**TrendSpotters #005: Cross-Asset Trading, Part 1**

**Candyce Edelen:** Hello and welcome to this installment of TrendSpotters. I'm Candyce Edelen and today we have the first of a two-part conversation on cross-asset trading. There is quite a bit of industry chatter about the differences between cross-asset trading and multi-asset trading, and I personally have been interested in this subject for quite a while. So I sat down with Harry Gozlan of smartTrade and Greg Wood of Credit Suisse to talk about it. We had a very informative discussion, and I'm excited to share the conversation with you, so let's get started.

My guests are Harry Gozlan of smartTrade, and Greg Wood of Credit Suisse. Harry is the CEO and founder of smartTrade, which provides cross-asset liquidity management solutions that handle aggregation, pricing, routing, and matching for all OTC and listed asset classes. Prior to smartTrade, Harry managed OTC derivatives and FX trading in a number of banks. Harry, welcome.

**Harry Gozlan:** Thank you, hi, Candyce. Hi, Greg.

**Candyce:** Greg Wood works for Credit Suisse's advanced execution services on their multi-asset class algorithmic trading desk, specializing in algorithmic and low latency execution futures. He has a background in multi-asset class execution initiatives, and has experience both in business development and on the technology side. Greg, thank you for joining us.

**Greg Wood:** My pleasure to be here today, Candyce.

**Candyce:** So, I'm Candyce Edelen, CEO of Propel Growth, and I will be your host for today's session. So, let's get started. Let's get started by just talking about what's the difference between multi-asset trading and cross-asset trading. Harry, you want to start?

**Harry:** Yes. I think it has been always a tricky definition, people talking of cross-asset versus multi-asset. I think there is a converging definition, which is that cross-asset is more something that would be coming from the buy side, trying to mix different assets in one multi-leg trade. It could be international securities, or buying one asset, selling another one. Multi-asset, I would say, is more something I would qualify from the sell side. So, trying to offer multiple assets under the same kind of framework or technology to enable their clients to trade multiple assets without having to change too many systems at the same time.



 

But, personally, I don't think there's a clear frontier between multi-asset and cross-asset, but that could be one definition.

**Candyce:** Greg, what do you think? Tell us more about your thoughts on this.

**Greg:** So, at Credit Suisse, we take a little bit more of a technical differentiation between multi-asset trading and cross-asset trading. Multi-asset is the ability to trade individual asset classes through the same systems. But each asset class is being traded on its own independently. Cross-asset is the ability to trade multiple asset classes simultaneously through those systems. But there is a correlation between the trading.

**Candyce:** So, the difference, really, is how you trade, where, if you're going to do multi-asset trading, the trades are pretty much, kind of, distinct. You're going to trade equities distinctly from FX, distinctly from options. Where, cross-asset, you may join multiple assets in a single basket to make the trade, because there's associations in your strategy between the two.

**Harry:** That's probably be the case, yeah. I think cross-asset may involve multiple legs, so you may have to do either a synthetic, create a synthetic instrument that will be combinations of different assets that would be presented as one synthetic instrument. So, when you hit it, it will involve multiple assets, and may generate multiple legs behind them. There is also a pure cross-asset, which is a more multi-leg trade. So I want to buy one security, sell other securities in the same time. So I think that's maybe the difference between multi-asset and cross-asset. At the end, the implications on the side of the person, on the entity which receives the order... Whether it's a synthetic or multi-asset or cross-asset is not very different. Because the big step is to be able to process different orders on different assets. Whether they come from the same synthetic or multi-leg instruction.

Or from multiple legs independently... Still implies that the bank or the entity or the broker is able to process these multiple assets exactly, seamlessly. So in some ways, the definition of fine tuning a cross-asset versus multi-asset is a bit theoretical. But it's a nice question to ask. [laughs]

**Candyce:** So what's the driver? Why would you do something with a multi-leg? What's a typical reason why a buy side would want to execute something like that?



 

**Harry:** I think probably Greg can answer, because he has more clients that are probably at the start of this demand. And who have started to ask Credit Suisse, "OK. Give me these multi-leg or multi-asset capabilities." And then maybe I will comment back.

**Greg:** I think there's... Just your previous point, Harry. There's an evolution in trading. The step from multi-asset to cross-asset is part of that evolution. One of the important steps to be able to move towards cross-asset trading is being able to offer the ability to trade all these individual asset classes. Particularly in a world, at the moment, where having the ability to do this electronically is very important.

Because as these asset classes become more electronic, it gives the buy side greater ability to trade these things at their own discretion. As opposed to the discretion of the broker or the dealer. What I would say is, there are several drivers around this. The buy side is consolidating. As is the whole of the street. We're trying to do more with less.

People are taking natural steps of looking for alternative alpha. They may be trading domestic equities first. Then they're looking into cross-border trading. They're using derivatives as a hedge, or even using derivatives as speculation, as an alternative source of alpha.

This introduces multi-asset capacity to their trading, where they want to be able to trade each of these asset classes in a similar manner.

And then, ultimately, manage, risk manage, position manage those asset classes. As the sell side, such as Credit Suisse, provides services to trade individual asset classes, it then gives us the ability to offer a greater level of connection between those asset classes.

So if people now want to start trading an auto hedge on their FX or if they want to be delta-hedged on their options, it gives us the ability to provide that as a service. Because we have all these asset classes within the same systems.



 

**Harry:** I would say, in some ways, my opinion also like Greg, is that the first demand comes from the clients or the buy-side. Probably the hedge funds were the first to really ask a single access point to multiple assets, to do cross-asset trades. Either auto-hedged securities or intelligent securities. Or whatever. Cash against futures. Basis trades, how many combinations that are stand-out combinations of multiple assets. The first reaction from the banks has been to say, "OK. We have very heterogenous systems on our side. We know we have siloed FX equities, rates. But we can probably assemble or present a single entry point to all these assets, to present a kind of cross-asset service to our clients."

The real gain after that is to realize that having to process multiple assets totally in a different manner based on the region or which bank actually originally was running this asset class.That merged with this other bank, etc... Created a cascading system that can still be presented under the same umbrella as a multi-asset system to a hedge fund. But which also puts the pressure on the points on the sell-side to say, "Why do we have all these kinds of multi-system, multi-asset everywhere in the bank? Why don't we organize our trading infrastructure as a real multi-asset trading infrastructure?"

That will be pushed from this first demand of, let's say, a hedge fund somewhere in Connecticut. This has pushed all the questions to... "OK. Why don't we organize our entire supply chain of services and prices inside, towards our client as a real multi-asset infrastructure?" That's, I think, the way it's moved. Now, we see more need to have a convergence of services.

Because it's easier to offer multi-asset or cross-asset services if they all come from the same kind of box or same kind of pattern, always replicating the same type of orders. The same kind of straight-through processing. The same kind of delivery access or mechanism.

Rather than have 20 different systems that are all not talking the same language, etc. So that's the way it came. At the end, it's a cost-cutting issue, probably, more than servicing hedge funds or people like that.

**Greg:** I think what has happened in the last few years is critical mass on the buy-side. Where the buy-side is demanding to have the ability to trade different asset classes in the same manner. So they don't want to have to do an FX deal or an OTC derivative over the phone if they're used to using a fixed connectivity to trade their equities or listed products. They want to trade the same way.



 

In the same way, they say, "Why do I have to trade FX like this? I would rather trade it in a similar manner to what I'm used to trading with my own algorithms or my own approach to trading the way I do for equities."

So over the last five years, that consolidation, that change in the buy-side; the buy-side now saying we want each of these asset classes to work the same has now driven the sell-side to obviously provide a similar service across their asset classes.

I think what has also happened recently with the current market conditions, as we look to reduce our overall expenditure, it's actually now making more sense as we bring these asset classes together to start using the same systems across those asset classes.

So that also allows us to leverage the same technology for where it's equities, futures, FX, it allows us to provide a homogenous service as opposed to a heterogenous siloed service that was previously provided by the brokers.

And I think this is obviously just a benefit now of both the buy-side — they get what they want — and to the sell-side, we obviously reduce our footprint in infrastructure to be able to provide a service across these asset classes.

**Candyce:** So we're talking about two business drivers there. One, the buy-side demand for being able to trade multiple assets the same way and to achieve cross-asset. And then, the business driver of consolidation and cutting costs internally by reducing the number of silos, and harmonizing and homogenizing the way that the assets are traded. There's also a business driver, I think, on risk management with the global economic crisis having driven a demand by the regulators as well as by the banks themselves, I think, to be able to manage risk and get a better visibility into exposure. Is that also a driver?

**Harry:** Yes, probably. In fact, the need to consolidate and to harmonize the risk management has also simplified the products that are traded. I would say there are more assets, but more simple products in some ways. If we compare the Pritiman case where we had in fact implicitly less multi-asset trading but many more synthetic multi-asset instruments that were flying all over the planet, I see today regulations has in some way killed the complexity of these very obscure products that nobody could account for, but also opened the need to have many more multi-asset transversal systems and methodology to measure risk, to measure credit exposure, to measure even after that, a more functional aspect like latency, etc., etc.



 

So I would say we have more assets that are traded the same way. A bigger demand for multi-asset, but with more simple products. Today we see more. If we take a foreign exchange, five years ago everybody was running, or seven years ago, after FX options trading.

So it was a hot topic. Today, if you go to any bank and you say, what do you do in the EFX? It's only spot. It doesn't mean options don't exist anymore. But the key point is, how do I deal with my spot liquidity, or how do I do with my interest rate swaps, how do I do with my futures, equity cash?

Those are the basic instruments that have been there for 50 years almost. Certainly all the complex ones have disappeared, even though there is still some problems right away. And the regulators in some ways have mostly focused on the simple instruments.

So the question is, how to regulate spot? It's not how to regulate the bigger exposures of some banks. It's not how to deal with the state-structured products that exist that in ETFs, for example, that are not easily controllable. I think we may see that the recent UBS case is, in some ways, a consequence of this lack of control. So we are only talking of creating safes on the IRS.

OK. Fine.

But regulation is pushing to simplifications, multi-assets that are more under control. So I think it's an interesting, for me, question to see why suddenly everybody's moving... I think most important reason are cost benefits of expenditures.

Because it's easier to manage five simple instruments with very huge volumes in a very standard and controlled manner, rather than offer complex instruments which require a lot of back office, middle office, front office guys with the risk of losing some money every year.

**Greg:** I think the point you make there is as these instruments become simpler, it actually makes them easier to define. Once you can define something it's easier to measure it. So if you take away some of the complexity of an OTC trade where it's a very bilateral definition of the instrument and you move towards more of a, "Here's a defined derivative that can be recorded and therefore measured, reported, etc.," which is obviously what a lot of Dodd-Frank is trying to do with regards to the OTC space.



 

That helps with risk management. So by reducing the complexity it makes it easier to measure the risk. Of course, there's always still going to be the need for certain participants to have more user-defined contracts. So that won't go away.

But I think, in terms of a lot more of this trading in asset classes away from the tradition listed space of equities, futures, options as we go into FX, bonds, interest rate swaps, etc. By making these instruments much more closely defined, carefully defined, it's going to allow us also to record it in our systems, to report to the regulators, and risk manage it for the sake of our internal books.

**Candyce Edelen:** We're going to have to leave off here for part one of this recording. I hope you've enjoyed this first part of the conversation. Please join us for part two where we dive more deeply into this fascinating topic.

Until then, I'm Candyce Edelen, CEO of PropelGrowth. I look forward to joining you again next time on TrendSpotters. Have a great day.



 