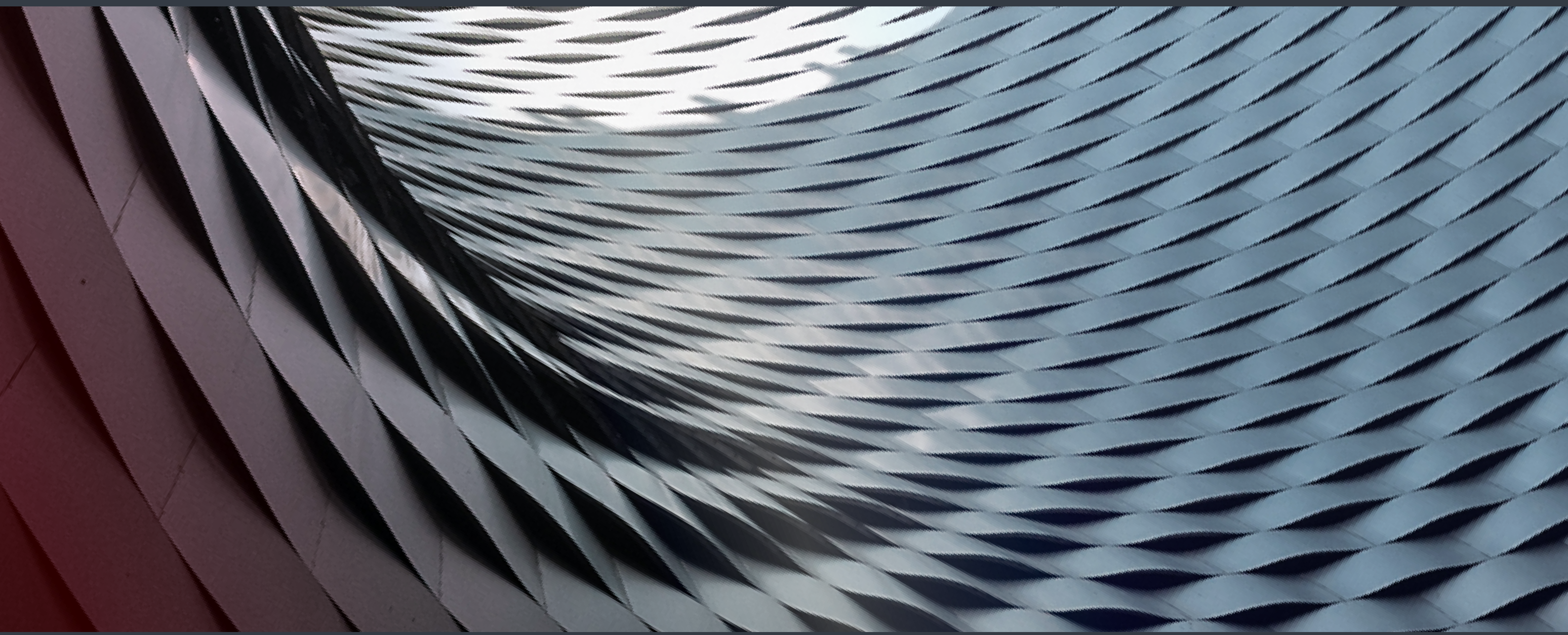
valantic

Report No.6 2023

Sell-Side Fixed Income Expert Network Report

The opportunity amid the volatility



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Research by

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Intro

Welcome to the sixth Sell-Side Fixed Income Expert Network Report, which is produced in collaboration with Acuiti. This report is based on a survey of the valantic FSA Fixed Income Expert Network – a group of senior executives from banks and brokers across the global market.

As we reach the end of what has been a highly volatile year for global fixed income markets, we reflect in this report on business performance and challenges. We find a market that has benefitted from the volatility as it helps clients navigate global uncertainties. However, challenges remain – most notably budget restraints and low levels of internal risk appetite at many firms.

In addition, we take a look at the continued rise of electronic trading, attitudes to risk-free-rate related initiatives in the US and some of the key growth areas in the market today.

As you review this report, please feel free to reach out to us directly to provide your thoughts, views and feedback on topics that you would like to see included in the next edition. In the meantime, have a wonderful festive period ahead of what looks set to be another busy year for fixed income markets in 2024.

Joachim Lauterbach
CEO, valantic FSA

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Section 1:

Business performance

Persistent volatility in fixed income markets has provided a boost to sell-side trading and execution desks during 2023.

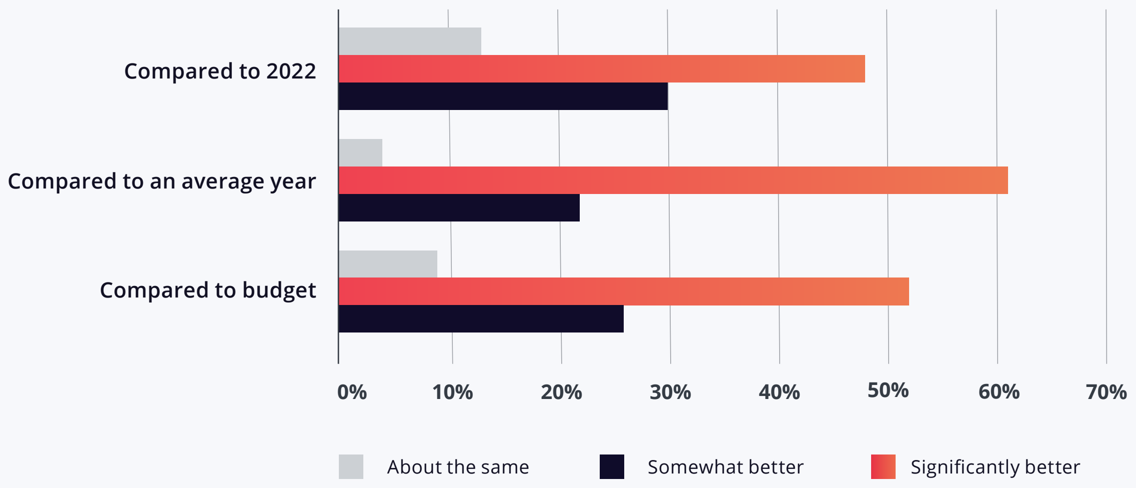
Volatility in the bond market hit highs not seen since the financial crisis according to the MOVE Index, which in March reached the highest level since 2008, as yields soared alongside falling bond prices.

While this created significant stress across much of the banking system, with several notable collapses in the US market over the spring, for sell-side fixed income desks the higher volatility led to more client activity and higher volumes.

Of the members of the valantic FSA Sell-Side Fixed Income Expert Network, **83%** reported that their business performance was either slightly better **(61%)** or significantly better than an average year **(22%)**.

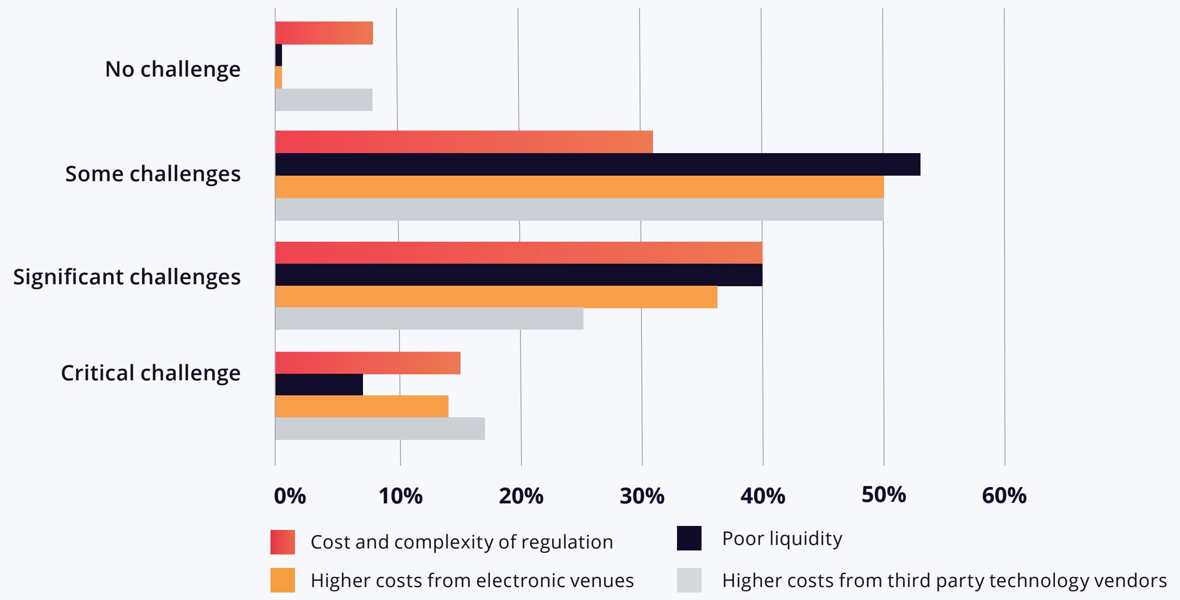
The positive business environment was not universal, however and there were pockets of poor performance across the market. Just under **10%** of respondents said that their business performance was worse than in 2022 and 13% said it was worse than what they had budgeted for.

How has your business performed in 2023 relative to last year, an average year and what you expected/budgeted for?



However, despite the busy markets, 2023 has also brought challenges for many firms.

During 2023, how much of a challenge have the following posed to your business?



Senior sell-side executives cited budget restraints within their firm as a critical challenge. This was particularly an issue for tier 2 and 3 banks. This reflects the fact that, while the economic conditions experienced during 2023 pose opportunities for trading desks, other areas of the bank are coming under pressure from the same factors. This is likely to be a defining trend for banks in 2024 as budgets are cut across the board to offset challenges in other business lines.

While 2023 has been a stellar year for the world's major banking groups as interest rates and busy markets boost revenues, the threat of recessions in major economies and growing global political uncertainty is expected to temper investment in 2024.This trend was evidenced by the fact that a lack of internal risk appetite was the second most significant challenge for sell-side desks.

At the same time, the underlying inflation in the market that has provided a boost to volumes and volatility for fixed income desks is also impacting costs. Members of the Expert Network reported rising cost of salaries as well as costs from technology vendors and electronic trading venues as key challenges.

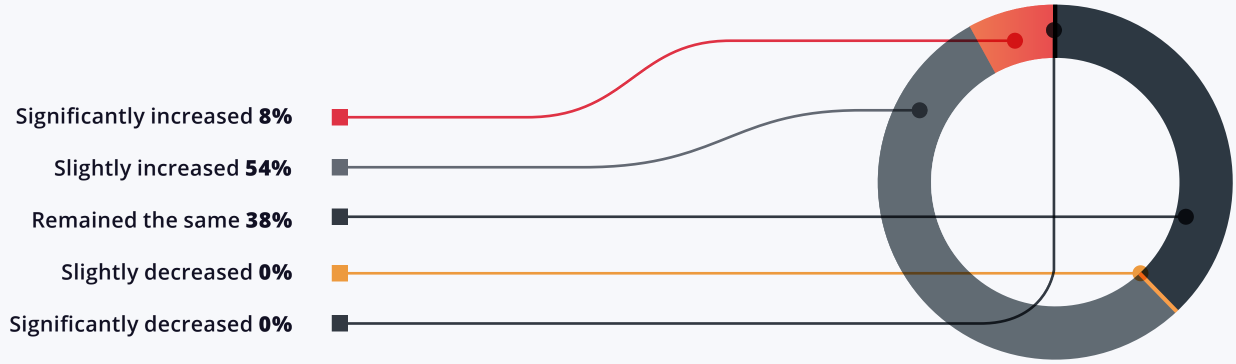
The salary inflation also results from a lack of available talent in the market. Finding skilled staff was the challenge that most respondents to the survey either cited as a critical or significant challenge.

As we move into 2024, wage inflation and competition for workers will likely recede if the US and Europe tip into recession. However, volatility is likely to diminish as well, which will reduce revenues and exacerbate some of the pressures seen in 2023.

Continued rise of electronic execution

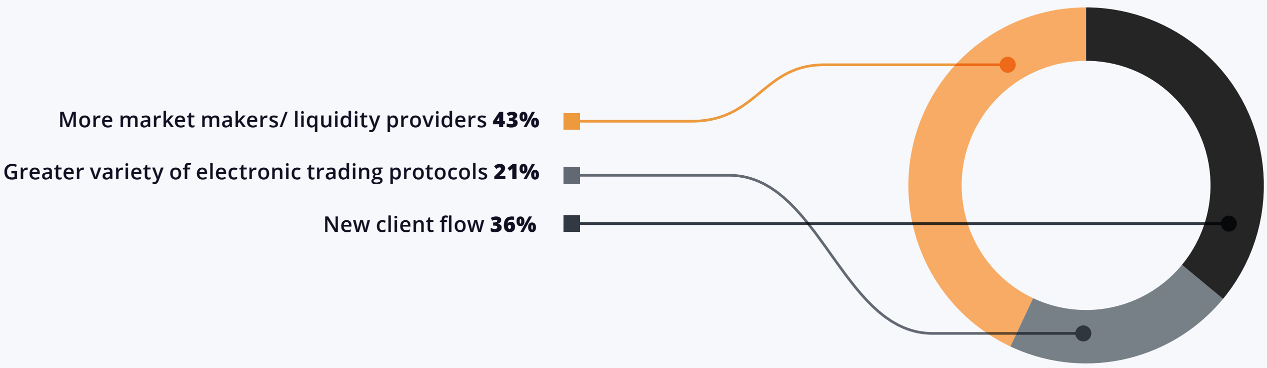
Another defining trend of 2023 has been the continued growth of electronic trading in fixed income. Despite the volatility, which traditionally has led to a move back to voice, **62%** of the network reported an increase in electronic trading volumes.

How has flow to electronic trading platforms from your client base changed during 2023?



The main driver behind the increase was cited by most respondents to be an increase in the number of electronic liquidity providers in the market, followed by new client flow.

What is the main driver of that increase?



Section 2:

Risk free rates

The cessation of Libor-referenced benchmarks represented one of the most significant operational shifts in the history of fixed income markets. Now, with the end of Libor firmly in the rearview mirror, thoughts are turning towards the future market.

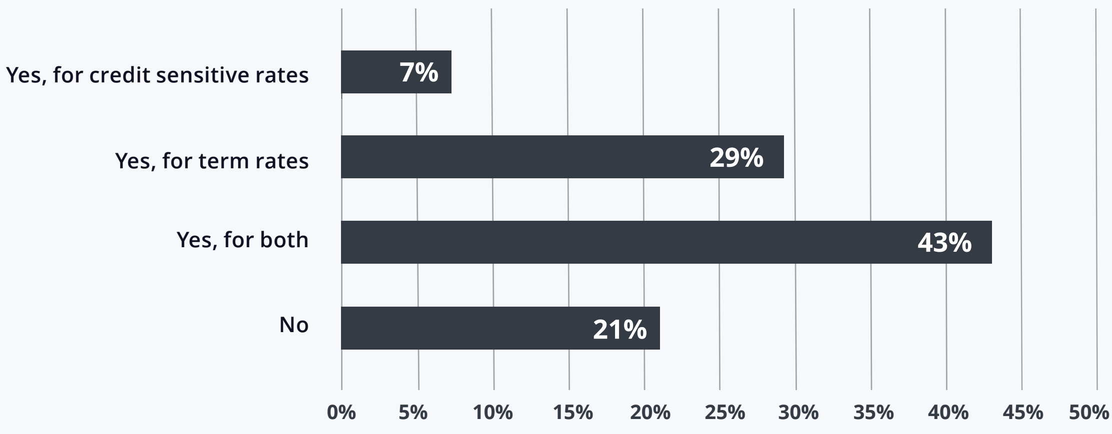
One of the key issues with the new risk-free rates that have replaced Libor-referenced benchmarks has been that their structure does not allow for term rates.

In the US, in response to this absence, several initiatives have been launched to provide RFR-based term rates. The US has also developed RFR-based credit-sensitive rates in the dollar market.

In July, IOSCO said that it had identified "varying degrees of vulnerability and concern" with the implementation of two credit-sensitive rates and two term Sofr rates.

The international monitoring body said that CSRs exhibit the same "inverted pyramid" weakness as Libor. They said that the term Sofr rates were "somewhat better placed" but still fell short of Sofr.

IOSCO recently warned that structural failings in certain credit sensitive and term rates in the Sofr market could threaten market integrity and financial stability. Do you agree with their stance?

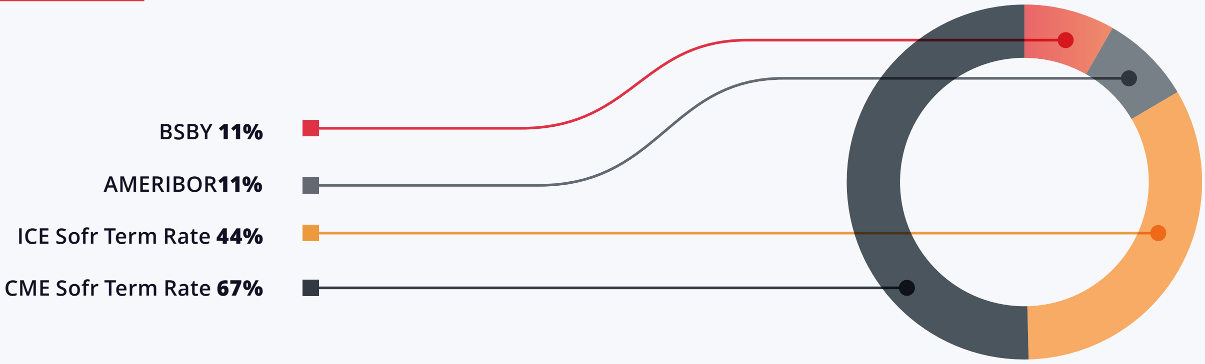


The Expert Network broadly agreed with the stance of IOSCO, with just **21%** disagreeing. However, interestingly concerns were higher for term rates than for credit-sensitive rates, although almost half of respondents shared IOSCO's concerns on both.

The network called for increased transparency and disclosure requirements for administrators of term rates and CSRs with half of respondents encouraging regulators to take action. **29%** said that the market should be left to decide.

When it came to which of the new benchmarks would become established in the US market, respondents to the survey clearly favored CME, followed by ICE. Only **11%** of respondents thought that AMERIBOR and BSBY would become established.

Do you think any of the following will become established benchmarks in the Sofr market?



Section 3:

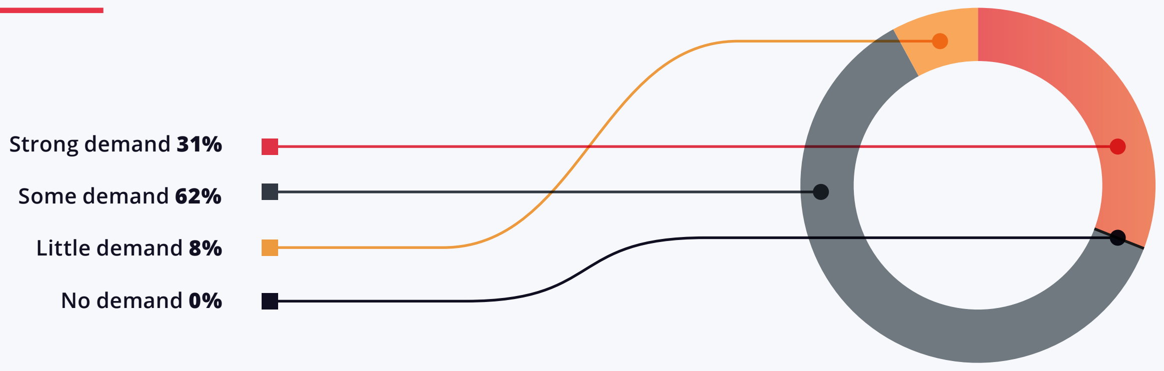
Growth trends: ESG and basket trading

ESG IN FIXED INCOME

Sustainable investment was born out of the equity markets and has had a slow creep into fixed income. Historical barriers to ESG in fixed income, such as the lack of a vote associated with bond investing and lower disclosure requirements, have been addressed and fixed income teams across the buy-side are integrating ESG strategies into their fixed income investments.

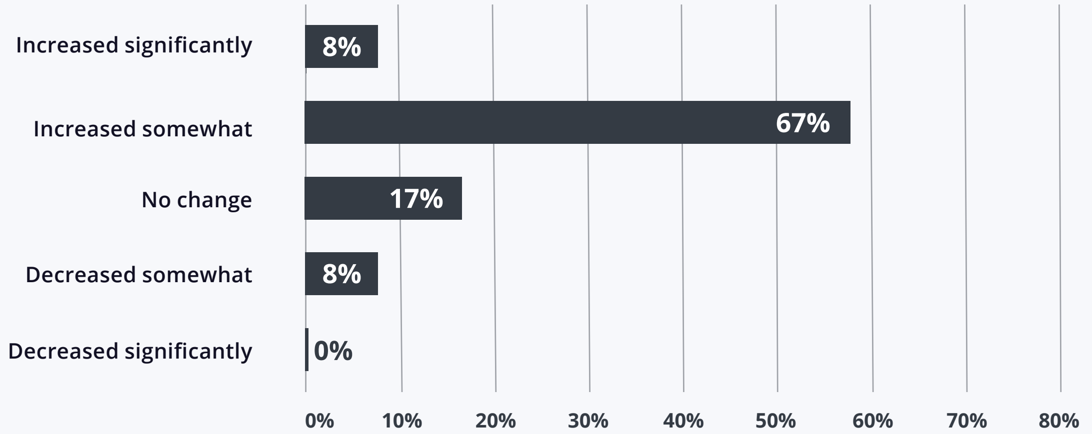
However, at the same time, there has been a significant push back against ESG investing in some States of the US, with several large asset managers forced to water down or remove ESG considerations from their investment strategy or risk being shut off from public investment vehicles.

How much demand do you see from clients to trade ESG-products in fixed income?



For now, however, demand from clients for ESG in fixed income remains strong and growing. Only **8%** of respondents reported little demand from clients to trade ESG products in fixed income, and almost a third reported strong demand.

How has that demand changed over the past 12 months?

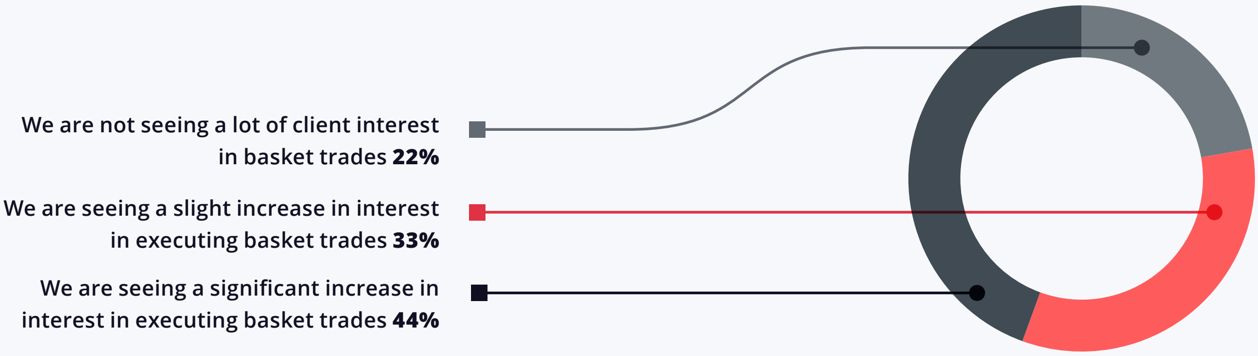


Despite the headwinds, this demand is growing with over 70% of the Expert Network reporting growing demand and just 8% reductions in demand.

BASKET TRADING

Another area of growth for sell-side fixed income desks is the growth of basket trading in response to client demand for tailored products.

How much client interest are you seeing in fixed income basket trading?

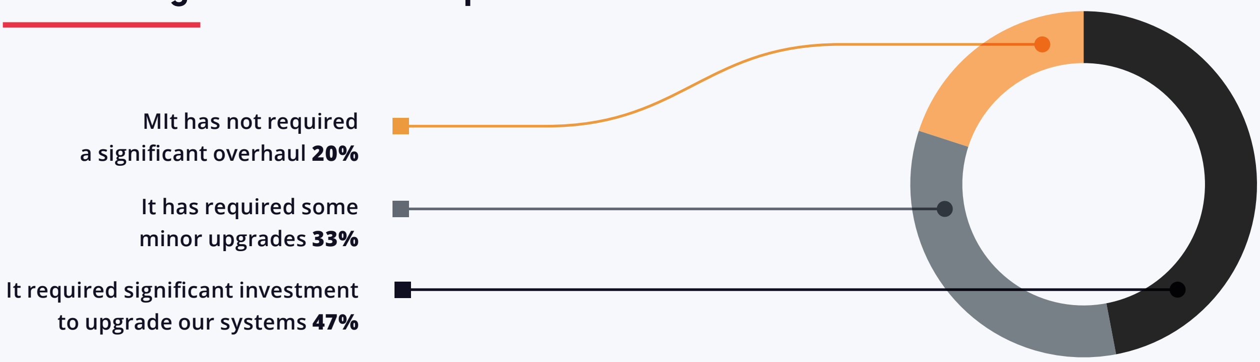


Demand here was more nuanced. There was a split among respondents with **22%** not seeing a lot of interest but **44%** seeing significant interest.

This is likely down to a split in the market between those that have invested in workflows to automate and offer cutting-edge tools to clients looking for baskets of trades and those that hadn't.

Of those that reported demand from clients for basket trading, almost half said that they had made significant investment in their systems to meet the demand.

How big an overhaul of your workflow processes has meeting client demand required?



Successfully offering basket trading to clients requires investment in automation in several areas such as the ability to transfer instruments in and out of baskets as well as significant investment in middle and back-office systems to be able to process the trades once executed.

Section 4:

Addressing fragmentation

The proliferation of trading venues in fixed income over the past five years has brought healthy competition and innovation to the market.

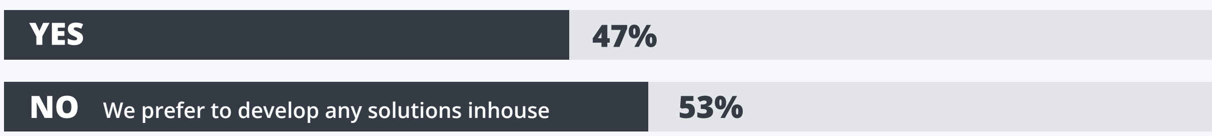
However, it has also created challenges for the sell-side in terms of aggregating pricing from multiple data sources. These can range from identifying as many data sources as possible (with some firms aiming to pull pricing negotiations from emails and chat platforms), to dealing with the different formats that the different data is produced in.

Almost nine in ten respondents cited the aggregation of pricing data as a challenge for their firm with **41%** saying it was a major challenge.

? How big a challenge is aggregating dealer-to-dealer and dealer-to-client fixed income pricing data from multiple sources (e.g. chat platforms, ECNs) for your firm

When it came to building solutions to address the challenge, firms marginally preferred an inhouse build over outsourcing but there was still strong demand for a third-party product.

Would consider working with a third-party provider to resolve the challenges faced in aggregating pricing data

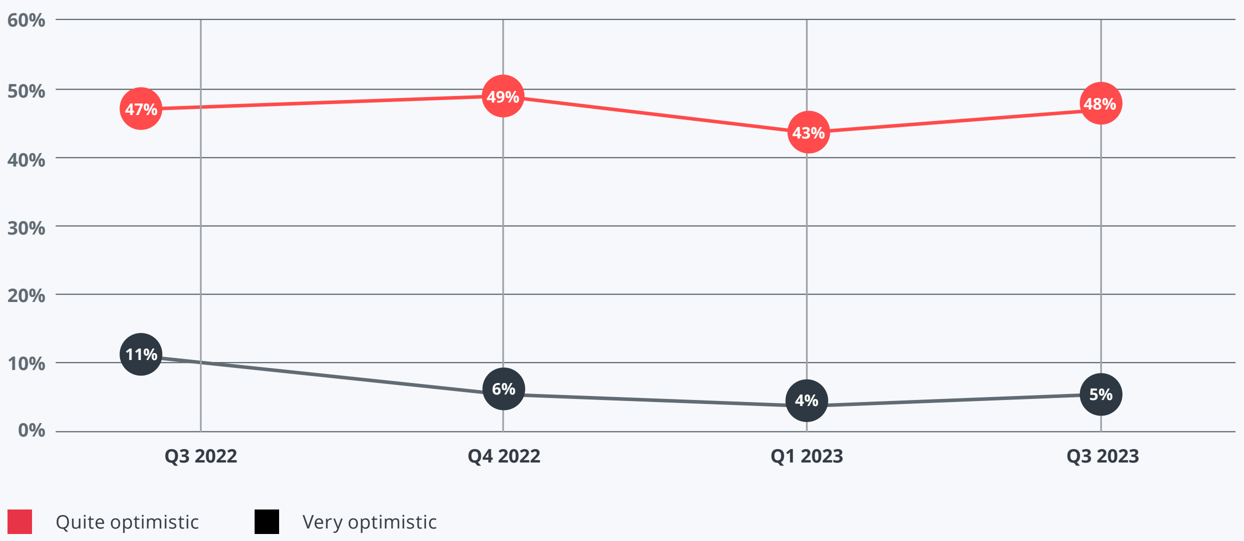


Section 5:

Sentiment

This index is calculated as a percentage of the total number of respondents from the Expert Network that were optimistic about their business performance in the upcoming quarter.

The valantic FSA Sell-Side Fixed Income Sentiment Index



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valantic FSA Smarter automation driving the financial industry.

Our heritage in financial markets stretches back over twenty years of building highly robust electronic trading and workflow automation solutions across Fixed Income, FX and Equities. Today, we provide our platform as a series of composable building blocks that address the core business needs of our clients. These are used to create fully customizable workflows for our clients' internal trading operations and to strengthen the electronic relationships with their customers.

We help our clients gain greater insight with our data-centric platform architecture and compelling HTML5 front ends. We supplement this with low-code development tools that enable our clients to further complement and customize our trading platforms.

Working in true partnership with our clients, our goal is to help them address their key business problems, while reducing their total cost of ownership through our complete SaaS and Managed Services offerings.