acuiti management intelligence

SPECIAL REPORT

Proprietary trading firms set sights on emerging markets

New markets set to take centre stage in 2021 as traders seek new opportunities for growth

Commissioned by:

AVELACOM

Proprietary trading firms look to emerging markets for growth

For most proprietary trading firms, 2020 was a tale of feast and famine as sharp bursts of volatility were followed by slumps in volumes on established markets.

According to Acuiti's monthly revenue tracker, despite 2020 being a very strong year for proprietary trading firms, they had better year-on-year revenues in just six out of the 11 months of the year to the end of November. This performance is characterised by a handful of exceptional months during the spring volatility and then several very challenging months as volatility and volumes fell to near record lows in many key benchmark contracts on established markets.

This polarisation of month-to-month revenues was exaggerated by the spread of Covid-19 and the associated volatility but reflects similar patterns in 2019 and presents a challenge to proprietary trading executives running businesses with large fixed costs.

To mitigate the challenge of unpredictable revenues and to find new sources of revenue, proprietary trading firms are increasingly looking to diversify the scope of trading operations with a wider adoption of new products and emerging markets.

For over a decade, the larger proprietary trading firms have expanded internationally opening up regional offices to capitalise on the opportunities offered by emerging markets.

Increasingly these markets are taking steps to encourage a wider breadth of trading firms without the need to open a regional office by simplifying regulations or increasing trading hours in order to attract more international trading participants. At the same time, the growing technology infrastructure around emerging market exchanges is reducing the barriers to entry.

In order to quantify demand for trading emerging markets, identify which markets were of the most interest to proprietary trading firms and better understand the barriers to adoption, Acuiti was commissioned by Avelacom to conduct a study of predominantly latency sensitive proprietary trading firms and their clearing providers. The results of that study are set out in this whitepaper.

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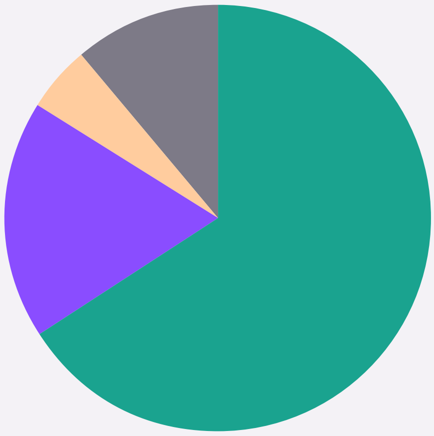
Where is the interest from proprietary trading firms?

Acuiti found strong demand from proprietary trading firms for trading emerging markets with 84% of respondents saying that they had a strong interest in trading emerging and frontier markets.

Of those executives surveyed by Acuiti, 18% said that the Covid-19 crisis had made them more likely to want to trade emerging markets. 16% said they had little interest in trading new markets with 5% saying the experience of Covid-19 had made them less likely to want to trade emerging markets.

Almost two thirds of respondents (63%) had started taking market data or connected to a new emerging market exchange over the past three years. Of those, 79% had done so on an exchange in Asia, 14% in South America and 7% in each of Eastern Europe and MEA.

How has your attitude to connecting to new emerging and frontier markets changed in light of the Covid-19 crisis?



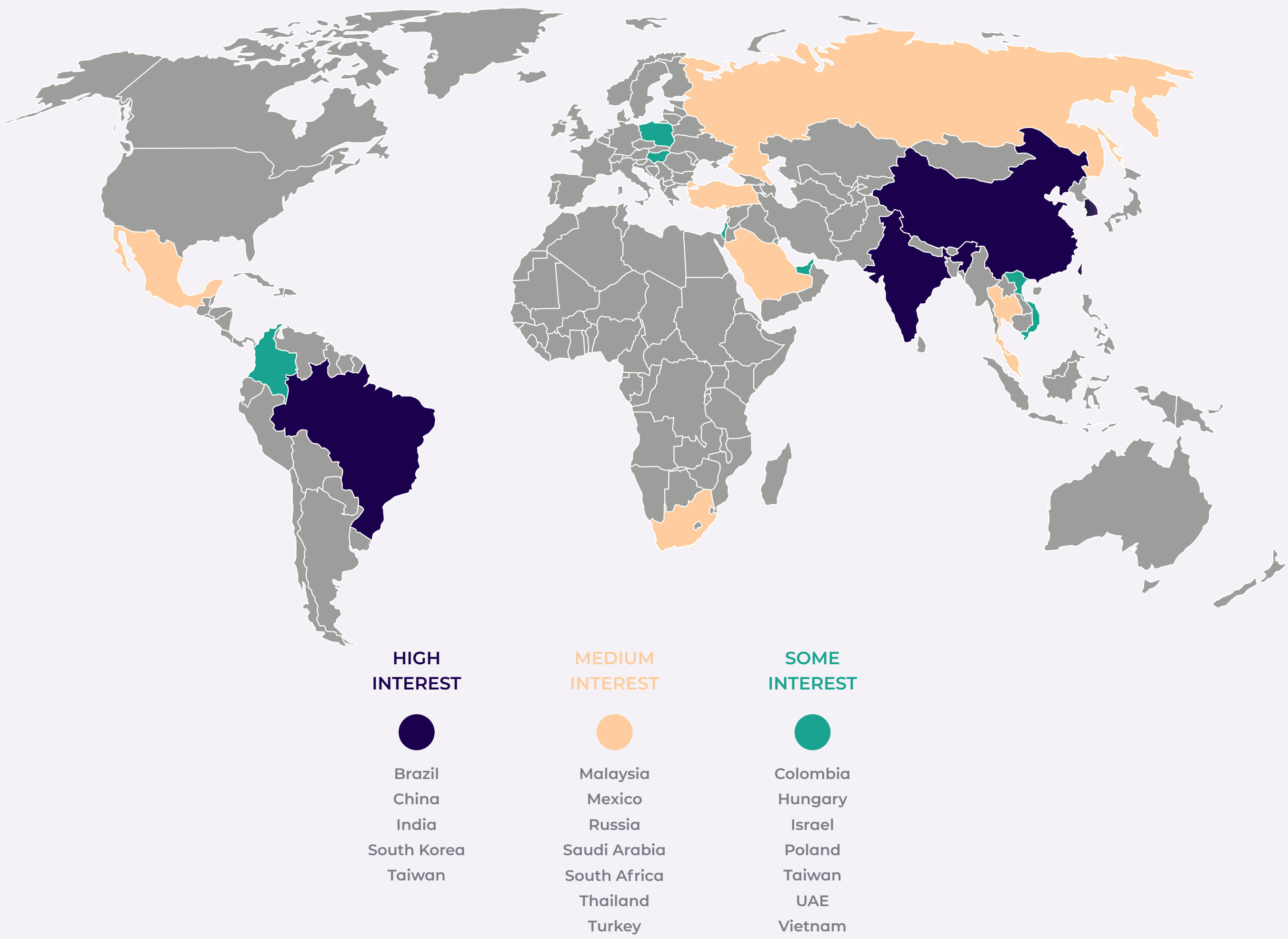
- My opinion has not changed and I have strong interest in trading new markets
- I am more likely today to want to trade new emerging/frontier markets
- I am less likely today to want to trade new emerging/frontier markets
- My opinion has not changed and I have little interest in trading new markets

Taiwan, China, South Korea, Brazil and Malaysia were the most commonly cited markets that firms had connected to over the past three years. India, Vietnam and Russia were also markets that several firms had onboarded while Poland, South Africa, UAE and Mexico were also cited.

The survey found strong evidence that demand for trading emerging markets was likely to accelerate further. While 63% of respondents had taken market data or started trading on an emerging or frontier market over the past three years, 74% intended to do so over the next 12 months, including 58% of firms that had not done so in the past three years.

China topped the list of countries that firms were looking to onboard with 56% of respondents planning to connect to or take market data from an exchange in China over the next 12 months. India also looks set for signficant growth cited by 52% of respondents.

Which emerging markets are proprietary trading firms interested in onboarding?



Firms that were looking to engage with India had typically already engaged with China. While all respondents that had already engaged with India had done so directly to the onshore market, the survey found that 71% of firms were considering the "offshore" hub Gift City either as the sole entry point to India or in addition to onshore markets suggesting an evolution of approach to trading Indian markets.

South America is also attracting strong interest with both Brazil and Mexico high up the list of markets that firms intended to engage with over the next year and Colombia also coming onto the radar of several firms.

Interestingly, Saudi Arabia featured strongly in terms of intentions, a finding that was backed up by the GCM survey (see page 11). Saudi Arabia's stock market Tadawul launched its derivatives market in August 2020 offering trading in the Saudi Futures 30 Index and plans to launch a suite of futures and options contracts in the coming 12 – 24 months.

South Africa and Thailand were also selected by several firms with UAE, Vietnam, Malaysia, Russia and Israel also among the markets firms intended to start trading in the next year.

The Avelacom view

China and Brazil attract the most interest from proprietary trading firms

Avelacom owns and operates global networks that connect many exchanges, ECNs and crypto exchanges, providing capital markets with the lowest latency infrastructure/market data and connectivity services.

We have significant experience and a strong presence across APAC, the Middle East, Latin America and Eastern Europe, providing clients accessing these markets with a ready-to-go IT infrastructure. Trading firms looking for arbitrage and diversification opportunities are often especially sensitive to the cost of roll out, particularly considering the importance of reliability and low latency to make entering these markets practical and beneficial.

The growth of trading in China has driven Avelacom's commitment to the region, with dedicated connectivity and guaranteed performance ensuring the fastest speed possible for arbitrage/market making strategies across all major Mainland China exchanges (SHFE, ZCE, Wuxi, DCE, CFFEX, SSE, SZSE) and international markets (LME, CME, ICE, SGX, HKEX, etc.).

B3 is one of the world's largest exchanges and increasing international access to this market has been a theme for the last year. In 2020 Avelacom launched an additional point of presence (PoP) in the B3 data center to add low latency access for investment banks and trading firms worldwide with B3's native market data feeds via Avelacom's 80+ global points of presence (PoPs).

What is driving demand for trading on emerging markets

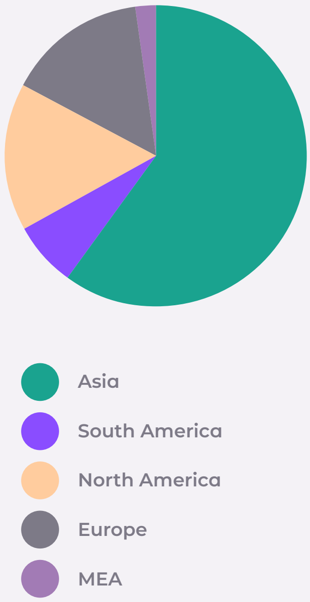
The drivers for a proprietary trading firm wanting to onboard a new market are myriad. Overall, a desire to diversify markets was the major driver selected by 65% of respondents. Arbitrage opportunities was second, selected by 62% of respondents.

Lower volatility and increased competition in incumbent markets was a greater driver of trading emerging markets for proprietary firms based in Europe and North America than in Asia with 43% and 36% of European and North American respondents with an interest in trading new markets citing lower volatility and increased competition respectively. This compared with 25% of 17% for respondents based in APAC.

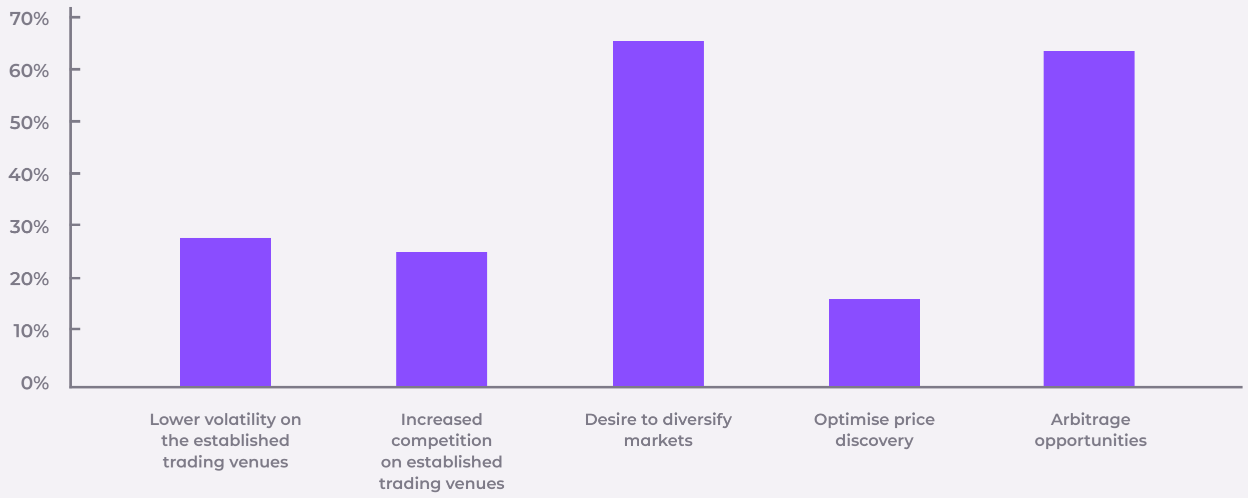
Emerging markets have been a key driver of volume growth in the global derivatives market creating huge opportunity for proprietary trading firms. In order to analyse the growth in individual contracts, Acuiti conducted an analysis of the Futures Industry Association (FIA) exchange traded volume data.

Taking the year-to-date volume from January to October, out of the top 100 fastest growing established contracts bu contract volume, 69 were in emerging markets. Asia was home to 60 with China alone accounting for 27. Brazil's B3 exchange boasted 7 of the top 100 fastest growing contracts. Asia dominated all asset classes aside from energy and interest rates (see next page).

Which continents are home to the top 100 fastest growing contracts?



What are the major drivers for trading on a new market?



Fastest growing contracts by asset class (2020 year to end October)

AGRICULTURE	REGION	EXCHANGE	INSTRUMENT	COUNTRY	YTD 2019	YTD 2020	% CHANGE
Egg	Asia	Dalian Commodity Exchange	Future	China	25,155,981	114,582,988	355.5%
RBD Palm Olein	Asia	Dalian Commodity Exchange	Future	China	58,841,777	250,673,122	326.0%
No. 1 Soybean	Asia	Dalian Commodity Exchange	Future	China	14,617,268	48,508,905	231.9%
Rapeseed Oil (OI)	Asia	Zhengzhou Commodity Exchange	Future	China	30,439,010	82,268,464	170.3%
Rubber	Asia	Shanghai Futures Exchange	Option	China	597,080	1,538,444	157.7%

CURRENCY	REGION	EXCHANGE	INSTRUMENT	COUNTRY	YTD 2019	YTD 2020	% CHANGE
Euro/US Dollar Cross Currency	Asia	Borsa Istanbul	Future	Turkey	733,894	4,965,956	576.7%
Mini US Dollar/Singapore Dollar	Asia	ICE Futures Singapore	Future	Singapore	96,143	562,666	485.2%
E-Micro AUD/USD	North America	CME	Future	United States	1,051,265	2,450,672	133.1%
US Dollar/Indian Rupee	Asia	MSX	Future	India	3,033,194	6,663,910	119.7%
EUR/Indian Rupee	Asia	NSE	Future	India	15,711,898	33,943,159	116.0%

ENERGY	REGION	EXCHANGE	INSTRUMENT	COUNTRY	YTD 2019	YTD 2020	% CHANGE
Heating Oil	Europe	ICE Futures Europe	Future	United Kingdom	7,633,078	30,567,811	300.5%
E-mini Natural Gas Futures (QG)	North America	NYMEX	Future	United States	327,432	1,262,855	285.7%
Natural Gas	Asia	MCX	Future	India	11,306,031	36,643,531	224.1%
Fuel Oil	Asia	Shangha Futures Exchange	Future	China	127,680,034	408,174,975	219.7%
NYH (RBOB) Gasoline (Monthly)	Europe	ICE Futures Europe	Future	United Kingdom	5,605,337	17,671,990	215.3%

EQUITY INDEX	REGION	EXCHANGE	INSTRUMENT	COUNTRY	YTD 2019	YTD 2020	% CHANGE
Mini Ibovespa Rollover	Latin America	B3	Future	Brazil	283,026	1,174,870	315.1%
DJIA Margin	Asia	Tokyo Financial Exchange	Future	Japan	1,842,919	4,824,766	161.8%
Nikkei 225 Margin	Asia	Tokyo Financial Exchange	Future	Japan	4,264,568	9,262,491	117.2%
Mini Taiex Futures (MTX)	Asia	Taiwan Futures Exchange	Future	Taiwan	24,961,765	50,715,604	103.2%
CNX Nifty Index	Asia	NSE	Option	India	962,089,047	1,888,130,848	96.3%

INTEREST RATES	REGION	EXCHANGE	INSTRUMENT	COUNTRY	YTD 2019	YTD 2020	% CHANGE
5 Year Treasury Bond	Asia	China Financial Futures Exchange	Future	China	1,348,413	4,690,963	247.9%
3 Month Sterling Overnight Index Average	Europe	ICE Futures Europe	Future	United Kingdom	2,544,893	5,832,384	129.2%
2 Year Treasury Bond	Asia	China Financial Futures Exchange	Future	China	876,261	1,980,772	126.0%
3 Month Secured Overnight Financing Rate	Europe	ICE Futures Europe	Future	United Kingdom	768,623	1,713,758	123.0%
10 Year Treasury Bond	Asia	China Financial Futures Exchange	Future	China	7,680,135	13,159,233	71.3%

NON-PRECIOUS METALS	REGION	EXCHANGE	INSTRUMENT	COUNTRY	YTD 2019	YTD 2020	% CHANGE
Silicon Manganese (SM)	Asia	Zhengzhou Commodity Exchange	Future	China	8,421,199	35,490,576	321.4%
Tin	Asia	Shanghai Futures Exchange	Future	China	2,686,743	10,780,388	301.2%
Ferrosilicon (SF)	Asia	Zhengzhou Commodity Exchange	Future	China	7,860,949	22,782,197	189.8%
Copper	Asia	Shanghai Futures Exchange	Future	China	30,445,985	44,659,791	46.7%
Aluminum	Asia	Shanghai Futures Exchange	Future	China	27,836,711	39,866,994	43.2%

OTHER	REGION	EXCHANGE	INSTRUMENT	COUNTRY	YTD 2019	YTD 2020	% CHANGE
Flat Glass (FG)	Asia	Zhengzhou Commodity Exchange	Future	China	24,463,434	134,423,042	449.5%
Polypropylene	Asia	Dalian Commodity Exchange	Future	China	77,958,664	135,760,766	74.1%
Linear Low Density Polyethylene (LLDPE)	Asia	Dalian Commodity Exchange	Future	China	52,311,673	75,310,971	44.0%
Polyvinyl Chloride (PVC)	Asia	Dalian Commodity Exchange	Future	China	27,664,876	39,334,382	42.2%
Methanol (MA)	Asia	Dalian Commodity Exchange	Future	China	214,641,086	264,614,935	23.3%

PRECIOUS METALS	REGION	EXCHANGE	INSTRUMENT	COUNTRY	YTD 2019	YTD 2020	% CHANGE
Gold Petal	Asia	MCX	Future	India	1,634,374	9,198,957	462.8%
E-Micro Gold Futures (MGC)	North America	Comex	Future	United States	4,502,875	18,594,952	313.0%
Silver Micro	Asia	MCX	Future	India	12,417,145	37,826,426	204.6%
USD/Ounce Gold	Asia	Borsa Istanbul	Future	Turkey	5,319,930	15,282,914	187.3%
Silver Mini	Asia	MCX	Future	India	6,866,714	18,579,948	170.6%

Source: Futures Industry Association
Data is from Jan - Oct 2020. Contracts launched in 2019 or those that traded fewer than 50,000 lots in 2019 have been removed.

Success story: Brazil's internationalisation

Brazil's B3 is a global success story when it comes to attracting international proprietary trading flow to its market. A decade ago, international participation on the exchange was below 10%, today it is around 40% in some contracts.

The exchange's success reflects how technological upgrades, international partnerships, focused market engagement and local trading conditions come together to create an attractive market for international trading firms.

B3 made an early decision to shift to a client-centric model in which the core focus was understanding the needs of proprietary trading firms. The exchange attended and ran international events over several years and engaged deeply with the international proprietary trading community.

B3 had a long-standing partnership with CME, which at the time had a stake in the exchange, and launched its products on CME's Globex platform, a move that increased international awareness and interest in the Brazilian market and drove demand for direct access to the exchange.

At the same time, B3 upgraded its co-location offering, restructured its clearing infrastructure to bring all instruments into one CCP and invested significantly in an upgrade of its trading platform and associated technology stack.

B3 also engaged with the key international clearing members (GCMs) for proprietary trading firms. This was focused on education to help GCMs navigate local rules with regards to moving money in and out of Brazil as well as gaining a deeper understanding of its client segregation model, which mirrors a remote clearing set-up.

The push towards greater international flow coincided with significant changes in the local market. Interest rates were falling to record lows forcing local asset managers and retail traders to invest in derivatives and equities to realise healthy yields. This served to increase volumes and the diversity of participants on the market, making it more attractive to international trading firms.

The exchange is currently developing a new order entry gateway based on the SBE binary protocol, which further optimise latency on the exchange following demand from international trading firms.

The Avelacom view

Our global IT infrastructure is designed to improve price discovery and arbitrage strategies across all derivatives markets in emerging countries

Avelacom's fiber backbone network forms optimal routes to/from the fastest growing markets allowing companies to access new connectivity options and IT resources, with better control of Total Cost of Ownership (TCO), without any compromise in data speed.

Avelacom's solutions are asset neutral and cover all key global markets:

FX
• Best latencies for the most popular FX triangle New York <> London <> Tokyo
• Optimal routes to/out Singapore, the world's e-FX hub

Equities
• Opportunities to to access new markets: Istanbul, Riyadh, Tel Aviv, Moscow, Johannesburg

Commodities
• Best-in-market connections between CME, LME, Chinese markets and Brazil

Cryptocurrencies
• High-speed access to global crypto exchanges: AWS <> AWS, AWS <> Alibaba based on Avelacom's low latency network

Overcoming the barriers to entering emerging markets

While the benefits to trading emerging markets are plentiful, so too are the barriers. Acuiti asked firms what barriers they experienced when on-boarding an emerging market and which of those had actually prevented them from doing so.

The most fundamental challenge firms face in trading a new market is a lack of provision of access from their clearing provider (GCM). This was selected by 62% of respondents as a major barrier to entering a new market and by far the most common reason a firm has actually been prevented from joining a new market.

Other major barriers to entry are the costs of IT infrastructure deployment at an exchange (selected by 59% of respondents), uncertain regulation (57%), costs of market data (46%) and a lack of understanding of the market rules (38%).

However, the survey found that most of the challenges were possible to overcome. In terms of the cost barriers, while 46% of respondents cited market data as a major barrier to on-boarding a new market, just 12% said they had been prevented from adopting a market by market data costs. Similarly, 35% cited the cost of connectivity and trading lines as a barrier but just 16% had been prevented from joining a market as a result of those costs.

This compares with 36% of respondents who had been stopped from trading a new market by uncertain regulations and 60% by the fact that their clearing provider doesn't offer access.

What are the major challenges you come across when onboarding a new exchange in an emerging market?

GCM intentions

Considering the centrality of clearing providers in enabling access to emerging markets, Acuiti surveyed GCMs on their intentions to connect to new markets in order to better understand where growth will be seen in 2021. Overall, 79% of GCMs reported seeing increased interest from their proprietary trading client base in trading new markets.

As a result, 57% of GCM respondents said they intended to offer access to a new emerging market over the next 12 months. Brazil and China were the most commonly cited countries that they were looking to offer access to. Saudi Arabia also featured prominently in terms of new markets GCMs were looking to on-board with Russia, Argentina and Mexico also featuring. Significantly, no GCMs surveyed said they were planning to offer clearing services to Indian markets reflecting the ongoing challenges international firms have in accessing onshore markets directly via an international GCM.

The costs, regulatory and technical requirements represent significant barriers to GCMs offering clearing to emerging markets with many countries restricting access to clearinghouses solely to domestic firms or requiring joint ventures and/or a local presence in order to offer clearing to international firms.

While this benefits local and regional firms, it also slows growth of international trading and countries that have facilitated access for international GCMs have seen significant growth in participation from international trading firms as a result.

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Conclusion:

Emerging markets set for accelerating growth in 2021

The Acuiti survey into attitudes, demand and intentions of proprietary trading firms points to a significant acceleration of adoption of emerging markets in the coming 12 to 36 months, driven in part by Covid but more reflecting an existing underlying trend towards diversification.

This trend is most pronounced in Asia where the proliferation of vibrant and growing markets is attracting significant interest, not just from regional and local firms but also from international firms driven by a desire to diversify the markets they trade and by lower volatility and increased competition on their domestic markets.

However, the expansion into new markets is limited by the availability of GCMs providing clearing access. This is likely to slow access to Indian onshore markets but increase interest in Brazil and China where GCMs plans to grow access to these markets.

Saudi Arabia is also poised for significant growth in international trading as the survey found strong interest from proprietary trading firms and intentions to offer access from GCMs.

Onboarding emerging markets can be a challenge, especially if a firm's clearing provider of choice doesn't offer access. In addition, firms trading emerging markets are more likely to be exposed to rule changes or sudden shifts in the regulatory landscape that may impact operations.

However, the growth in trading volume in emerging markets is one of the dominant trends across global derivatives markets. Volatility in established markets is likely to be mirrored in emerging markets but, crucially, emerging markets also offer the prospect of volatility during quieter periods in established markets. Firms that can diversify markets and increase access to emerging and frontier markets will benefit significantly from the growth and volatility of these regions.

About Avelacom

Avelacom owns and operates a global network connecting to an impressive 80+ liquidity sources. Avelacom is renowned for its low latency solutions in particular: we have a 6-year experience in building shorter, new and unique paths between various exchanges/ECNs/crypto exchanges and provide capital markets with the lowest latency infrastructure/market data and connectivity services.

Avelacom's solutions are designed to improve automated market making, and arbitrage and liquidity aggregation strategies – all of which are highly sensitive to latency, jitter and other data transfer issues. Our flagship products include: standard and low latency connectivity, market data, co-location, Infrastructure-as-a-Service (IaaS).

Avelacom's expertise and presence across emerging markets in APAC, the Middle East, Eastern Europe and Latin America help make these markets easier to setup and explore new trading opportunities.

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