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Giants like JPMorgan, Morgan Stanley, and Tradeweb are embracing a credit-trading revolution to move multi-billion-dollar bond portfolios in minutes

Alex Morrell and Dan DeFrancesco

- Credit portfolio trading has exploded in 2019, according to Wall Street executives.
- Investors are flocking toward the tool, and trading firms can facilitate it, as a way to exchange large, diverse bundles of bonds all at once with the help of algorithms and ETFs.
- Wall Street's top fixed-income trading banks have experienced enormous growth in volumes and competition and are investing to capture the growing demand.
- Electronic bond-trading marketplaces are joining the fray, too. Tradeweb launched its product less than a year ago, and MarketAxess is set to counter with its own offering in November.

Tradeweb

Chris Bruner, head of US credit at Tradeweb

One of the hottest trends in credit trading over the past year has every big bank and many trading venues investing money and resources to keep pace with what has become a vastly changing world.

This year marked an inflection point for credit portfolio trading, with volumes surging across Wall Street's biggest bond-trading desks as clients grew more comfortable with the transactions and banks and venues built out the capabilities to handle them.

The shift means hedge funds and asset managers are increasingly adjusting their portfolios by bundling transactions together versus handling them piecemeal – making it easier and often cheaper for banks' biggest clients to reach the same end result. Bond index fund fees have come under intense competitive pressure industry-wide, leaving fund managers desperate to cut their own costs.

It's the latest in a string of innovations to come to the credit market in recent years, pushing the industry towards increased electronification and away from high-touch practices that dominated the space for so long.

The top-ranked fixed income, currencies, and commodities (FICC) trading firms on Wall Street – including JPMorgan, Bank of America Merrill Lynch, Barclays, Morgan Stanley, and Citigroup have all seen significant growth in their portfolio trading businesses in 2019.

"Credit portfolio trading has grown tremendously. If you just think about where people are going in terms of sourcing liquidity, we expect this to double in the next couple of years, if not triple," said Edward Koo, the head of North American single-name CDS trading, portfolio trading, and e-trading at JPMorgan Chase.

Meanwhile, Tradeweb, one of the largest electronic marketplaces for trading corporate bonds, has also enjoyed a strong uptick in portfolio trades since it went live with it less than a year ago. One of its biggest competitors, MarketAxess, has plans to launch its own offering in November.

More than just the latest trend to hit bond trading in recent years, portfolio trading is an example of top industry players racing to keep pace in a market being upended by technology – or risk getting left behind.

Banks are seeing big growth in portfolio trading

The concept of portfolio trading has been around for a while. But recent technological firepower has allowed the process to evolve from the hyper-manual passing of Excel spreadsheets back and forth to handling large or complex trades with ease and regularity due to algorithms and advanced risk analysis.

The way it works is pretty straightforward: Instead of hitting up individual brokers to trade bonds one at a time, an investor offers up or requests an entire basket of them, potentially hundreds of different securities, to execute in one fell swoop using algorithms and ETFs.

There's no standard definition of what qualifies as a portfolio trade across institutions, so it's difficult to compare efforts. But executives across big-bank trading operations describe a massive uptick in 2019.

To be sure, FICC trading revenues have generally been steadily shrinking industry-wide following the financial crisis, and while the portfolio trades represent a source of volume, they also are

seen as lower-margin than old-school bond trades.

Bank of America handled a $1.5 billion bespoke trade this summer comprising hundreds of bonds. It took under an hour, and cost the client less than three basis points – less than what it typically costs to execute an individual $25 million investment-grade bond trade – and they used bond ETFs to help offload the risk, executives at the firm told Business Insider.

The firm launched its portfolio trading desk in early 2017 and has seen volumes balloon in 2019, and in July it went live with a new team focused on harnessing the firm's success trading bond portfolios and ETFs and deploying that across the fixed-income asset classes.

Goldman Sachs is considered a pioneer in credit portfolio trading, with efforts at an algo-driven offering dating back to 2016. The bank did more than $30 billion in these trades in 2018, the Financial Times reported, up from $7 billion in 2017.

The top-ranked FICC firm on Wall Street, JPMorgan's initial foray into portfolio trading came in spring of 2018, but the bank started ramping up its efforts in earnest this April, adding headcount to Koo's team. By volume, the firm estimates bond portfolio trades have as much as quadrupled year-over-year.

Drew Mogavero, co-head of US credit trading at Barclays, told Business Insider his firm has been active in portfolio trading since the second half of 2018 and has experienced "meaningful" growth throughout 2019.

"We haven't found many folks who aren't interested in learning more about it," he added.

Morgan Stanley, meanwhile, has seen a considerable increase in the volumes and number of clients involved since setting up a dedicated portfolio trading team within its credit division in March 2018. Year-over-year, the bank has seen a 60% increase in portfolio trading volumes as of October, with plans to continue to invest in tech and resources towards growing the effort, Edward Bayliss, head of macro credit at Morgan Stanley, told Business Insider.

"Portfolio trading has become an integral part of our overall credit trading business," he said.

Even non-bank dealers have gotten in on the action. Proprietary trading firm Jane Street, a major player in the ETF-trading space, has also been challenging the banks with its bond portfolio offering, handling $12.5 billion in volume in the second half of 2018, according to Bloomberg.

Citigroup, the second-ranked FICC-trading bank, launched its systematic portfolio trading option this April, rolling it out first in investment-grade bonds and then high-yield debt this summer.

"Competition in the portfolio trading space from both banks and non-bank participants is increasing rapidly," Joe Geraci, cohead of global spread products at Citigroup, said.

Investors find plenty of use cases for portfolio trading

Investors big and small have shown interest in portfolio trading. For some it's a complement to ETF trading, where hundreds of bonds can be transformed into ETF shares. Others see its benefits in the ability to quickly adjust the risk portfolio of a certain strategy.

"There's been tremendous take-up from many different investor bases, whether it's asset managers, insurance companies, levered accounts. It's a more efficient mechanism and vehicle with which to displace risk," JPMorgan's Koo said.

To be sure, some in the industry have pointed to portfolio trading only benefiting the largest investors. After all, only a fraction of investors have the capital to execute a portfolio trade over a billion dollars. However, trades don't need to be gigantic to yield benefits, either – they can also be used for moving a large amount of small bonds. "There are many, many different usages. Certain ones are growing a little bit faster than the others, but they're all sort of coming together and that's why you see sort of this velocity and this exponential growth," Koo added. Trading venues also want in. While portfolio trading can be done directly between banks and their customers, electric trading venues are also getting in on the action, offering a one-stop shop for investors to source portfolio trades amongst dealers more easily. Tradeweb, which went public in April and is among the wave of electronic marketplaces that have seen an increasing amount of trading volume in recent years, began offering portfolio trading at the end of 2018. As of the end of September, the trading venue has already eclipsed $25 billion in portfolio trades, with a couple trades breaking the $1 billion mark, Chris Bruner, head of US credit at Tradeweb, told Business Insider. Average portfolio trade sizes are between $50 million to $100 million, with the mean continuing to skew higher as customers have grown more comfortable with the trading protocol, he added.

Bruner sees a key benefit of portfolio trading in its ability to allow investors to move bonds that don't typically trade often.

"There's an opportunity for those less-liquid securities to trade more from portfolio trading," Bruner told Business Insider. "If you put it in a basket of a hundred bonds, a liquidity provider is more interested in getting the whole trade and a little less worried about, 'Hey, do 20% of these securities not trade very often?' Because they want the whole trade."

To be clear, portfolio trading doesn't completely eliminate the liquidity issue that has plagued the bond market for so long. Ultimately, there's no silver bullet to systematically price a bond that hasn't traded in a year.

Intercontinental Exchange and Bloomberg LP also have offerings to facilitate portfolio trades. In June, MarketAxess, the largest electronic trading venue for US corporate bonds, announced plans to launch portfolio trading in the fall, though the firm had previously targeted early 2019, according to the FT. A MarketAxess spokesperson confirmed the marketplace will go live with portfolio trading in November.

And while dealers and trading venues alike are pushing to build out portfolio trading offerings, some investors warn there is only so much business to go around.

"There's a lot of investment in terms of the set up and the structure that the bank needs to facilitate this activity, as well as an explicit investment in technology," a senior executive at a large asset management firm recently told BI, adding that there are only "a handful of players that can do this in a meaningful way."

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