

Newton's Views

By Sandra Sciotto-Cook and Gary Wallace, Credit Suisse

Sandra Sciotto-Cook and Gary Wallace of Credit Suisse sat down to discuss the pros and cons of electronic and algorithmic trading with Tony Russell, Head of UK Equities Trading at Newton Investment Management in London.

"Newton, takes a global approach to multi-asset class trading from its London office" Tony explained. Newton has four equity and two fixed-income traders that cover all markets globally out of London. All of the company's equity business is done out of their London headquarters. As a firm, Newton is a stock picker, that also has a strong focus on small-and mid-cap stocks in the UK and their business is split into 90% equity and 10% Fixed Income.

Electronic trading offers: total freedom on how an order is traded; a more cost-effective method of executing an order electronically; anonymity during a trade; increased efficiency as algorithms help automate a considerable proportion of the order flow; and time-savings. Also, fills are updated in real-time, doing away with the need to call up sales-traders for reports on how the execution of the order is progressing.

On the other hand, he is disappointed that many brokers are experiencing delays, caused by traders being unable to link market fills automatically to client orders. This he expresses wastes time, as fills returning from the market have to be manually allocated to client parent orders in the broker's Order Management System, leading to delays in getting fills information back promptly and these also contain no real depth as numerous fills are lumped together in one fill.

When algorithmic trading became more mainstream following the decimalization of Wall Street in 2000, Tony admitted that he had been sceptical about algo's value



Tony Russell,
Head of UK Equities Trading,
Newton Investment Management.

Newton Investment Management

Established in 1978, Newton Investment Management currently manages funds worth in excess of GBP32.8 billion on behalf of private investors, institutions, charities and pension funds. With investment management as the only focus of Newton's business, the firm's product offerings mainly cover Investment, EP, ISA, Bond, Diversified, UK Equity and Specialist Equity funds. Newton is owned by the US-based Mellon Financial Corporation, which has approximately \$5.3 trillion in assets under management, administration or custody, including \$918 billion under management.

to trade financial instruments in electronic markets. The extent to which algorithmic trading has been widely embraced by the marketplace is reflected to some degree in Tony's marked change in attitude towards algorithmic trading over the past six years. He now acknowledges that there is a place for algorithmic trading and what's more it's no longer an option but a necessity in order to gain and maintain competitive advantage.

“ Algorithmic trading ... it's no longer an option but a necessity ...”

Algorithms, Tony points out, can help take care of the labour intensive side of the business as they can be deployed to do the 'grunt' work on an order. This frees time for buy side dealers to focus more on using DMA to be more responsive to advantageous prices and pick spots where they can add value.

Tony warned that brokers who only offer “plain vanilla” algos that use common benchmarks such as VWAP to determine when to place an order, or other basic algorithms such as With Volume, will be left behind in the marketplace. Tony suggested that brokers aiming to stand a cut above the rest; deploy more advanced algorithms that could be used to achieve specific trading objectives, deal effectively with trading small- and mid-cap stocks, trade aggressively and grab liquidity without impact.

In some ways, he believes, trading has been made easier by transferring part of the responsibility and risk involved in handling the orders away from the broker and on to the buy side. Yet many buy-side desks are finding the transition to managing their own orders difficult, although he says, this is not the case with Newton. Other shortcomings include the sheer number of algorithms to choose from. Tony stressed he needs reliable measurement tools to help evaluate what he should be deploying, and whether he is using the algorithms he has selected well.

This brings us onto his wish list. “It's all well and good”, Tony pointed out, “to have electronic trading and access to algorithms, however, the lack of reliable Execution Performance Measurement Tools can make it difficult to work out which algorithms would be of greatest use to Newton. Quarterly TCA (Transaction Cost Analysis) then becomes not as useful in this instance to him. In this respect, he sees that pre-and post-trade analytics will play a very important role in evaluating a broker's offerings. He added that he will be watching out for developments in Post Trade Analytics to compare brokers' algorithms and evaluate their performance with a view to choosing the winners.

Ideally, he would like post trade analytics to be broker neutral, and would expect an EMS (Execution Management System) to offer this functionality to avoid being biased. It's an understandable wish, given that this high-speed gateway was designed to provide access to multiple

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execution venues, DMA order types, market data and algorithmic trading strategies. Elaborating further on the issue of broker neutrality, Tony said he disagreed with the growing practice of brokers acquiring technology vendors. This he fears will jeopardise anonymity in the marketplace, and is thus convinced vendors should be broker neutral to prevent instances of bias occurring.

What else would help Newton enhance its trading capabilities? “Having a multi-broker and multi-asset class trading platform” was Tony's reply. To his mind, the most advantageous trading system would have the following characteristics:

- (i) full EMS integration with internal OMS and Proprietary Systems,
- (ii) integrated, broker neutral pre- and post-trade analytics,
- (iii) access to 'dark pools of liquidity', as well as,
- (iv) unlimited access to broker algorithms and DMA

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Newton currently uses Charles River Version 6, and will be upgrading to version 8.1.5 by the end of the first quarter of 2007. Tony said he was looking forward to having a new system that combines the functionality of an OMS with that of an EMS. In fact the new system promises more pre-and post trade analytics, historical data, and pre-trade integration within the blotter. He added that he is particularly pleased with the level of service his firm has received from Charles River over the last five to six years, as they maintain effective channels of communication and liaise well with him on what is required in future product releases. He is also quick to note that Charles River is continually reinvesting in its OMS, a product that has managed to remain independent by not being sold on to brokers.

With regard to the future, Tony would like to see algorithms being developed for other asset classes such as for futures

and foreign exchange, plus more algorithms to find dark pools of liquidity, which would be particularly useful when trading the US and Asian markets. In addition, he looks forward to the day when single broker-independent workstations are able to provide access to all the trading tools he needs, including pre- and post-trade analytics.

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How does Tony see the future of the regulatory environment as it affects electronic trading, taking shape? Primarily, he views the current fragmentation of the US trading markets as a pre-cursor of what will happen in Europe, following the introduction of MiFID. Under MiFID, brokers will have to build smart-order routing technologies in order to keep ahead of the competition as the EU tries to create a more level playing field to protect investors, and respond to innovations in the securities markets. The brokers that will stand out in the post-MiFID marketplace, he maintained, are the ones that have built the necessary technology to access multiple trading destinations to avoid missing out on liquidity, speed and price improvement. The US

experience shows that simply accessing the market becomes completely dependant on smart order routing and order placement strategies.

And what does the future hold for sales-traders: will their roles be replaced by algorithms? Apparently not, according to Tony, who believes that algorithmic trading will merely change the traditional role played by the sales-trader. He anticipates the sales-traders will increasingly deal with the more complicated orders where they can add value, while smaller orders will be directed electronically via DMA and algorithms. While he sees himself using DMA for the small orders, algorithms for larger orders, he still plans to call on sales-traders for capital commitment. Traditional sales-traders take heed, however, when he points to the future he sees greater numbers of orders being traded electronically. Tony predicted that as clients become more used to receiving immediate fills, the sales-traders will have to become more adept, so as not to be left behind by the efficiency of electronic trading. **FIX**

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