

Brandywine Global Investment Management



Brandywine Global is improving trading efficiency and accessing global Emerging Market bond liquidity through electronic trading.

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THE CHALLENGES OF EMERGING MARKETS

Emerging market economies are continually beset with change – in their politics, in commodity prices that drive their economies, and in the financial and geopolitical signals received from the developed world. These periods of social and political volatility are transmitted to their bond markets. While markets like Mexico and Brazil are large, many emerging bond markets are small and do not attract attention from large foreign investors, resulting in mixed or variable liquidity.

"The front end of the market tends to be liquid, but as you move further out the curve, each country has its own unique dynamics," observes Dennis Dow, head of fixed income trading at Brandywine Global Investment Management of Philadelphia. "In the Malaysian market, for instance, once a bond goes off the run it becomes more challenging to trade. It's the same thing in Indonesia – there are parts of the curve that are liquid and other maturities that trade by appointment."

Brandywine Global is a sizeable investor in emerging markets fixed income and a frequent trader through MarketAxess. "We're not a dedicated emerging markets manager," says Dow, "but we manage nearly \$60 billion in global fixed income across approximately 160 funds and separate accounts, with 10% to 50% of those account assets invested in emerging markets."

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UNIQUE BONDS AT BETTER LEVELS

Brandywine Global is one of over 1,000 client firms and 80 dealers trading in hard currency emerging market bonds and 26 local currency emerging markets through MarketAxess. For the full year 2018, emerging market trading on the MarketAxess platform rose 23% to \$378 billion and contributed nearly a quarter of MarketAxess' total traded volume.

Brandywine Global invests in government bonds of emerging markets denominated in local currencies, and follows a value style that seeks assets that offer the best combination of high real yield and attractive fundamentals given the firm's macroeconomic outlook. Portfolio managers express their points of view in relatively concentrated portfolios – holding between 25 and 50 positions – and will wait from months to several years for a reward from more normal market environments.

"MarketAxess has reached a critical mass of dealers and countries on its emerging market platform, and there are enough dealers willing to supply liquidity," Dow explains. "The more people you can put in competition, the better results you'll get."

Local currency bonds, at \$16 trillion, represent the lion's share of global emerging markets. "For the local currency bonds that we invest in, the dealers tend to be niche players based in the home country of the asset – São Paulo, Mexico City, Moscow, or the Middle East," says Dow. "Without MarketAxess, we wouldn't typically get access to the local dealers," he adds. "These are symbiotic relationships, beneficial to both sides – we're getting unique bonds at better levels from them, and they're getting access to us that they wouldn't have otherwise."

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DENNIS DOW

Head of Fixed Income Trading
Brandywine Global Investment Management

A LIGHTER WORKLOAD, AT THE RIGHT TIME OF DAY

"We implement our portfolio strategies with large positions, ranging from hundreds of millions to billions," Dow explains. "Although we make just a few of those long-term block trades per week, we rely on dealers to work them." He points out, however, that larger trades transacted by traditional means have become more difficult. "There's less liquidity in the market as dealers have reduced the balance sheet they devote to emerging markets, and for that matter, to all of fixed income."

Brandywine Global's trading desk also is active with many smaller trades, adjusting accounts as clients add or withdraw capital and rolling local currency forwards. "We make a fair amount of small 'market maintenance' trades a day, and they account for 80% or 90% of our transactions," Dow says.

Brandywine Global began emerging market trading through MarketAxess in 2015, initially in small transactions, but has progressed to larger and larger trades. "Thanks to MarketAxess the small to mid-sized trades have become substantially easier, and I've been getting much better execution."

Dow says that trading through MarketAxess brings not only liquidity but greater efficiency to the desk's workflow. "We have crunch times with two-hour windows to work up and execute the smaller trades. Our order management system is integrated with MarketAxess, and the ability to place those into MarketAxess has made us much more efficient. Let's say each trade is now taking a quarter of the time when I had to call three dealers to get levels, so MarketAxess has probably increased our efficiency by 75%. By carrying out the mechanical trades, MarketAxess allows me to focus on bigger things that really need to be managed."

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MarketAxess also solves the inherent emerging markets problem of differences in trading hours. "All our trading is from Philadelphia, with the bulk of it from 7:00 in the morning until noon when we can trade with London and the U.S.," Dow says. He used to give orders to dealers, who would in turn send them to their branches in Singapore or Hong Kong to execute overnight, and receive back-standing orders or a range of prices.

"Before I had MarketAxess, to get prices I would have to get on the phone with three or four dealers, scour runs, and trade at night from home. When you're calling so many people, sometimes the market moves before they all get back. It's much cleaner to have 8 or 10 dealers all on an equal footing as to time and language."

AUTOMATING BEST EXECUTION

Dow can make a convincing case to clients on best execution. "My business model is easy to explain – all the small trades go into competition on electronic platforms where they are not likely to move the market. For larger trades, we rely on our relationships with banks. I can show that electronic trading through MarketAxess encompasses all of the dealers and the buy side as well. That means that I've gotten the best possible liquidity and levels available, all on one platform."

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"And it's all documented, so if anyone asks how I arrived at a price, it's simple to explain. When I have indications from 15 dealers and show the level that I got, it's hard to argue that we did not get best execution," Dow notes. That includes Brandywine Global's compliance teams. "They understand that the more automated and documented the trading systems are, the easier it is to explain to auditors and clients and everyone involved. For us, it was not a hard selling point. It's not rocket science, just common sense."

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"Bond market liquidity in general is more challenging than it has been," Dow says. "For any market where there is a wider bid-ask spread, as there is in the emerging markets, the more people you can put in competition, the more it will help in better execution and liquidity."

"The benefits are not just to the smaller, far-away dealers," he adds. "For any dealer that is aggressively pricing trades, we look back at our history, and that record goes into our decision on who gets a shot at the bigger trades. It's not just the smaller guys – anyone who is more aggressive on small trades is more likely to get the larger business."

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