Re-thinking bank client trading
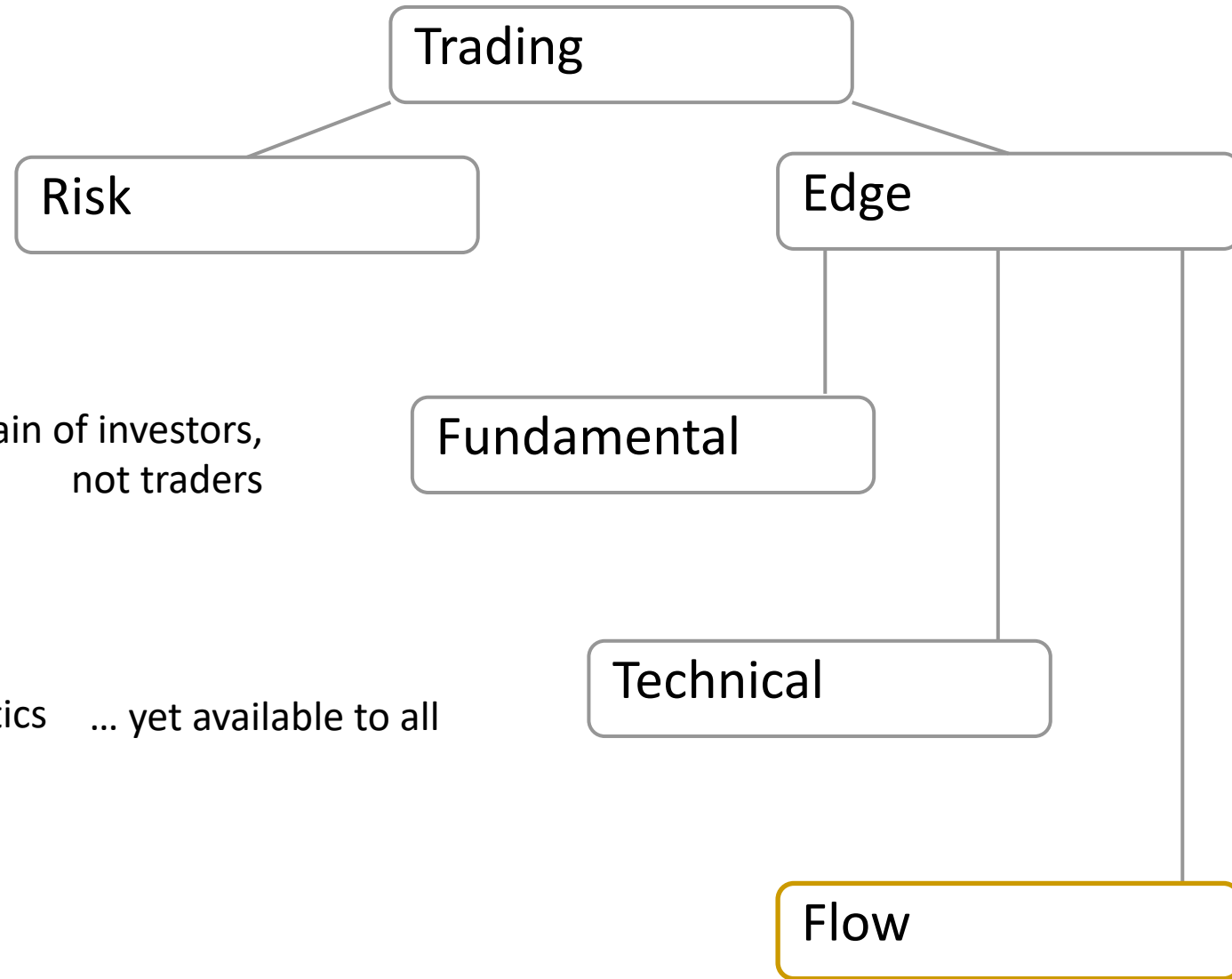
Taking lead from data-driven technology sector

Background

Two pillars:

Source of edge:

o   No signal for in
      and out trading

Second-best:
      o   Suitable horizon
      o   Rooted in statistics

And then:

Trading

Risk

Edge

Domain of investors,
not traders

Fundamental

... yet available to all

Technical

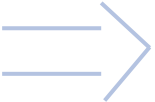Flow

Flow: best source of edge for a bank

- Best fit in terms of horizon/frequency: best predictor of imbalances over several days for FX, several weeks for rates – ones bank traders are supposed to capture
    - Supported by market microstructure research
- Inaccessible to other players – unique to banks

Where does your bank stands?
Do you press this edge hard enough?

Lowest-hanging fruit

Efficiency metrics

55/45 + 55/45 + 55/45 + 55/45 ... ⟹ Robust advantage

Each signal relatively small   ...yet added on top of each other

Direct utilisation   [X]

For a given instrument, have you
checked all patterns / combinations for:
- biggest clients
- most frequent ones
- where see biggest share of business
- most informed (funds)
- distinct groups (of smaller ones)

Some competitors more advanced

Beating them = being best per unit of resources spent

Indirect – related   [X]

RUB example for reference:
- OFZ, Russia Eurobonds etc in Russia complex
- MXN, PLN etc in EM complex

Data-within-reach analysis   [X]

- Who is most missing puzzle within easy reach?
  - Could be toxic OR
  - Needs tailored effort to access

Idea

Solution: internal price mechanism for flow information

Price – best invention of markets
- *regulating, everything falls into perfect order*
- *starts a "beating heart" for any system*

In concrete terms: group within trading that will operate the following loop:

First iteration – going over all existing flow data
- maxing out the metrics – every bit that tips the scale

Next – run systematic model to take advantage of AND expand the edge
- pricing as key component: the more some input helps P&L of such model, the more the group pays

Drawing parallels with: treasury departments
- sets transfer pricing for liquidity depending on how much use
- same logic for information – "Information Treasury" within markets departments

Pioneering approach: leaders, not followers

Pricing model perspective
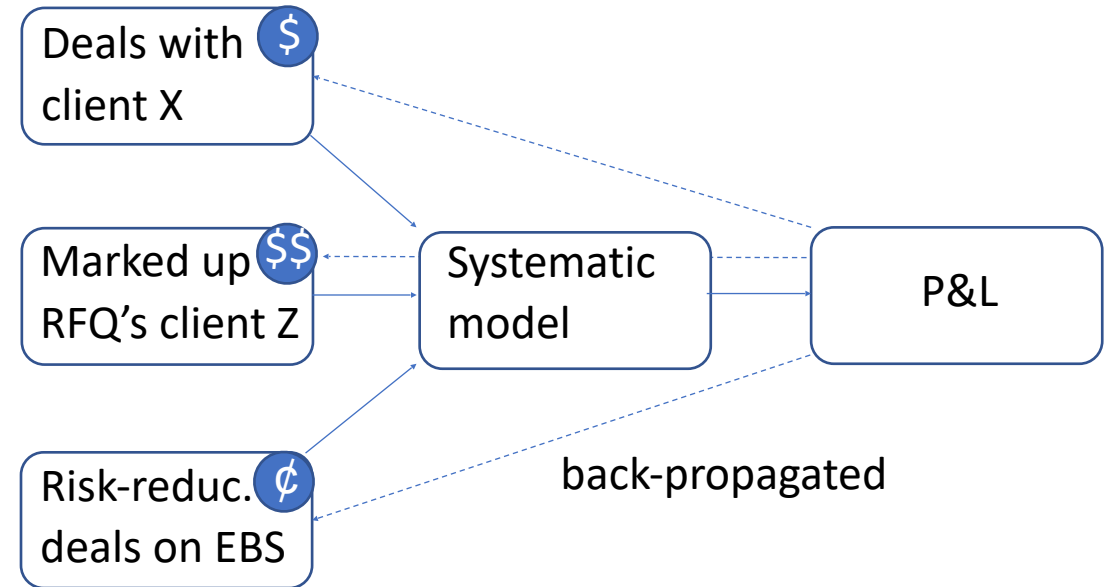
As a general rule, higher price if:
- Consistent deal flow
- See high percentage of client activity
- Have history
- Fills the gap

Even for outgoing counterparty trades:
- Anonymous exchange eg MOEX – zero
- EBS – some information content

More subtle:
- marking up passes where have clue (now it's lost)

Pricing traders perspective

For traders only P&L matters
- Backbone incentive
- Convincing – unreliable

>

Absolute level:
- of interest to traders
- motivating to win flow

>

Model overall ("master") level of risk

Second-order

Indirect P&L incentive (amplifying):
- Get great edge themselves – signal will be shared
- Proactive – if something in RUB impacts MXN, will come to MXN guy
- Confident flow effort not wasted, but squeezed to max

Model information advantage
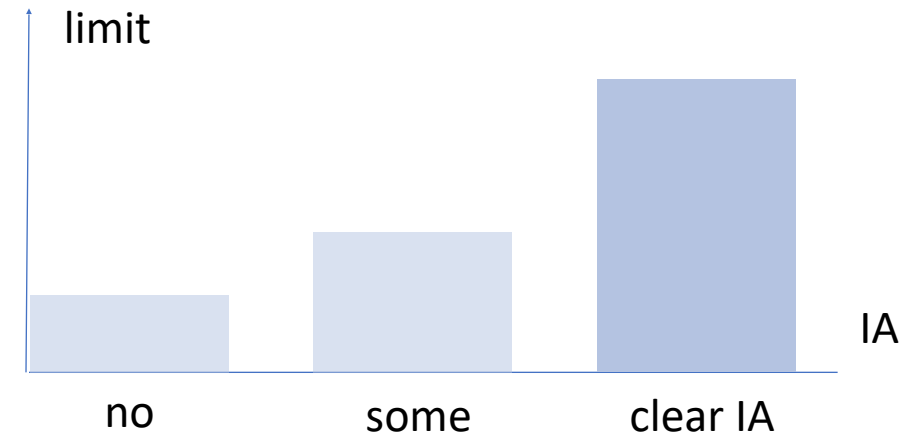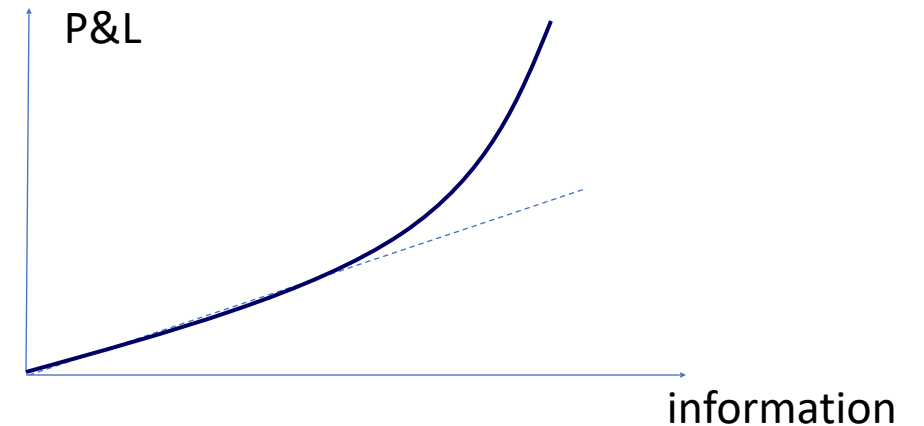
Ideally P&L dependent only on:
- Quantity of flow
- Quality of flow

Sort of dependency?
- Better than linear, because getting critical mass creates externalities

Information advantage (IA) indicator:
best informed trades = best risk/reward

Dynamic tie between IA and limits –
press harder to realize high IA

Model process-driven

Virtuous loop, built-in self-enhancement

Imperative: bad trading decisions cannot derail the loop:

Trading model can only be process-driven = systematic

Features in our case:

- Sound and transparent concept, no black box
    - Replicating as close as possible collective mind of smartest clients where they vote with their money
- Advanced statistics – powerful tool for all things risk
    - The best approach – quintessentially statistical

more areas with high IA

more P&L

better prices for flow
can be offered

more flow
better flow
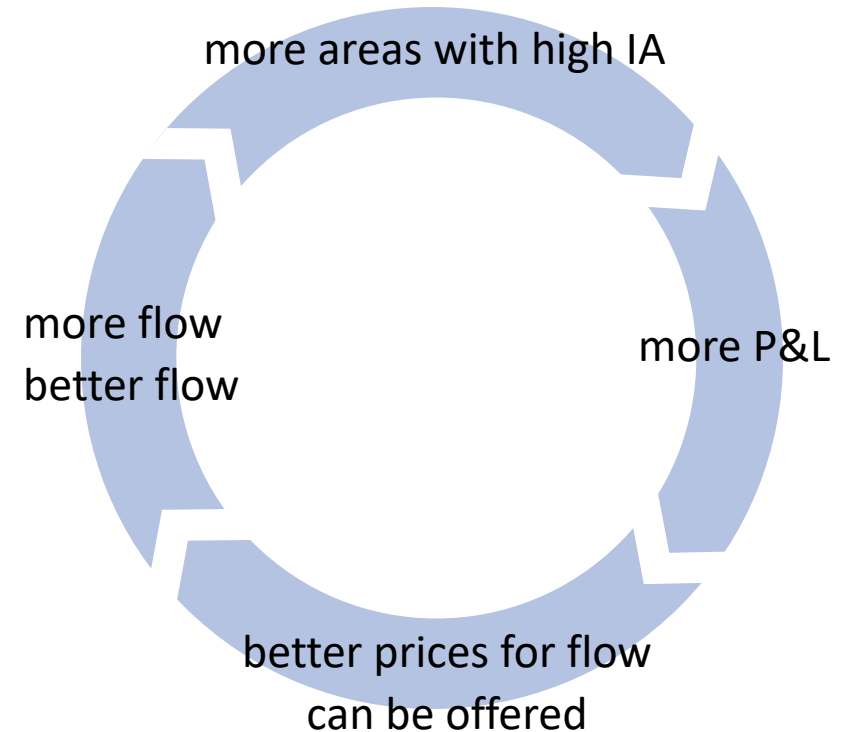
Benefits

Management

Systematic statistical picture of markets

"These are buying, these are selling, these are conspicuously absent – and it means the following"
- Report each day
- The more activity generated – the clearer the picture

Outside-the-box:
- Own prop as good indicator:
  - Everyone one way – telling of upcoming short-term move against it
  - Sound basis – proxy of street positioning
- Sales know their clients – knowledge wasted
  - Systematic questionnaire (aggregated)
- Regular in-house technical / strategist signals can also be thought of as flow for additional overlay
  - Might be powerful combination

Capital efficiency:

- Freeing up capital through improved risk/reward
  - Bigger budget on same risk

Traders as driving force

Leaders in the client process

- Proactive push to bring in more flow
- No point in sales push if trader not interested enough
- Vice versa will always work. If sales see eager trader, will do their part

Higher interbank profile

Second-order, but still significant value

- No sales involved, any trader can become a specialist and attract interdealer flow

Further motivating portfolio-level market-making:

- Difficult to win focusing to close each deal at profit
- Statistical, portfolio approach – a necessity (BE target over a sample of deals/clients etc)

Example of XTX Markets:
  - 150 math/cs specialists
  - no traders
  - #3 FX player in 5 years (only JPM and UBS ahead)
- Illustrates direction
- In combination with bank-specific advantages can go a long way

Redefining the business for digital economy age

Breakthrough in data acquisition and processing > Redefining business as proactive data extraction and monetization

Pricing mechanism   Data   Model   P&L

Incidentally, reminiscent of... digital economy leaders – technology sector

- Allows to leap-frog the competition
- Without need for any major overhaul

Thank you