INNOVATION IN FIXED INCOME: AUTOMATING THE FUTURE

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Among the many effects on financial markets from the Covid-19 pandemic, one of the more interesting ones was a temporary surge of interest in voice trading. Some traders working from home and looking to execute a large trade struggled to cope with the volatility that ensued, and many found themselves reverting to voice.

But whilst voice is likely to retain appeal for large parts of the Fixed Income community, the spike in this type of trading represents an anomaly. Well before Covid-19, Fixed Income had begun a long-term trend towards greater automation. And as the world begins to envision a post-Covid-19 environment, we can only expect that trend to reassert itself.

Electronic trading in U.S. Treasuries in some cases already accounts for about two-thirds of activity, whilst Fixed Income platforms report a rising tide of algo-driven trades. It is not just the sell side that is embracing automation. A study by Greenwich Associates, issued just before Covid-19 began to disrupt global markets, showed that 65% of investors thought electronic market-making was improving liquidity in the corporate bond market. Fixed Income venues report increasing electronification, driven not only by algorithmic trading but also by the cost benefits that come from automation.

Still, every big trend in markets requires innovation – and the Fixed Income automation story is no exception.

One of the critical components to this transformation is normalisation. Fixed Income assets have more terms than other assets, and trading them is much more complex than trading cash equities or futures. A single entity may have issued numerous securities, each with different coupons and maturities, and potentially with different pricing conventions.

Meanwhile, venues have individual protocols for connectivity. As a result, any firm looking to trade in multiple locations in Fixed Income markets historically has had to consider the cost and resource implications that come with automating in this space.

A handful of technology-based firms, however, have been working hard to bring electronic Fixed Income trading up to the same level as other markets. Vela is one of those firms.

Vela has a direct market access (DMA) solution that covers 40+ major listed derivatives venues with a growing number of destinations in the Fixed Income markets. Low-latency and fully normalised access to these venues are key to building sophisticated algos for trading. As a fully hosted and managed solution, it also means that buy-side firms with limited IT resources can focus on their core business. This allows them to consider trading in dozens of additional markets without having to worry about expensive development or long lead times.

There are some good reasons why electronification makes sense for Fixed Income. A regulatory push towards transparency and post-trade reporting makes electronic trading much more attractive. Also, brokers for some time have been de-risking and adopting an agency model. Vela's DMA Platform takes account of these trends, building in drop copies for sponsor brokers as well as risk management controls.

As we shift to a post-pandemic world, automated Fixed Income trading is only set to grow. For sophisticated buy-side market participants that rely on automation, this is an attractive space. But it requires platform providers that understand electronic trading and the complexities that come with Fixed Income instruments.