman



MarketAxess estimates that it handles nearly a fifth of all investment-grade corporate bond trades in the US © Micha Theiner

Sachs goes further, with a “sell” recommendation, saying that the company’s aggressive valuation – 79 times this year’s earnings, the fifth highest among the S&P 500 – is bound to fall.

By its own estimates, MarketAxess handles nearly a fifth of all investment-grade corporate bond trades in the US, up from about 12 per cent five years ago. It also trades just above 10 per cent of all high-yield bonds, up from 3 per cent over the same period.

The way Mr McVey sees it, the forces behind his company’s rise have much to do with tightened regulatory requirements on the big banks after the crisis. If big banks can use electronic venues to dip in

and out of positions more quickly, they can operate with much leaner trading inventories of their own, and therefore keep capital requirements at a minimum.

“They want to continue to provide a service to their clients but they are transitioning to a model where they take less risk, not more risk,” said Mr McVey, a former head of North American fixed-income sales at JPMorgan.

The big names on Wall Street continue to struggle to get to grips with the new environment, with many still making cuts to front-line staff to offset sluggish revenues. Morgan Stanley, for example, enjoyed seven days of at least \$100m in net trading

revenues during the second quarter of 2011.

During the same period this year there were none, it disclosed in a recent filing. “The business is clearly under secular pressure,” said Chris Kotowski, analyst at Oppenheimer in New York.

Even so, expansion has come at a cost to MarketAxess. In the quarter to June, expenses were up 17.6 per cent to \$64m as the company hired more senior executives and technologists. Coupled with higher clearing costs and lower-than-forecast revenues, the numbers missed analysts’ expectations.

That puts a premium on top-line growth. MarketAxess this month signed a deal to buy LiquidityEdge for \$150m, to get into the \$16tn market for trading US Treasuries. Part of the higher expenses includes preparing a partnership with Virtu Financial to trade exchange-traded funds.

Among its plans for the future: “portfolios” of trades, which involves trading big baskets of bonds simultaneously.

Mr McVey is confident that the company will continue to grow, pointing to the rising influence of algorithms that can price and execute trades without human involvement.

That will be particularly felt for smaller deals, he says, which many banks are unwilling to take on because the margins on offer are too small. But he adds that it is no longer just banks looking to use the technology.

“The dealer algos are one side of that equation but investors are really starting to invest in automating more and more as well,” said the CEO. “There is still so much more coming in the future.”

Investors’ “enthusiastic” reception to the Tradeweb IPO – up about 150 per cent since listing – has been validation for the industry, he added. “It shows fixed-income broadly is in the middle of a structural change.”

