Streamlining Execution: Automated Trading on Buy Side Equity Desks

Introduction

During Summer 2020 The Finance Hive brought together a small group of buy side head traders interested in discussing how their firms were embracing automation. Although they differed in the extent to which automation was a feature of their existing workflow and execution, they were united in their appetite to learn, share experiences and brainstorm on expectations as to the next steps. The group were keen to capitalise on opportunity and assess the benefits that automation may have for their firm.

Joining the discussion were three representatives from Finance Hive recommended partner, Bloomberg – who were on hand to provide market expertise around the data required to analyse and implement more systematic and advanced automation. Bloomberg were also present to share experiences of how they had helped their clients on the automation journey's that they had embarked on, as well as to listen to collective buy side feedback on how the vendor community could better help them meet their objectives.

While the atmosphere was mainly optimistic, and participants at all levels of the automation spectrum were keen to understand and identify opportunities where it might be able to make their workflow or execution more efficient and cost effective; there was also some concern expressed as to what the future role of the buy side trader might look like. Automation was ultimately seen as an enabler – but only to those who could be dynamic enough to embrace evolving responsibilities and grow their skill sets. There will always be a need for the human touch on the trading desk, and the group agreed that relationships with brokers remain equally important in an automated world.

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Conversation Summary

A key finding from the conversation was that the term "automation" clearly means different things to different people. Over the course of the boardroom the group touched on algo wheels and how the criteria for selection, modification, rankings, and weightings were set, order-routing and systematically directing flow. However, most of the interest was directed towards combining the power of machines with the human touch to optimise trading performance. The group identified several benefits of establishing an optimal hybrid of tech and trader, including:

- Freeing up trader time to focus on more value-add tasks and managing more difficult trades

- Reduction of operational risk

- More scientific algo selection

- Removal of trader bias

- Improved data capture for execution analysis

- More systematic demonstration of best execution

Data

The key area when starting or scaling the level of automation on the trading desk is accessing, analysing, and understanding data. The first steps are to identify what data you have or can collect, and then understand how you can post-trade data to look back and create a set of rules for which trades are automated, which venues are selected and at what time. Looking back allows you to move forward, but there must also be an element of pre-trade analytics to measure expected outcome and create a point of reference for the post-trade data you are looking at.

However, acquiring a large enough data lake to generate these useful insights is a challenge faced by all but the largest and most active trading desks. The group agreed that you need at least 1000-2000 samples per day to be able to draw meaningful conclusions – and even then, there needs to be an element of randomness to be able to remove the inherent trader bias you will find in your sample. Even with the required data, it can still be challenging to create patterns and generate conclusions.

The group expressed an interest to go back to the order generation level to be able to help them with this problem, but event here there are issues due to limitations with parent-level TCA.

To overcome the problem of not being able to amass enough data to start putting an automation framework in place, the group agreed that the standardisation and aggregation of peer analysis data pools is an essential development that needs to take place.

There was debate about the extent to which buy side should interfere in the routing logic of broker algos, or whether they should interfere to have more control. Broadly, the consensus was that buy side should leave this element of execution to their brokers, as the quality of their venue selection will be reflected in their performance. So if you dedicate your time to creating a framework to analyse this performance then you can achieve the same benefits. But in specific instances where market impact or access to much deeper liquidity is of imperative importance then there can be a case for getting involved.

Some traders who were further down the line of the automated-execution track discussed the ways they were or were planning to move from one touch trading to no touch. This led to a discussion on the growing trend of building IOIs into EMS platforms and the benefits of pushed alerts from pre-trade tools. Focusing on these areas can help to provide you with quicker market insights and drastically improve decision making times.

Everyone was at different stages of their journey, but generally heading in the same direction. There were nuances in the resources available and how these were being applied – but the rational and motivation for automation was consistent across the group.

Key Takeaways

At the end of the conversation, we asked each buy side participant to highlight their key takeaway from the discussion. This is what they said:

It's reassuring to know that everything we're doing is consistent with where the industry is at. As much as I love venue selection and routing analysis, it's interesting to hear that others aren't getting bogged down with that - they are leaving it to their brokers. You don't need to micro-manage a broker. Although it can be beneficial to start from the parent level, really look at the alpha profile for your PM's orders.

Technology is advancing at a phenomenal pace at the same time as markets are getting more complex and fragmented. It feels like in the last 10 years we've made a move to electronic but now it really feels we're at that stage where the next evolution is achieving scale and even greater efficiency. Alerts play a big part in this. We're going to see some interesting developments in the next few years - it's exciting.

It's good to know we're moving in the right direction. It's interesting that at this point in the market people are making it up as they go along - but we're all coming to roughly the same conclusion.

Data seems to stand out - we either have too much or too little. We need to think about how to resource our businesses in a world where data is becoming increasingly important. Not by getting a data guy who can trade, but by getting a framework in place that does not blow your budget to work but genuinely adds benefit to the shareholders.

Algos are more or less the same from all the brokers - that's the conclusion we came to internally so it's great to hear others have too.

Nothing is trying to replace the role of the trader - the tech will enhance the role we do and give us more time to focus on the bigger picture and more important situations. We need to embrace that. At our firm we need better access to the data that will facilitate this and need to invest in developing skillsets to help us use it across all aspects of the business.

It's interesting to hear how the trading desk is evolving to embrace automated trading, but it's important that we don't do so in isolation. We need to work with PMs to understand how these new systems and the newly found time and insights we can gather can help them. Automated trading has to be a collaborative process across the business.