FINANCIAL TIMES
MONDAY 7 JANUARY 2019
FTfm

Fund Management

Technology will sharpen the trader's competitive edge

Desks of tomorrow will have a more direct involvement in generating alpha

COMMENT

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Greater market transparency and the adoption of technology are two trends often cited as being responsible for the gradual demise of the trading desk.

When it comes to the buyside, however, this new transparency and technology reveal the extent of traders' contribution to alpha generation, helping to balance the relationship between trader and portfolio manager.

This change is most noticeable with regard to transparency. The second Markets in Financial Instruments Directive introduced the unbundling of research costs from trading costs, which freed asset managers from the conflict of interest inherent in their relationship with brokers.

When Mifid II came in, much was made of the reduction in the sellside's capacity to produce research and how this could affect equity market liquidity and the buyside's ability to generate alpha. Neither worry materialised. What did result, though, is a greater awareness of the importance of quality of execution.

Even the best ideas can fail because of poor execution and market impact. Partly thanks to greater transparency, today's traders can make the case that intelligent trading decisions do lead to improved fund performance.

At a time when flows to passive investments are rising and investment ideas are increasingly commoditised, active managers have to work harder to keep a competitive edge. A choice between poor execution versus best execution can make all the difference for returns.

The second trend is the advance of technology. The buzz around artificial intelligence (AI) is often accompanied by scare stories about the demise of traditional jobs, including those in asset management.

Technological change should not frighten traders. So far, it has made markets more efficient and provided ways to improve the quality of execution, from smart order routing to algorithmic trading.

The advent of AI should be seen in this light, as an opportunity to automate the mundane and so free time and resources for alpha generation. AI adds to the buyside trader's capacity to mine data, analyse it and turn it into actionable information.

The rise of passive investing and the democratisation of information has led to asset managers all having access to the same sellside (or independent) research, forecasts and analyst calls. This makes it more important to find a way to stand out.

If it is true that 80 per cent of information was created in the past two years, it is clear that there are other sources of data that could give asset managers an edge. Traders who make the most of tech will be able to deal with the vast amounts of unstructured data and turn it to their advantage.

With this in mind, tomorrow's smart trading desks should include tools for trade execution and ways to sharpen performance using AI, data science and machine learning.

Traders have the opportunity to shift the emphasis from delivering savings through better liquidity sourcing and execution to providing value via a more direct involvement in generating alpha.

In the short term, traders may not deliver alpha in the traditional sense. Their contribution should, however, increase to the point where they can make a difference to an asset manager's ability to beat the indices.

We are entering an age in which traders and portfolio managers will work more closely together to generate performance. This should be applauded. When all parts of the investment process do this, they deliver better returns for investors.

Transparency and technology make the traders' case stronger. Despite the scare stories, there has never been a better time to be a buyside trader.

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