CONNECT
WITH YOUR
COMMUNITY

THE FINANCE HIVE LIVE

USA Global FX Steering Meeting

New York City
May 2017

What the event was all about...

The 3rd Annual USA Global FX Steering Meeting brought together leading buy side FX trading professionals and their providers, who play a key role in driving the evolution of the FX market structure and financial technology.

We were delighted to welcome David Clark as Chairman; David is the Chairman of the Wholesale Markets Brokers' Association, a member of the Bank of England FX Committee and has been instrumental in the much-anticipated FX Global Code of Conduct which was published on 25 May 2017; the code outlines a single set of global principles of good practice for the FX market.

The meeting featured 8 intensive roundtable sessions and this report outlines the key discussion points from each table and recommendations for the future:

1. Best Execution in FX (FX Connect and Currenex).
2. Liquidity Management (Hotspot).
3. Algos (State Street).
4. Platforms (Nex Markets).
5. Post-Election Volatility.
6. Russia (Moscow Exchange).
7. G10 vs EM (State Street).
8. Exploiting Changes in Market Structure (VIA FX).

We look forward to seeing you at our next Finance Hive Live and if you're not yet a member, for more information about joining The Finance Hive Network visit www.thehive-network.com or contact Julie (email julie@thehive-network.com)

Best wishes

Noj, Sally and Julie.

Noj Mather
Co-Founder The Hive Network

Sally Green
Co-Founder The Hive Network

Julie Nicolas
MD The Finance Hive

Thank you to our event partners:

CURRENEX®
FX Connect®
HEDGE CONNECTION Where Hedge Funds and Investors Come Together
NEX Markets
EBS Institutional
HOTSPOT a CBOE company
MOSCOW EXCHANGE
VIA FX
STATE STREET

1

BEST EXECUTION

FX Connect and Currenex

"There is no 'one size fits all' answer for best execution; it means something different to each individual"
"Best execution is specific to each participant's eco-system"

> *A superior format for interaction with peers compared to 'standard' conference.*

Key Discussion Points:
What does Best Execution mean? The best price?
Broad agreement that TCA is one component but there are more drivers than just price aspects. For example Pre & post trade compliance , Pre-IPO market, ETF flows.

Ideal solution that Best Execution is based upon:

- Each Individual's needs & resources.
- Systematic approach.
- Consistent methodology; easily explained with ability to be flexible according to market demands or conditions.
- Best execution for FX; don't turn it into poor relation of equity.

To have a Best Execution policy requires following conditions:

- Understanding of investment objectives.
- Capture data that evaluates performance .
- Communicate to stakeholders.
- Use 3rd party if possible.

More automation of trade decisions to qualitatively & quantitatively manage and measure each trade.

Knowing where and how to access liquidity is key to Best Execution.

Difference between liquidity providers versus takers - high frequency traders bidding trades against real money longer term flows.

2 LIQUIDITY MANAGEMENT

Hotspot

“Crucial for firms to have real time TCA to properly evaluate liquidity.”
“Diversity of liquidity is hugely important.”

Key Discussion Points:

- Market fragmentation brings opportunity and innovation; core business drives level of liquidity needs
- Liquidity is very fragmented which is an issue and buy side firms need to do their homework to diversity and connect to the proper venues
- The fragmentation is such that many believe there are only 3 liquidity providers all pushing toward E trade
- Grading liquidity is not just about best price but also on market impact, overall cost to grade, access to the market and consistency
- Buy side firms are actively using Algos from banks, third parties and internal Algos due to increased demand for transparency particularly around forwards and NDFs
- Bank Algos are increasingly leveraging ECN liquidity, however there is still a level of concern around the quality of Bank Algos
- Concern about liquidity gaps during market events as LPs pull out
- There is a need for a credit solution so buy side firms can trade with anonymous venues
- View on FX Global Code of Conduct: concern on how enforceable the code will be? Buy side firms are adopting a ‘wait and see’ approach.
- Rise of non bank liquidity providers are providing stiff competition to banks; if banks continue to be restrained there was general agreement that non bank market makers will increase market share.

> *“The FX Hive was a unique hands on learning experience that was a fresh breath from standard conference formats.”*

3

ALGOS

State Street

"Algos can be demonstrably better for operational efficiency, particularly larger sizes."
"Key factors in looking to use Algos: execution and operational efficiency."
"Algos are good for short dates but haven't been well developed for Spot yet."

Key Discussion Points

- **Approximately 25-30% of attendees use Algos**.
- **Three underlying reasons attendees use Algos:**
  Three classifications prevailed;
  1 - Execute large trades and capture market liquidity,
  2 -Minimize market impact,
  3- Execute trades quickly.
  Namely it is the frequency and/or volume of trades that should drive the decision to use Algos.
- **Liquidity was a hot topic and discussed at each session:**
  Three classifications prevailed;
  1 - Principal liquidity which relies on a banks client flow and internalization rate,
  2 - Hybrid (the most popular) which combines principle liquidity and liquidity directly from other banks and/or ECNs,
  3 - Direct Market Access (DMA): connecting to ECNs (this was a favourite amongst hedge funds).
- **Algo selection was also a thoroughly discussed topic:**
  Some attendees developed their own strategies internally, some utilized bank sponsored offerings while others were attracted to third party offerings, overall hedge funds developed their own and would only use a bank offering if it had DMA liquidity, real money clients were more inclined to use a bank offering and preferred hybrid liquidity but understood the benefit from principle only pricing.
- **Attendees challenges developing their own algos:**
  Post trade allocations, STP and connectivity overall were concerns voiced by both buy and sell-side participants, these areas were expensive to coordinate and build on the back end of an Algo trade, all attendees agreed that banks were the most efficient and best to handle these risk(s).
- **Real money concerns:**
  How to should start implementing Algos into their execution toolkit, the consensus was to start slowly with a trusted bank(s) offering to gain confidence.
- **Judging an Algos performance:**
  This was hard to judge and comparing various algo strategies with differing liquidity was challenging.
  Post trade TCA was a requirement from all current and potential users as this was a way for them to gauge the execution quality of the algo.
  Pre trade TCA was an area of growing interest but most participants understood the challenges required to deliver it, both hedge fund and real money users would like pre trade TCA and all required post trade TCA.

4 PLATFORMS

NEX Markets

"I need to minimize the number of platforms I use, and maximize access to the market"
"The numerous options for execution and the lack of central regulations makes platform choice and use difficult."

In General:

- Too many Spot platforms.
- Not enough complete workflow platforms.
- Clear demand for FX platforms.

Key Discussion Points:

- Liquidity: Access to Banks, non-Banks, Order Books and Futures.
- Algos: concern that Bank Algos only execute against that Bank's liquidity.
- Credit Intermediation: Asset managers have a huge problem with open market access, which existing solutions (PB's, CME etc.) do not resolve.
- Workflow: Platforms are much more than liquidity access tools, and need to cover Workflow, Compliance, LP management, TCA etc.
- Need for Buy-side co-ordination to create new clearing solutions.
- Platforms more than connecting liquidity – TCA to inform the trader.
- Intermediaries are usurping alpha.
- Many different expectations about what is needed from a platform; platforms are not only about technology, complexity and asset classes..
- Interaction between platforms / exchanges / OTC / still live.
- Liquidity source for platforms.
- EFP availability for / on platforms.

> *A superb and engaging format, informal enough to get full disclosure.*

5

POST ELECTION VOLATILITY

Michael Kramer (Mott Capital Management)

Volatility is dependent on the investor's time horizon. A long term investor may be less swayed by market fluctuations as opposed to a day trader. Significant amount of headline risk, meaning markets are quick to react to a headline or piece of news without knowing all of the details, or taking the time to investigate it further. For example Trump election was an example of headline risk, once investors went through the thought process investor nerves subsided.

> *I will definitely attend again. Well put together, dynamic event.*

Key Discussion Points:

- How much do polls drive markets? Perhaps the best strategy is to ignore short term volatility and focus on the long run.
- Investor's reactions to events (elections etc.) mostly dependent on their investment time horizon. S/T investors more sensitive/reactionary to political events.
- Hence if a market is considered volatile, then shouldn't it be measured relative to time horizons?
- Determine what timeframe you are aiming to trade.
- Post-vote volatility has been surprisingly low – especially relative to unanticipated events.
- Even knowing that an event may create volatility it becomes the direction of the move that is important.
- In some cases an event can create volatility the tricky part is getting the direction correct.
- There are different ways to measure volatility, is it historic or implied? There is big difference between the two, we need to know which one it is we are trying to measure.
- Digestion of information and speed drivers causes fluctuations as well
- VIX indicates surprise is coming; although at times VIX is low but intra-day volatility can be high.
- Is volatility being underestimated to the upside?
- Lack of consensus about where volatility is headed due to different points of view on Trump, EU, commodities.

6

RUSSIA

Moscow Exchange

"Opportunity in Russia is greater than any perceived political uncertainty or risk"
"Reassuring to understand mechanisms for managing risk on MOEX with more transparent credible mechanisms in place."

Emerging Markets:

1. **Fear**
- Geopolitics, trust, sustained liquidity.
2. **Understanding**
- Opportunities.
- FX and other asset classes.
- Jurisdiction / infrastructure / sustainability / risk.
3. **Discovery**
- Accessible exchange has evolved with a clearing bank and infrastructure (domestic & international).

Key Discussion Points:

- Russian liquidity has improved vastly over the last two years; significant corporate governance development and evolving market structure for Russian asset markets.
- Moscow Exchange a decent alternative for banks and for FX liquidity.
- The Russian Central Bank is increasingly improving access for investors to their capital markets.
- Look beyond misconceptions, fear of sanctions and geo-political risks to understand the strong fundamentals which is the current status of Russian market; investment opportunities; exchange health; Mandated dividend policy.
- Better access to local markets; more transparency; better corporate governance; more stock choices via different industries etc.
- IPOs; 3 types dividend equity markets; 200+funds / buy side; reforms listing corporate governance.
- How? CCD exchange model repository; settlement: in Russia; outside; JPMorgan; CBR; Open; accessible; transparent; Ex/securities / derivatives.

7

EM vs G10

State Street

"To take EM vs G10 you've got to consider difference in liquidity and type of platform."
"EM and G10 are lockstep for now in a low volume environment."

EM - Key Discussion Points:

- Scope for more currency pairs in EM.
- How do we make sense of the unusually low volume, low interest rate, and low inflationary environment of today's EM? How do we adapt to the new change in regime?
- EM recovery contingent upon DM not raising rates too fast and inflation remaining subdued.
- General optimism with respect to global risk environment but still many people sceptical of unknown, hard to articulate risks.
- EM looks attractive, from both carry and valuation perspective but where is the funding coming from? CAD? AUD?
- For CAD, oil and the Canadian housing market were cited as reasons to go short CAD
- China is still central, especially the question of how much it tightens liquidity.

G10 - Key Discussion Points:

- Low yields for longer in US.
- Dollar may be overvalued but markets can overshoot.
- Generally high level of confidence that US inflation is just around the corner.
- Risk events are assumed to be less yet continuity is not a given.
- Volatility will stay low as long as interest rates do; there is concern about low volatility as it can result in above average valuation.
- FED Rate Cycle: agreement that there is no need for the Fed to get overly aggressive in their hiking cycle.

Summary:

- **General belief China is a source of risk to EM** due to its large economy, its importance to global macro, as well as issues related to global liquidity, commodity prices, and financial stability.
- **The low-vol environment is helping in EM:** However was the positive price action in EM justified, or simply a function of low volatility and a lack of external catalysts? A bubble could be growing, but it will take time for a shock capable of reversing the current trend.
- **Positioning in EM is very crowded;** without significant change many believe EM will outperform in this low yield, high liquidity market.
- **BRL and MXN highlighted as favourite EM longs** currently but also liked TRY due to high yields and relative valuation to other EM.
- **South Africa discussion;** potential opportunity if Zuma is removed, but if unlikely to happen the removal of the finance minister is a red flag for the short-term stability of the ZAR.
- **The consensus was that EUR was no longer a greater funder due to belief that ECB will change policy stances** and many saw a future strong EUR squeeze to the topside
- **US inflation:** on one side scepticism over the so-called "Trump trade", based on the notion that markets had over-priced the likelihood of significant fiscal expansion in the US.
- **On the other side, belief that higher US inflation is likely,** which could prompt a more hawkish stance from the Fed and, in turn, pressure on EM asset prices.
- **The Fed is wary of attracting too many inflows into the strong USD** which will likely cap US rates, which is a bull case for EM and the high yielders in EM will outperform on the back of this.

8

MARKET STRUCTURE

VIA FX

Big banks traditionally warehousing risk simply don't do this anymore; this has created opportunities for buyside-buyside potentially and for foreign banks to fill in the gap.

Key Discussion Points:

1. **Declining PB (Prime Brokerage) model, largely due to onerous regulatory requirements.** Furthermore as many hedge funds are finding it a challenge to sustain profitability, this will impact on profitability of Bank PB.

- Consequently Bank PB is in decline, as are bank FX services and quality of analysis.
- Bank research vs independent research? More buy side research in the future? There is concern that the amount of freely available quality research has decreased due to the move to tighten analyst resource. Therefore providing major players with a huge advantage managing budgets for tailored, independent analysis.

2. **New age of collateral.**

- Consequently is there going to be an evolution as to how information will be shared, to allow for transparency of information, available to all, regardless of institution size?

3. **Machines vs. voice.**

- Still relationship driven but more reliant on E trading.
- Key to success of more automated market is to bring more human knowledge and behaviour into the data.

4. **MiFID II**

- MiFID II is due to come into force in January 2018; it could see the development of desks that internalise asset management / treasury flows to open market with the aim of increased transparency.
- How is regulation driving changes in market structure? Is regulation driving the industry or is industry driving regulation?
- Many banks will need to invest/ upgrade in tools including real-time analytics, sophisticated alerting capabilities and increased automation to help ease the burden of satisfying MiFID II requirements.
- In addition a significant provision of MiFID II is that investment research payments are to be expressly 'unbundled' from other payments.

5. **Buyside-Buyside matching.**

- Big banks traditionally warehousing risk simply don't do this anymore and there is a continuing imbalance between the shrinking sell side and growing buyside.
- Therefore firms have had to adjust; expanding trading desks to tap liquidity through a diverse set of channels, creating opportunities for buyside-buyside matching to generate its own liquidity and for foreign banks to fill in the gap.
- FX TCA is also now widely used as a result of the changes in market structure.

Future Hive Live Meetings...

Asia Global FX, Singapore:
September 7, 2017

Exclusively for Asia's leading buy side FX trading desks Interactive meeting examining institutional & retail FX trading technology as well as regional liquidity.

Essential for any Head of Trading/ Portfolio Manager keen to collaborate with private roundtable discussions.

Exclusively for senior buy side FX professionals to discuss major FX trading concerns strictly behind closed doors.

London Global FX:
December 5, 2017

Topics to include:
- TCA
- Algos
- Best Execution
- Regulation
- Accessing new liquidity
- Role of Banks & Exchanges
- Brexit
- EM inc. Asia & Russia

For more information about these meetings or to reserve your place please contact Julie Nicolas: Julie@thehive-network.com