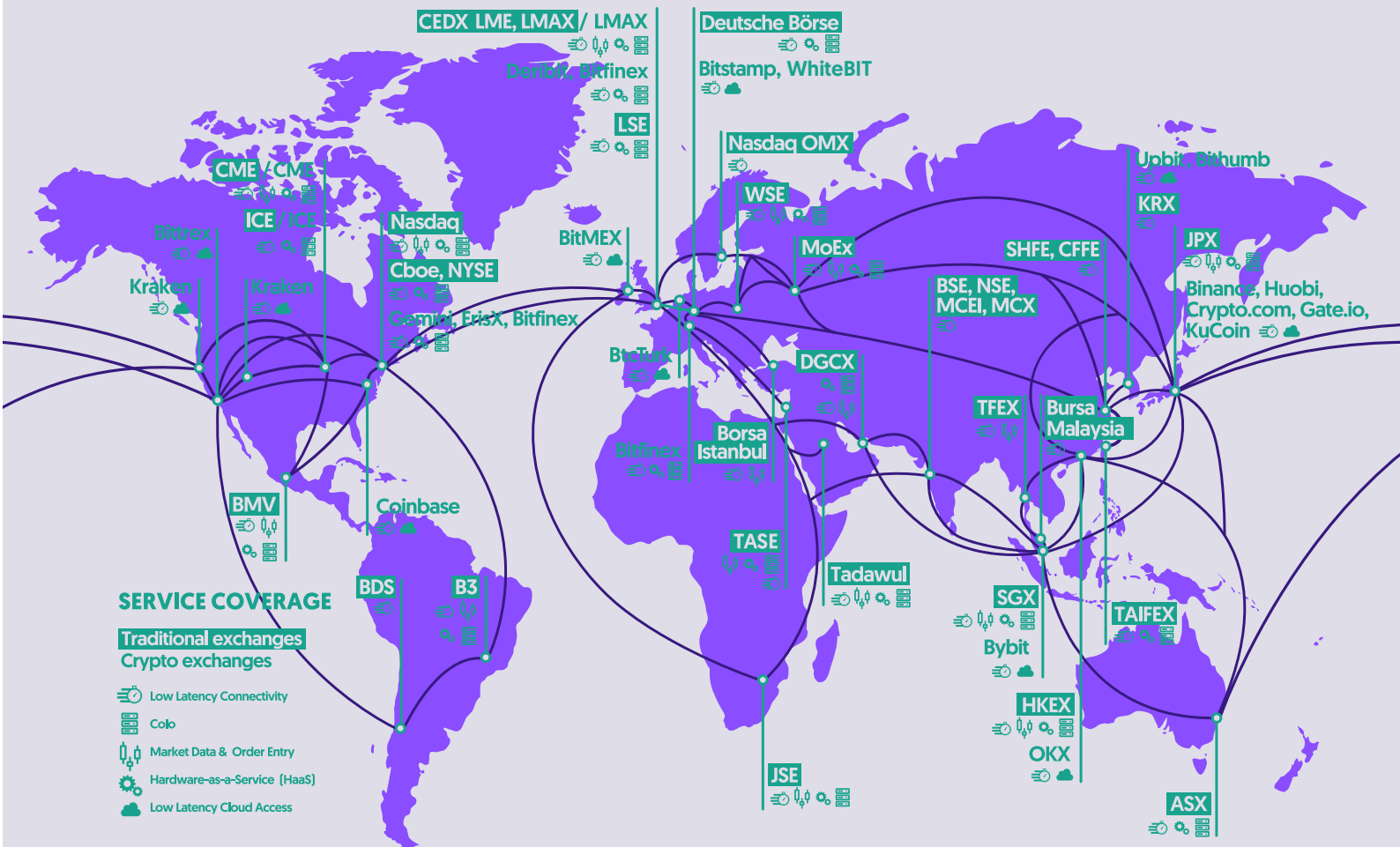


Produced in association with

A blurred background image of a financial chart, likely a candlestick chart, with a prominent purple arc overlaying it. The chart shows various data points and trends, with a purple arc highlighting a specific section. The background is dark, and the chart elements are in shades of gray and white.

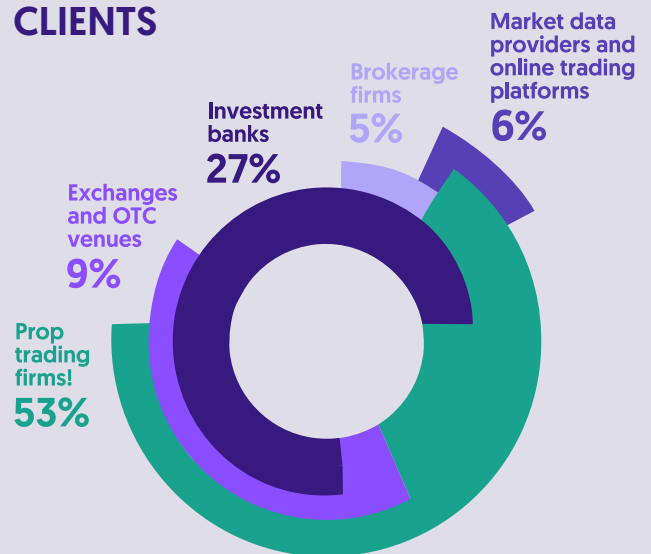
# AVELACOM



**#1**  
**ULTRA LOW LATENCY**  
**INFRASTRUCTURE**  
**FOR MARKET MAKERS**  
**AND ARBITRAGE TRADERS**



## OUR CLIENTS





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# About this report

Welcome to the Q3 Proprietary Trading Management Insight Report. This report is based on a survey of the Acuiti Proprietary Trading Expert Network, a group of senior executives from across the global proprietary trading community. Each quarter's report is based on questions submitted by the network, by Acuiti and by Avelacom, our report partner.

This quarterly edition of the Acuiti Proprietary Trading Network reports on a challenging year to date for the global prop community. Volatility has reduced trading opportunities and business performance during the first half of 2023, while liquidity issues continue to create additional risks.

But there have still been pockets of opportunity, with interest rates performing well for many firms and firms reporting a strong performance from Asian markets. And as this quarter's sentiment score shows, optimism is also rising for the quarter ahead.

We explore all these trends below, as well as examining what can be done to boost retail participation in European markets and Expert Members' views on how regulation will change their approach to cryptocurrencies, as well as their engagement with OTC markets.

# Looking back at H1 2023



After the volatility experienced during H1 2022, this year was always likely to be a slower one for proprietary trading firms. Indeed, for most of the network, the first half of this year has been a disappointing period.

A majority of members reported a worse performance for the period compared to both last year, an average year and their budget set at the beginning of the year. Firms that were a hybrid of point and click and algo performed worse during the first half of the year, with around 65% reporting being down on an average year.

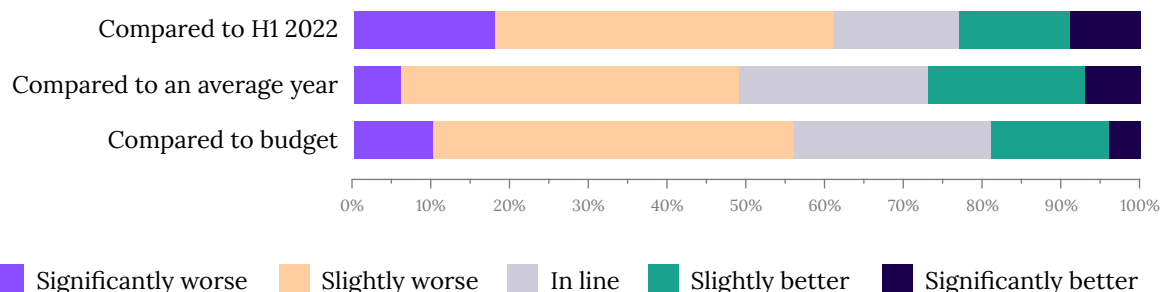
For most firms, performance was weakest when compared to H1 2022. That was an especially

volatile period by historical standards. Supply chain disruption worsened by Russia's invasion of Ukraine mixed with uncertainty around central banks' capacities to stamp down on inflation drove strong market movements.

The volatility both boosted overall volumes and the need for market participants to frequently hedge and reposition amid intra-day volatility.

This year, volatility has been less sustained and was unsurprisingly the key driver of the relatively poor performance firms experienced. In addition, and in Europe especially, many firms have struggled with liquidity challenges in markets that have made it hard to take advantage of price movements (see next page).

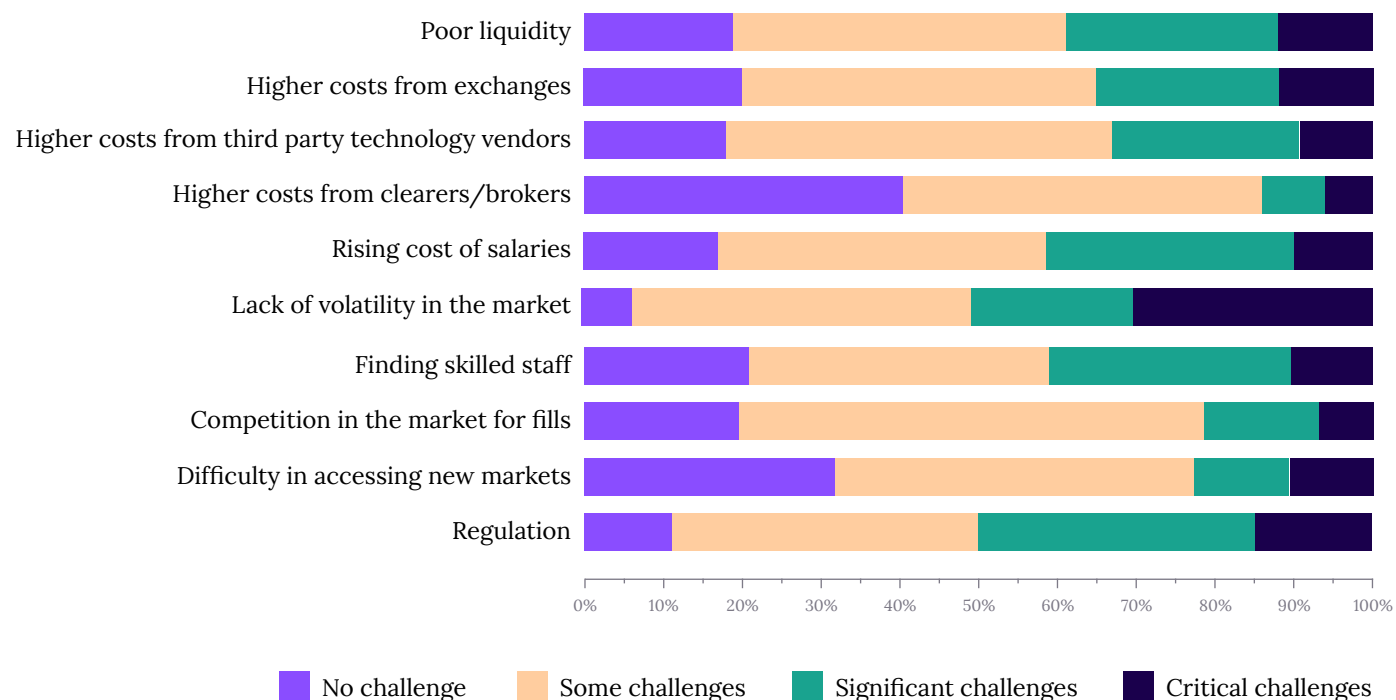
**How did your business perform in the first half of 2023 relative to last year, an average year and what you expected/budgeted for?**



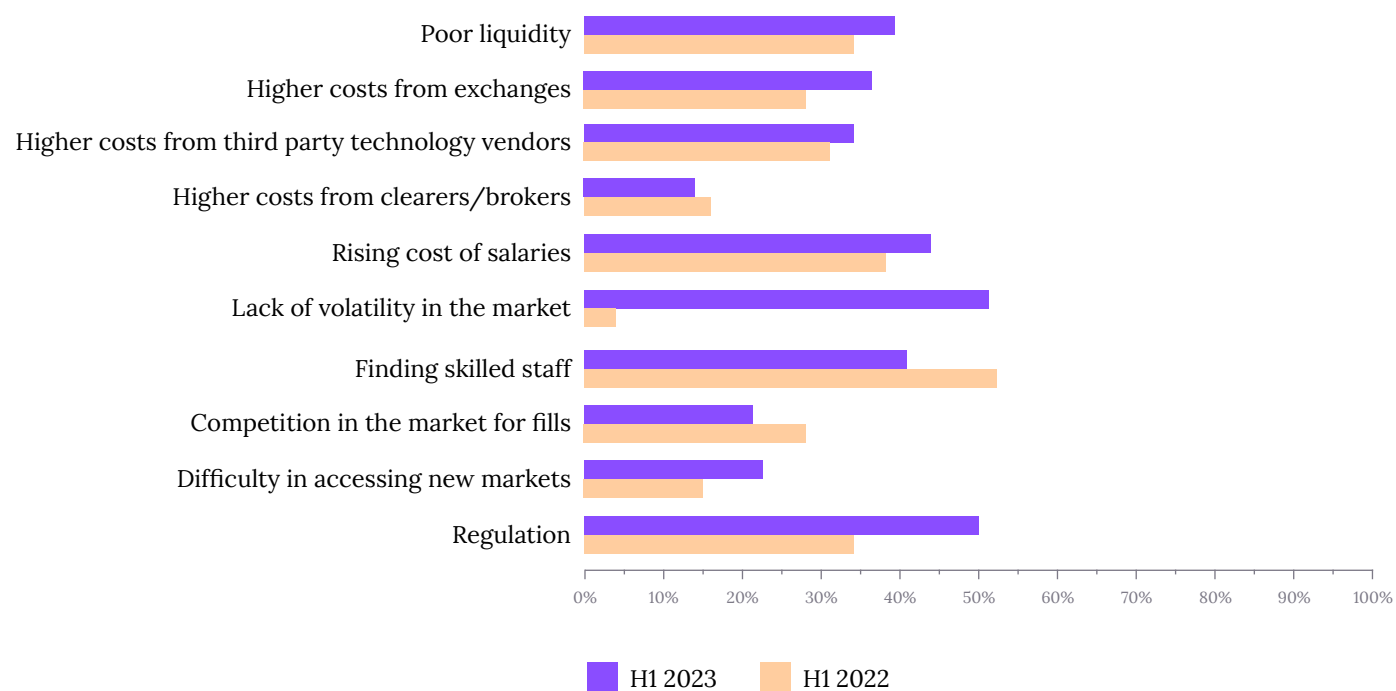
Liquidity has been a longstanding gripe among market participants and this quarter was cited as the major challenge to firms.

Firms also cited regulation (reactions to IFR/D are covered in **Hot Topics**) and higher costs from exchanges.

### During the first half of 2023, how much of a challenge did the following pose to your business?



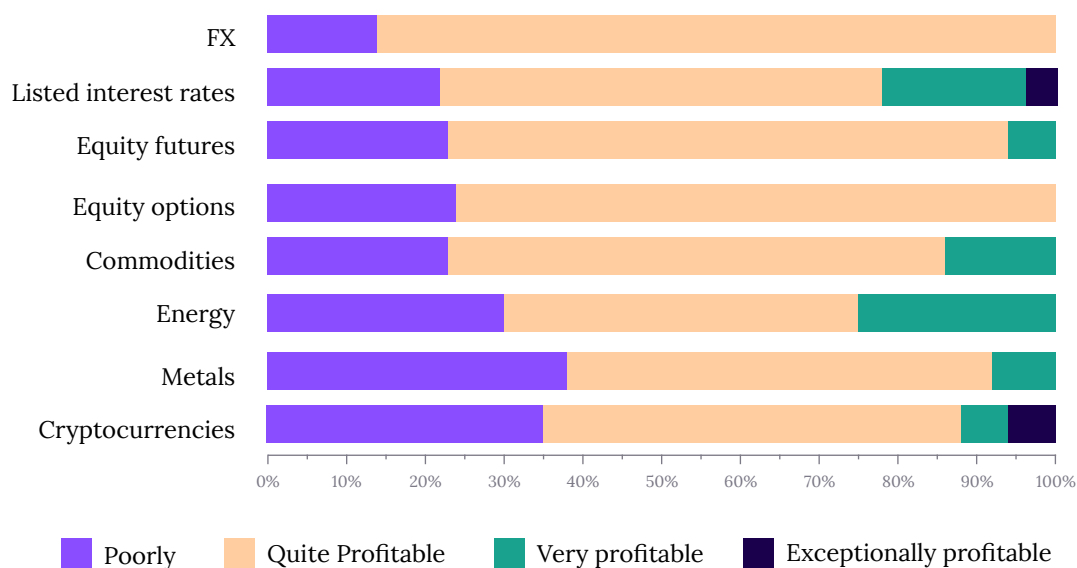
### % of respondents rating each challenge as significant or critical in H1 2022 vs H1 2023?



Compared with H1 2022, several challenges remain constant. However, the challenge posed by the lack of volatility has spiked aggressively and the challenge posed by regulation has increased significantly. While volatility has come down this year, it has still been more elevated in some asset classes, with rates being a prime example.

Listed interest rate products were cited as the most profitable asset class overall for H1 2023. In energy, a winners and losers trend was perceptible, with just over a third of firms posting good returns and a slightly smaller percentage reporting a difficult six months. Metals was the worst performer, with crypto also underwhelming for most.

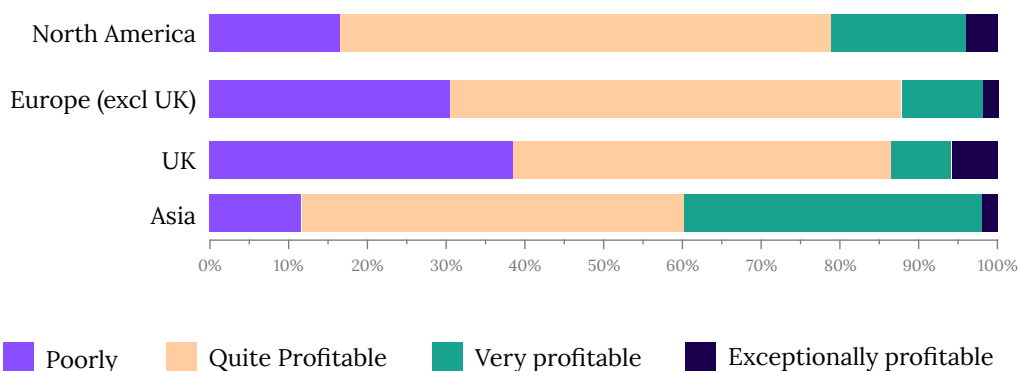
### How did the following asset classes perform for your business in H1 2023?



Regionally, Asia was the top market while Europe and the UK were notable poor performers. Year-on-year volumes are down at Eurex and Euronext, according to FIA data, while on-screen liquidity continues to be reported as challenging by the local prop

trading community. North America was a mixed picture, with a fall in overall volumes at some exchanges contrasting with a surge in short-dated options activity which boosted performance for options market makers in particular.

### How did the following regions perform for your business in H1 2023 in terms of trading on exchanges in those regions?



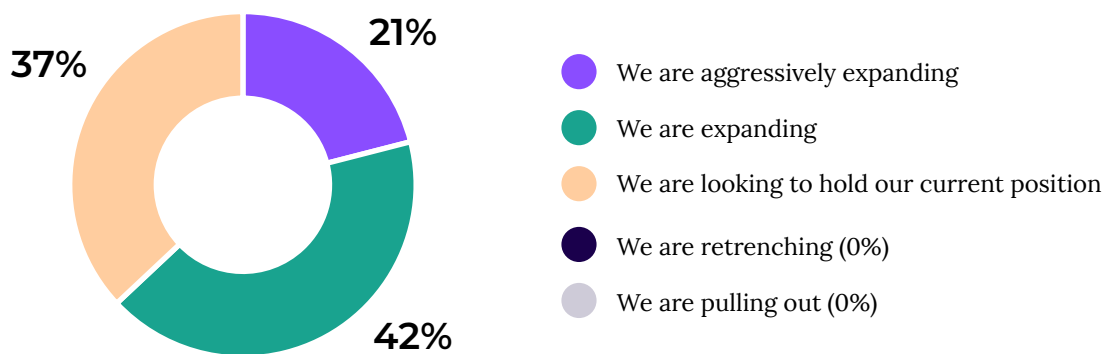
# Crypto Attitudes



Despite the crypto winter, cryptocurrency markets still offer opportunity for some firms. But the risk of losses is also high and a trust deficit following the FTX scandal is yet to fully clear. This has slowed the pace of new entrants to the market. However, for those with existing

business lines into the market, a majority are either expanding or aggressively expanding. None were currently retrenching or pulling out, although several firms said they had pulled back to some extent from the market over the past 12 months.

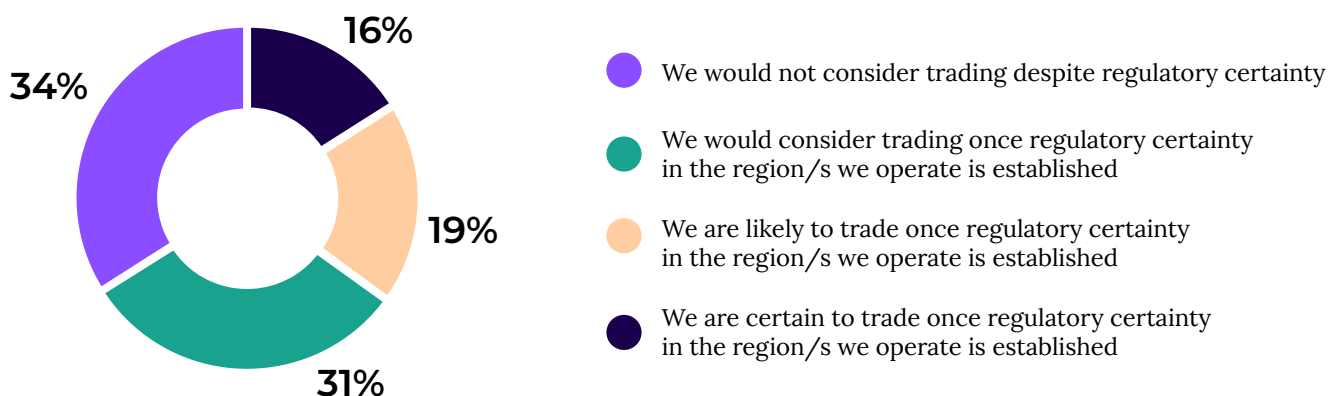
## What best describes your attitude to your crypto business at present?



In a boost to the industry, more jurisdictions are approaching a clearer regulatory base for cryptocurrency. TradFi market participants have long cited regulation as an essential step

to unlocking institutional investment in the asset class. The EU, UK, Dubai and Hong Kong are now all at different stages of adopting frameworks for digital assets.

## How is the development of regulatory frameworks in major financial centres impacting your attitudes towards adopting crypto trading?





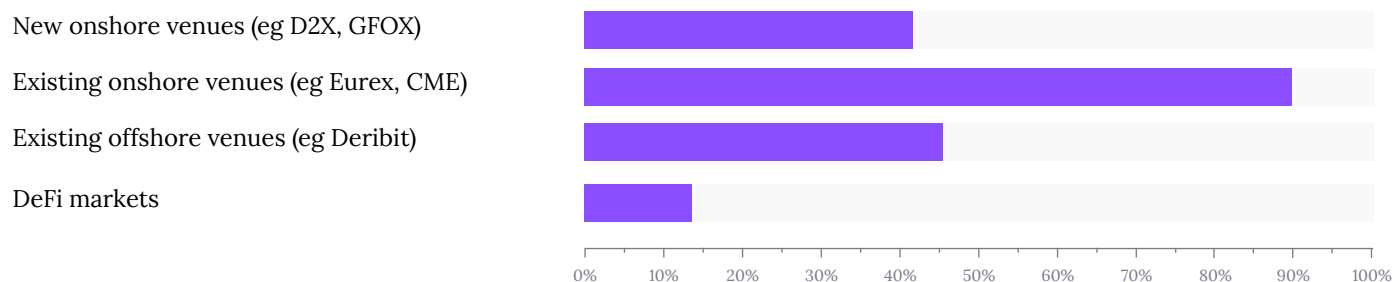
Around a third of respondents were not interested in cryptocurrency exposure, whatever its regulatory standing. However, the rest of the network all showed varying degrees of openness to start trading crypto on the back of established regulatory frameworks (see chart on previous page).

Firms that were planning to start trading crypto showed a bias towards established onshore, TradFi venues. But new specialist onshore venues, such as D2X and GFOX, are also attracting interest as are existing offshore venues such as Deribit.

Several new exchanges are soon to launch in the UK or EU and have built dedicated digital asset trading infrastructure that is based around regulatory frameworks. These firms are pursuing different approaches when it comes to areas like clearing and market structure.

While some offshore venues have taken a reputational hit in the wake of FTX's collapse, after which US regulators in particular took a harder stance with the exchanges, they still hold appeal for traders as they host large market shares and often boast significant retail order flow.

## Which markets would you be likely to connect to in order to trade crypto?



# Assessing OTC markets



A long-running theme of our prop trading reports has been members' concerns about the liquidity profile of listed derivatives in Europe. The vast majority of prop trading firms' activity is still centred on exchange-traded derivatives, however. But members reported a noticeable trend of increasing their level of OTC trading over the last five years, while few were decreasing their exposures.

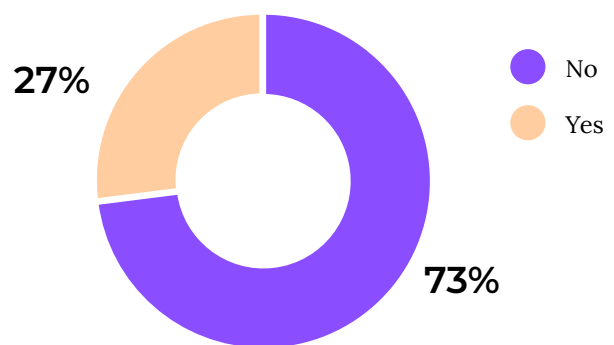
Poor listed market liquidity has been a main driver of this shift. But members also reported finding better pricing in OTC markets. The data also shows that prop trading firms are using OTC markets in tandem with their listed positioning, to hedge for those exposures.

However, OTC exposure is not a panacea for the problems that prop traders experience in listed markets. There are market and operational costs to trading in these products. These include a lack of transparency in pricing and having to maintain an ISDA agreement with counterparties. Among those members who had decreased their OTC exposures over the last five years, costs were cited as the only reason for doing so.

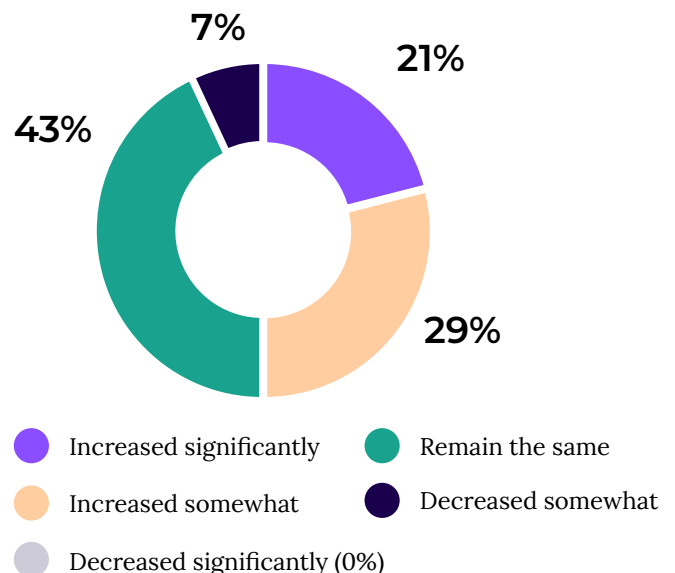
## What is the biggest driver behind the increase in OTC trading?

1. Poor liquidity in listed markets
2. Better pricing in OTC markets
3. Can't access specific exposures in listed markets

## Does your firm trade OTC products?



## How has the level of OTC trading changed at your firm over the past five years?



# Hot Topics

In this section we examine prop trading firms' attitudes to a range of key topics suggested by the network that are currently facing their industry.



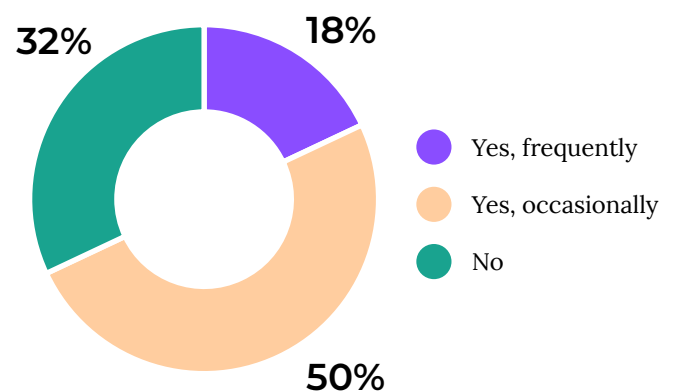
## Liquidity squeezes

While volatility is a fundamental condition for prop firm's success, it also creates challenges such as liquidity squeezes. Most of the network reported being impacted by these to some degree.

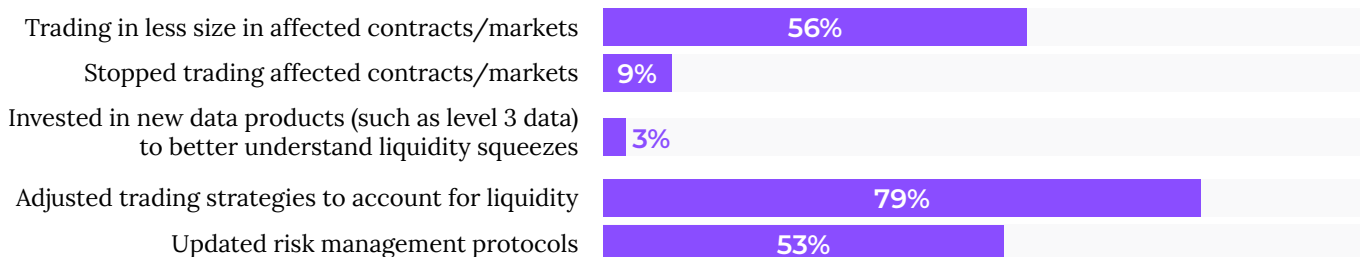
To mitigate these squeezes, most of the network were adjusting their trading strategies to account for liquidity. Concerningly, many were trading in smaller size in the contracts and markets that had been affected.

This dynamic could risk creating a vicious circle, where lower sized trades further worsen liquidity.

Have your trading strategies been impact by liquidity squeeze moves in markets?



How are you managing or reacting to those squeezes?



# Readying for IFR/D

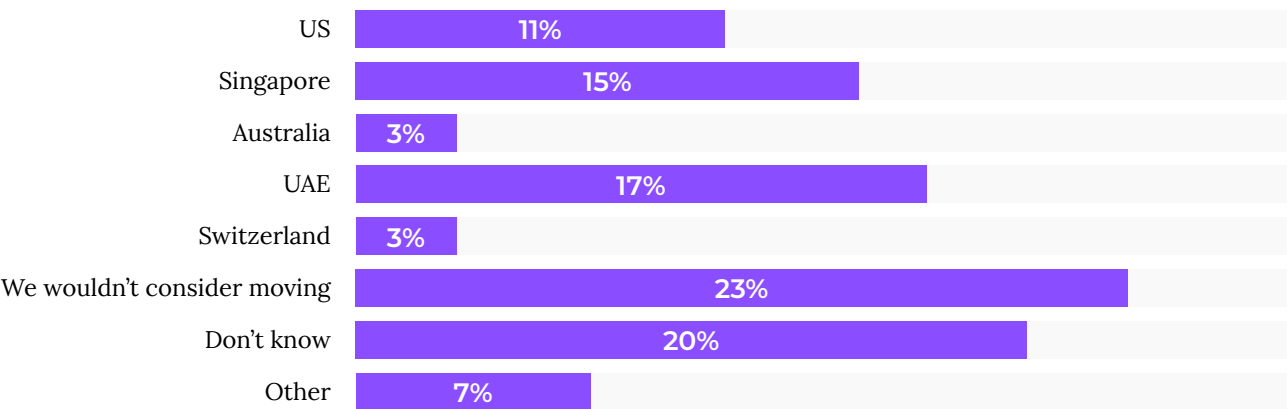
In the Q2 Proprietary Trading Insight Report, we detailed the multiple challenges that the Investment Firm Prudential Regime posed to prop trading firms operational in the UK and EU. The new rules will require significant changes in the governance structures and cost-base of firms. Even more seriously, it is set to balloon firms' capital requirements to a potentially ruinous level.

As a result, many firms said they were

considering moving their operations outside the EU and UK. Some even said they would stop trading EU exposure altogether.

Among those who were considering moving their operations, the UAE was the most cited jurisdiction to go to. The US and Singapore were also cited frequently, in particular by lower latency trading firms, while Australia and Switzerland are also under consideration from a few firms.

**Last report, we found that significant numbers of firms were considering moving some operations outside the EU if IFR/D wasn't reformed. If you were to move your domicile outside the EU/UK, which region do you think you would be most likely to move to?**



For those firms that have to meet IFR/D's considerable regulatory capital requirements, network members were most likely to be planning to fund additional capital with

existing reserves or cashflow, or seek new investment from existing shareholders. None were looking to use debt to fund the requirements.



# Boosting European retail presence

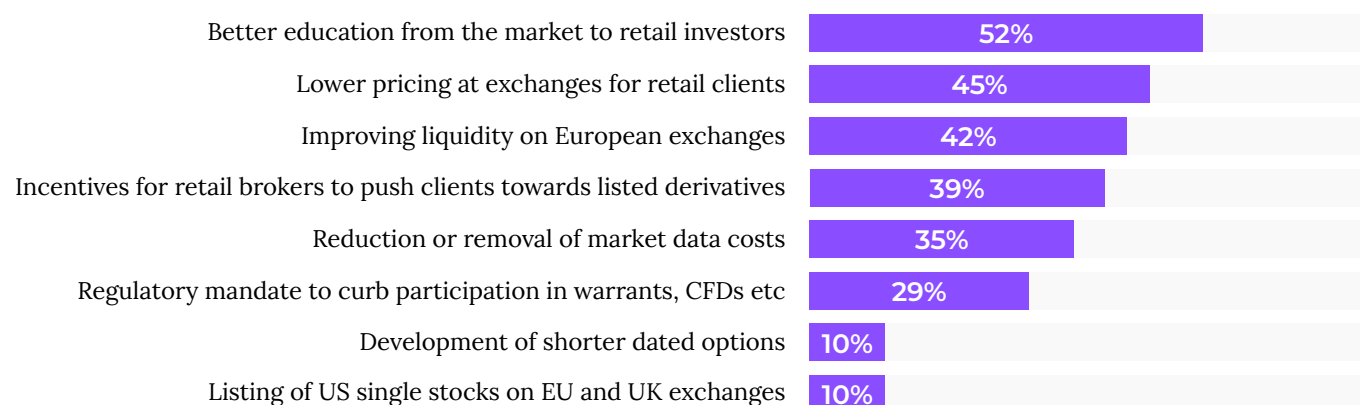
Market participants have long identified a lack of retail participation as one the key reasons why European listed derivatives markets suffer with poor liquidity. European traders have often looked with envy at comparable participation in the US, where options markets in particular have been revolutionised by their growing popularity with retail participants.

For members of the Acuiti Expert Network, the best routes to achieving a similar situation in

Europe would be better education for retail. Lower pricing from exchanges for retail was also a popular choice, as was improved listed liquidity and incentives for retail brokers. Members also suggested direct access and better disintermediation as an option.

Few members cited shorter dated options, despite their explosion in popularity in the US. Eurex has recently taken steps to launch its own short-dated options suite.

## What do you think could be done to increase retail participation in European listed derivatives markets and stop flow going to products such as warrants, CFDs



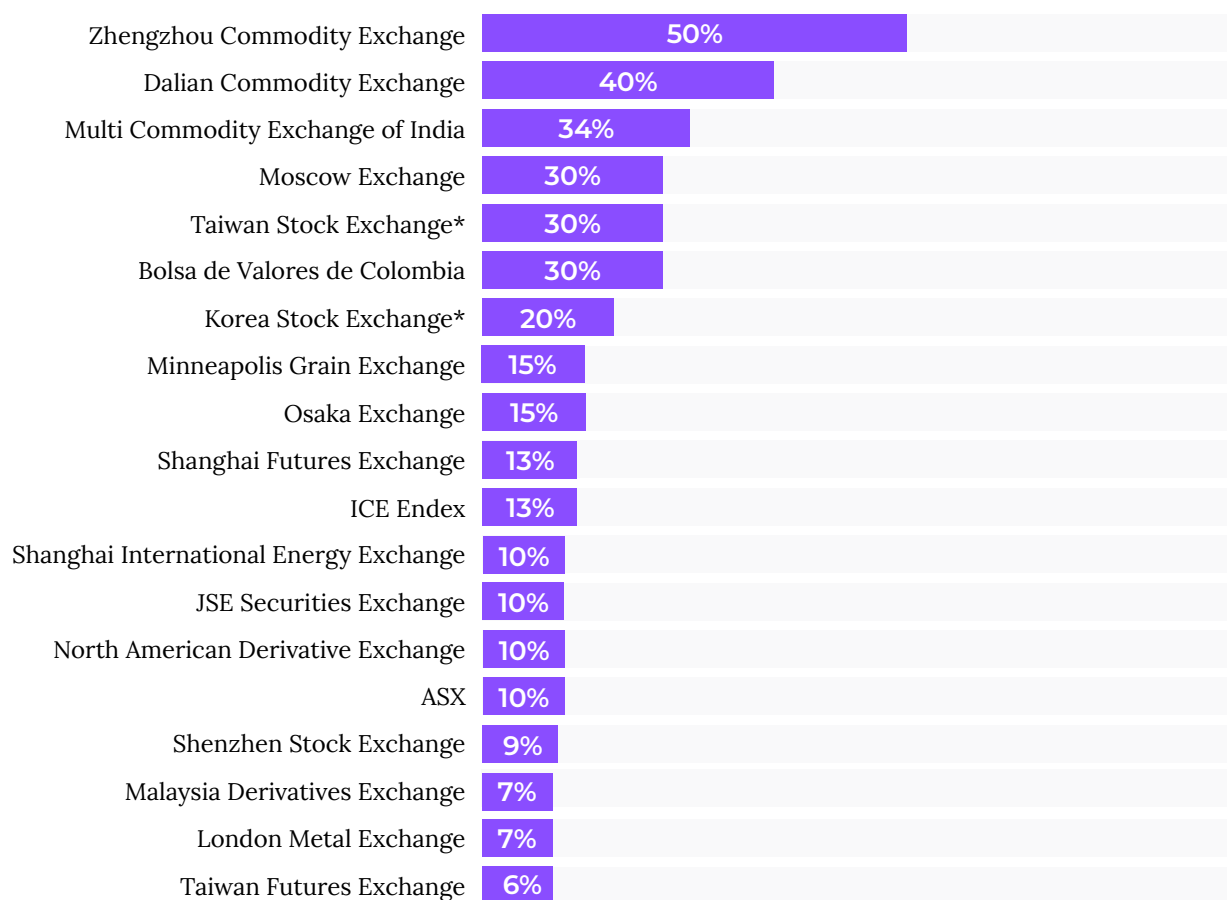
# Contracts and markets



## The Avelacom Exchange Growth Index

The Avelacom Exchange Growth Index is a benchmark of quarter-on-quarter volume growth across cash equities and derivatives markets. Exchanges must have been trading

for more than one year to feature in the index. Futures and options data is provided by the FIA, cash equities from the exchange websites.



\*Cash equities

Source: FIA, Exchange Websites



# New contracts

The table below, based on data provided by ETD (formerly Euromoney TRADEDATA), profiles the performance of the top 20 new contracts launched last quarter, based on average daily volume.



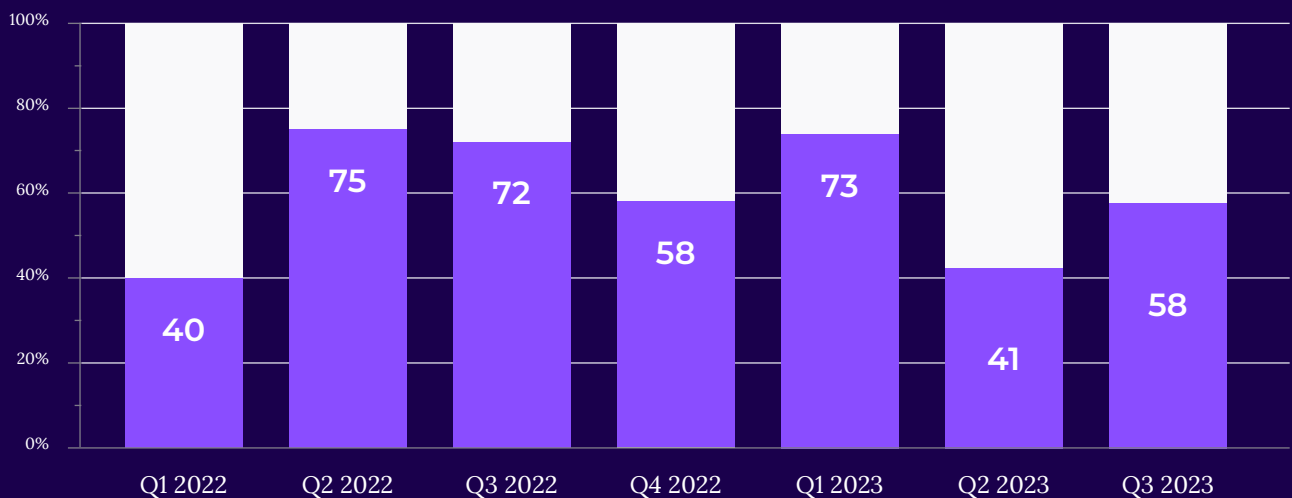
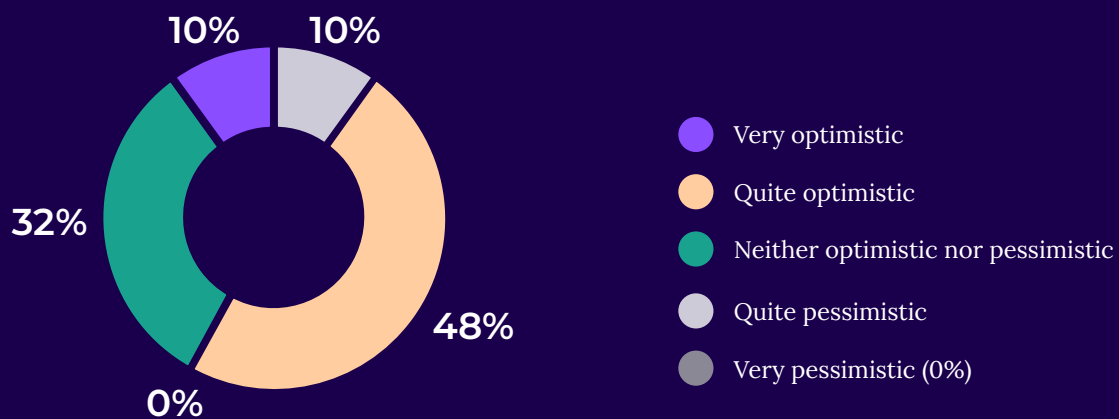
Exchange	Contract	Type	Volume	Open Interest	ADV	Launch
Shanghai Stock Exchange	STAR 50 ETF	Option	7,607,601	590,792	190,190	05-Jun
Shanghai Stock Exchange	E FUND STAR 50 ETF	Option	2,399,850	142,067	59,996	05-Jun
Dalian Commodity Exchange	Ethenylbenzene	Option	2,314,416	84,402	38,573	15-May
Osaka Exchange	Nikkei 225 Micro	Future	1,246,894	21,356	20,111	29-Mar
Dalian Commodity Exchange	Mono Ethylene Glycol (MEG)	Option	1,228,860	71,159	20,481	15-May
Osaka Exchange	Nikkei 225 Mini	Option	1,173,128	42,566	18,921	26-Mar
Shanghai Futures Exchange	Aluminum Oxide	Future	446,726	68,373	20,305	06-Jun
China Financial Futures Exchange	30-year China Government Bond	Future	397,633	42,314	6,627	21-Apr
Osaka Exchange	Nikkei 225 Mini Weekly	Option	79,401	-	1,280	29-Mar
Osaka Exchange	3-Month TONA	Future	41,055	14,701	662	29-Mar
National Stock Exchange of India	WTI Crude Oil	Future	28,722	455	448	15-May
National Stock Exchange of India	Natural Gas (Henry Hub)	Future	16,354	364	255	15-May
Coinbase Derivatives	Bitcoin	Future	15,280	132	347	04-Jun
Coinbase Derivatives	Ether	Future	6,603	99	150	06-Jun
Eurex	MSCI World Real Estate	Future	5,117	5,117	116	12-Jun
Asia Pacific Exchange	Gold Perpetual 1 Troy Ounce	Future	1,964	6,832	46	31-May
Eurex	FTSE Bitcoin Index	Future	1,864	12	30	17-Apr
Chicago Mercantile Exchange	USD/CNH	Option	801	801	12	03-Apr
Chicago Mercantile Exchange	Philadelphia CDD Index	Future	750	-	34	22-Mar
Asia Pacific Exchange	Gold Perpetual 10 Troy Ounce	Future	661	1,486	15	31-May

# Outlook

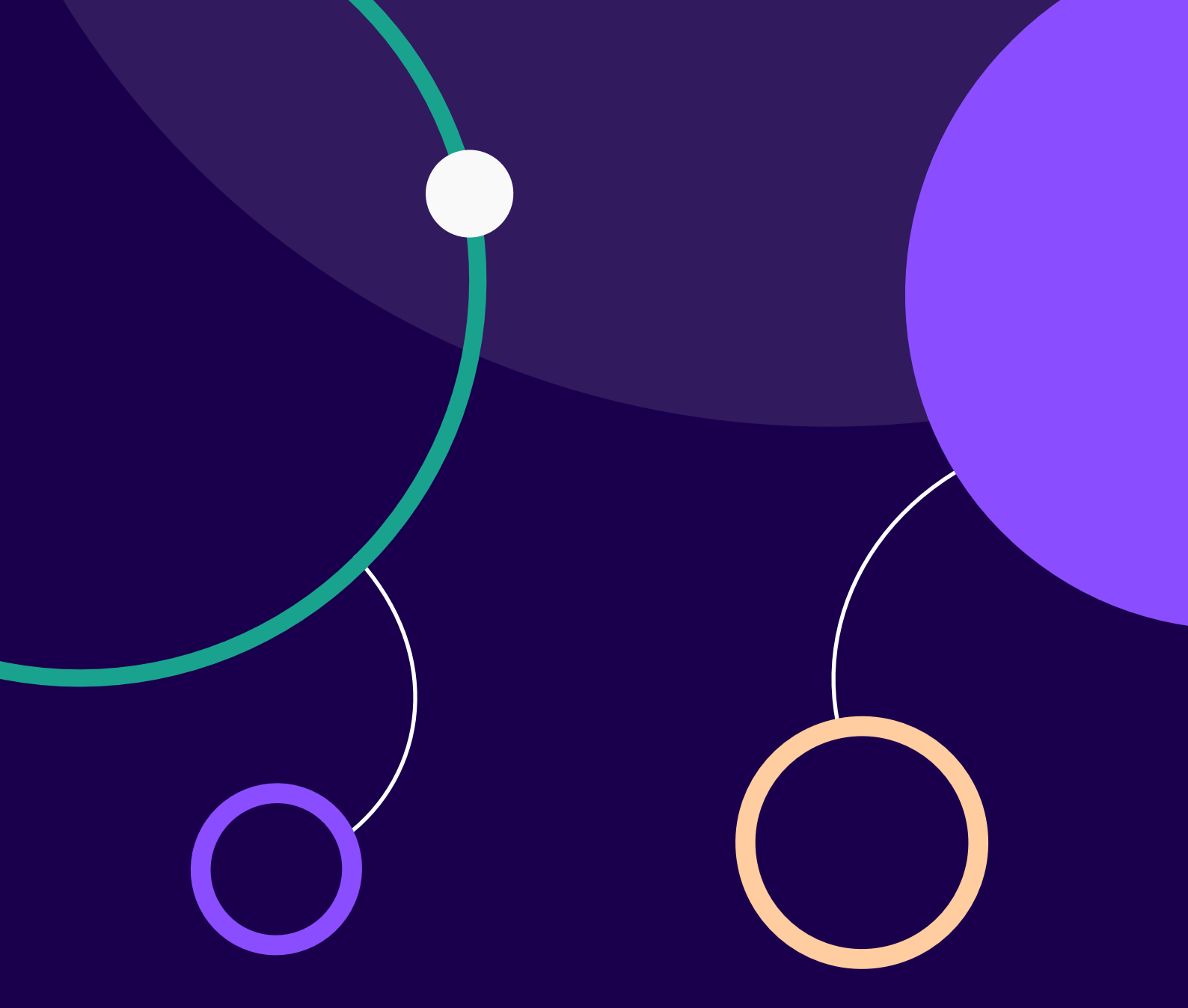
Despite the struggles that many faced in the first half of this year, the network posted an improved sentiment score compared to last

quarter, increasing from 41 to 58. This is still substantially below the 73 score recorded in the first quarter of this year, however.

**Looking ahead to the next three months, how optimistic are you about the environment for your business performance?**







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