

Q&A

Walk on the buy-side!

By Michael Corcoran, Head of Business Development, ITG Hoenig



As the first in a series of interviews / discussions with buy-side professionals in the Asia Pacific region, FIXGlobal asked Michael Corcoran of ITG to sit down with

Francis So, Head of Asia Pacific Trading at ABN - AMRO Asset Management and discuss some of the current issues being talked about across the industry.

Michael Corcoran: Can we start by getting an overview of the type of business you conduct and in which markets?

Francis So: We primarily concentrate on equity trading covering about 13 to 14 different markets, all the way from markets Down Under up to Japan and across to India and Pakistan. It's basically a centralized dealing desk that covers pan Asia. As part of our global initiative we will be implementing a new trading system by the end of the year, after which we will also be taking over the Asian trading portion for our Amsterdam office, which is our head office. We have both Asian and European clients, although our focus is more of an Asian mandate that's been tailored for Asia and traded out of Asia. The Amsterdam desk trades more of an EFAA style account in which they will have a portion that's set for Asia as well.

Michael Corcoran: What about FIX, are you FIX connected right now?

Francis So: We are using FIX in an indirect way at the moment by routing orders through Bloomberg. But that will change by year-end when we implement a new order management system called Minerva, which will replace an



Francis So, ABN-AMRO Asset Management

in-house system and enable us to connect to the majority of our counterparties directly via FIX.

Michael Corcoran: And are there trading challenges, compared to those that your European colleagues face, and that you see as specific to Asia?

Francis So: I don't necessarily see the challenges as different as the ultimate goal is finding best execution and adding alpha to the process. I think one of the main differences is the way liquidity is sourced and the different venues available to investors. In Asia the stock exchanges have a monopoly so that's principally where you're going to find liquidity. If you're talking about the US and Europe, there are a lot of different ECNs available where you might find liquidity.

Michael Corcoran: There have been attempts to bring specific liquidity pools to various Asian markets, yet they have not enjoyed the US or European experience. Have you got some thoughts on that?

Francis So: I think it a combination of a few of things, firstly the monopoly of the Exchanges leading to less

fragmentation, regulatory issues and culture. Predominantly, Asian traders are very used to trading through the exchanges where they can see live time data. Order types also play an important role where I believe a vast majority are done on a CD over the day basis.

Michael Corcoran: I'm wondering whether the wide spreads in Asia have played a part?

Francis So: I think spreads have played a part. Prior to the Hong Kong Exchange reducing spreads, there was a lot of volume on both the bid and offer side. Once those spreads came in, there was a significant reduction on both sides, creating much more intraday price volatility. With the spreads continuing to come in, I think traders will want to see much greater size and will probably try using crossing networks going forward.

With the spreads continuing to come in, I think traders will want to see much greater size and will probably try using crossing networks going forward

Michael Corcoran: We hear that in Asia the trade flow is often directed by the portfolio manager to pay for research. How does this fit with the notion of "Best Execution"?

Francis So: It's a bit mixed and I think it's more of an ongoing education process with the fund managers. The CP176 rules, for example; - I'm sure that a lot of fund managers within Asia are not very familiar with them. The point of the education is to get the fund managers to buy into this idea of Best Execution. I believe once that is achieved, execution on the buy side will have much more say in terms of where orders are placed. ABN - AMRO Asset Management still has a commission schedule that we broadly follow, however, we don't necessarily need to follow that commission schedule for every order. If we find that a particular broker can perform a best execution price or has blocks available, we will deal away without referring to the commission schedule.

Michael Corcoran: And if you found brokers that weren't part of the schedule but they could add value on the liquidity front, would they be able to be brought in as part of that process?

Francis So: Absolutely. We should not be disadvantaging our clients if there's a particular liquidity pool that we feel we should be able to deal in.

Michael Corcoran: We all talk about this notion of "Best Execution", but there seems to be various definitions. How do you define it?

Francis So: From my point of view, it's really trying to find the best price available in the context of the order size. As the old saying goes 'Buy low, sell high'. I also believe that within this concept, understanding the fund manager's needs/thought process plays an important role. Open communication with fund managers can add alpha to the overall investment process.

From ABN's point of view, what we're trying to do is have discussions with different fund managers and determine what sort of benchmarks they want to meet

Michael Corcoran: So is it then fair to say that best execution becomes a relative measure, not an absolute measure?

Francis So: Yes, absolutely! From ABN's point of view, what we're trying to do is have discussions with different fund managers and determine what sort of benchmarks they want to meet. Once those benchmarks are clearly defined, it's much easier for the dealers to go out and do their job. At least they know that they have a certain benchmark they need to be meeting. So it is definitely a relative measure.

Michael Corcoran: In the context of block trades, it's been suggested that block trading is achieving best execution, but maybe you're suggesting it's just one piece of the weaponry?

Francis So: Agreed. Block trading can reduce a lot of implementation costs. Not only can dealing in size at a certain price help, but also market impact can be reduced because you're not continually stepping into the market to trade.

Michael Corcoran: Within the Asia Pacific context, when we're talking block trading, are we really talking client to client, or client to broker capital?

Francis So: It probably means more client to client. I haven't seen a broker able to put up the capital commitment that might be required, particularly for less liquid names.

Michael Corcoran: How do you go about putting the trade size and liquidity issues together into a benchmark that makes sense?

Francis So: Ah, that's quite tricky. The majority of times our fund managers use a VWAP benchmark, so it's more of an

education process to inform the fund managers that other benchmarks are available. I think it's good to have a benchmark, but you also need to know your fund managers. You need to know what they are thinking about and why they are doing what they are doing....simply put, understanding their investment process.

Michael Corcoran: So are you suggesting it becomes more of a team approach to the whole trading process?

Francis So: Yes. We are not separate from the fund manager. We are actually creating a team that is one part of the fund manager, with execution contributing to the overall performance. So we act as one team.

Michael Corcoran: Do you think ABN - AMRO Asset Management is unique in that sense?

Francis So: No, absolutely not. I believe that any other major fund house will have this sort of structure in place already.

Our Amsterdam office has already gone through an exercise on unbundling, mainly on the side of fund managers actually valuing brokers' research...eventually I think that push is going to come to the Asian office

Michael Corcoran: Earlier you mentioned the FSA's CP176 regulations, which of course are concerned about unbundling dealing and research. It sounds like you are moving towards being CP176 compliant, yet you are not regulated by the FSA. Why are you doing this?

Francis So: Because eventually we probably will need to be compliant. Our Amsterdam office has already gone through an exercise on unbundling, mainly on the side of fund managers actually valuing brokers' research. Eventually I think that push is going to come to the Asian office.

Michael Corcoran: In what time frame do you expect to see this push into Asia and where is the push coming from?

Francis So: Timeframe; one to two years. I believe a lot of the push is coming from clients. I would assume, I can't be sure about this, but much of it is probably coming from consultants as well, because they are going out to clients and asking how much is actually being paid for research. They are seeking clarity on where commission dollars are being spent.

Michael Corcoran: The benefits and costs of doing this: - obviously the client thinks it's to their benefit, but at the end of the day, is the real cost to them going to change? And is there a benefit that is brought to the industry out of this?

Francis So: That's a tough one. I think eventually clients will definitely see benefits, but commission is only a small part of the overall trading cost. Since commissions are an absolute amount that they can actually see, that's where a lot of attention is being focused. Once the unbundling is done and a value is placed on a broker's research, you can start to bargain for much lower commission rates which will eventually flow back through to the client.

Michael Corcoran: Winners and losers in this process?

Francis So: I think from the buy side perspective, that the dealers will definitely be winners because they will have much more say on how the executions are allocated. The losers I feel are probably the brokers because a hard dollar value is going to be assigned to them now.

Michael Corcoran: Taking a step back to Pre-Trade analytics; initially Asia seemed slow to take it up, but all of a sudden everyone's talking about it. What is ABN AM's position?

Francis So: Once we receive orders, we'll try to do pre-trade analysis just to see how the orders should be reacting. It's not to say that pre-trade analytics are going to tell me how I should be trading, but they'll just give me advice in terms of where it has traded previously. So I need to combine the pre-trade analysis with the real-time information that we have; it could be market news, events gone, or other information that helps determine the best strategy. For example, if we had a basket of trades with relatively small names, a pre-trade model might suggest only a marginal impact, therefore we might put those names into a programme trade. But if we have certain names popping up that look to be much more difficult, maybe we will take those away from the programme trade and work them ourselves.

Michael Corcoran: You spoke earlier about internal education and working as a team with your PMs. Where do you think the buy side is with regards to pre-trade analytics?

Francis So: I think the majority of buy sides use pre trade in one form or another whether it is done using a broker system or mentally. PMs' mainly focus on their stock selection but more and more are now looking at liquidity impact. I believe part of the dealer's job is to run pre-trade models allowing the PMs to focus on what they do best. We can analyze trades and go back to the fund managers and show them the impact costs that are coming out. But it's not



to say that those are absolute numbers. They all vary because of the market volatility.

Michael Corcoran: Some dealers on the buy side seem to suggest that pre-trade is integral to pushing trade education back up the chain to the PMs. I guess we're hearing a slightly different thought process from your side?

Francis So: Yes, slightly different. Maybe I'm old-fashioned, but I think fund managers should be focused on what they do best, which is stock picking. Having said that, sometimes fund managers place orders but don't realize the impact that the order may have. Pre-Trade as an educational tool can be helpful in that scenario, but it is more case by case.

Michael Corcoran: Does the same theory apply to the post-trade?

Francis So: Yes, however, we haven't, per se, used it a lot.

Michael Corcoran: I'm curious then, in relation to Best Execution, how does one know what the best execution is,

or was, or could have been, unless one has some form of post trade to reflect upon?

Francis So: I think it goes back to determining appropriate benchmarks, which also becomes quite a client specific type of proposition. So, if you have set certain benchmarks, the numbers will spill out. Peer group comparisons may be more useful in this context than simple post trade.

Michael Corcoran: Algorithmic trading, are you a user?

Francis So: Given our current trading system, we are not using any algorithmic trading at the moment. There is a possibility of doing so using Bloomberg, but it would really come down to both a resources issue and an education issue for my dealers. There are so many algorithms out there that we need to find out what they all mean. For a dealer to effectively use algorithms, they would need to understand what the algorithm is doing and how it's doing it.

Michael Corcoran: On your point about trading systems, I guess that you're talking about connectivity?

Francis So: Connectivity, yes correct. No Fix, no algo!

Michael Corcoran: When your new dealing system is in place with direct FIX connectivity, will algos be something that you want to use?

Francis So: Yes, absolutely. We will probably do a certain percentage of our trading via algos. And, again, it also ties into the pre-trade analytics. Once we do that, we can filter out which trades we can probably do via algos, which trades will be programme trades and which trades we will want to work via the cash equities desks.

Michael Corcoran: While you are not using algos directly, due to your systems, are your brokers trading your orders via algos anyway? If so, what percentage?

Francis So: I'm not sure what percentage, but I'm very sure that they are using algos in some manner. I think in particular, when orders are given CD / VWAP they are

A more personal level of service.

Call the Cantor Asian Equities Sales & Trading Desk
on +852 3558 5450 or email us at asianequitiesinfo@cantor.com
www.cantor.com

CANTOR
Fitzgerald

Cantor Fitzgerald (Hong Kong) Capital Markets Limited is regulated by the Hong Kong Securities and Futures Commission



definitely using algos. That's why we're trying to be much more pro-active and trying to take market views.

Michael Corcoran: It sounds therefore, that you might have a slight issue with a broker taking an order from you and simply putting it into an algo when you have not directed it there?

Francis So: Well, I don't necessarily have an issue with that as long as they are able to provide market colour. If they are just sticking it into an algo the whole day and not calling me, I will have issues.

Michael Corcoran: Is this really a client servicing issue?

Francis So: Yes. That's exactly why, on the buy side, you need to know what the algorithms are doing and what you actually want to achieve using those algorithms.

Michael Corcoran: How do you find out?

Francis So: It may come back to some trial and error, using the algos to see whether or not it fits your particular style.

Michael Corcoran: Regarding trial and error, it's been suggested that to do so is to risk client money in the process. Should brokers be doing more to show evidence of algo performance before you're asked to conduct trial and error, or is it an understanding that this is simply how the industry works?

Francis So: Well, I think it has to be both ways. First of all, yes, brokers definitely should try to provide some sort of evidence on how algos are working. But also on the buy side, you need to know what the algos are going to be doing to the order. So I don't feel that it's right to just push all responsibility to the sell side. If I'm going to be using an algorithm, I need to ensure that it's the right algorithm.

Michael Corcoran: If we could be as harsh as to put a score of 1 to 10 on how the sell side has performed in explaining algos, what would it be?

Francis So: Probably a 3. They have gone out to try to sell algos, but there has been little explanation as to how the algos work. But that may be really an unfair comment. I think it also needs to be driven by the client. If the client is also interested in using algos, they need to have some idea of exactly what they want to be achieving from these algos or have brokers design specific algos for them.

Michael Corcoran: What do you think have been the biggest changes to the industry over the past few years?

Francis So: One major change I think is that our clients are actually looking a lot more at short-term performance versus long-term performance. That has put more pressure

on fund managers and therefore more pressure on dealing to execute much more efficiently.

Michael Corcoran: Has this 'short-termism' brought positive change?

Francis So: Yes and no. From the dealing perspective I would say yes, because dealers are beginning to have greater autonomy in terms of where they trade and how to achieve best price. At the same time, it has created a lot more volatility and intraday volatility, making timing of stock selection from a PM's perspective more difficult.

Michael Corcoran: Finally, what advice could you give the sell side to ensure they cope with these issues and stay in touch with your needs?

Francis So: I think the sell side probably needs to be much more pro-active in terms of giving views. The key word is "pro-active". If we're looking at the unbundling issue, I think it is being much more audible to the buy side dealers and providing them value added market colour. Actually, it's more than just market colour, it is views, their specific views. Whether they are right or wrong is another issue, but the buy side needs to hear those comments.

As we evolve through unbundling and algorithms, the nature of the relationship between buy side and sell side dealers will change such that the sell side dealer will need to bring a higher level of value-add, taking a more consultative approach. It's a two-way street and we understand that you're not always going to be right, but we still want to hear your considered opinion. If you're unwilling to provide an opinion for fear of being wrong, I'm unlikely to come to you for execution. At the end of the day, the buy side dealer needs to decide whether or not to act on your advice, as we still have ultimate responsibility and control of the order.

Michael Corcoran: Francis, thank you very much for your time.

Francis So: My pleasure. **FIX**

Any thoughts on this or other articles?

Please send any comments, referring to this article as Vol 1 Issue 10 AP1, direct to Edward at edward@fixglobal.com