THE TRADE
WORKING FOR THE BUY-SIDE

The 2014 Algorithmic Trading Survey

long-only firms

Recognising excellence in the delivery of algorithmic trading solutions

Featuring

- Market review
- Broker roll of honour
- Market feedback
- Buy-side forum

Illustration: iStockphoto

Keeping the customer satisfied

Familiarity breeds contentment as algo performance rated higher than ever

The TRADE's 7th annual Algorithmic Trading Survey shows long-only firms finding value by working closely with a smaller range of providers in a maturing market.

Client satisfaction levels are higher than ever among buy-side users of execution algorithms, according to The TRADE's seventh annual Algorithmic Trading Survey. Good news for providers no doubt, but offset by confirmation that the period of peak growth is well and truly behind us. For the third year in succession opinions were offered by more than 150 buy-side traders; evaluating more than 20 banks and brokers; and offering many thousands of individual evaluations concerning service quality.

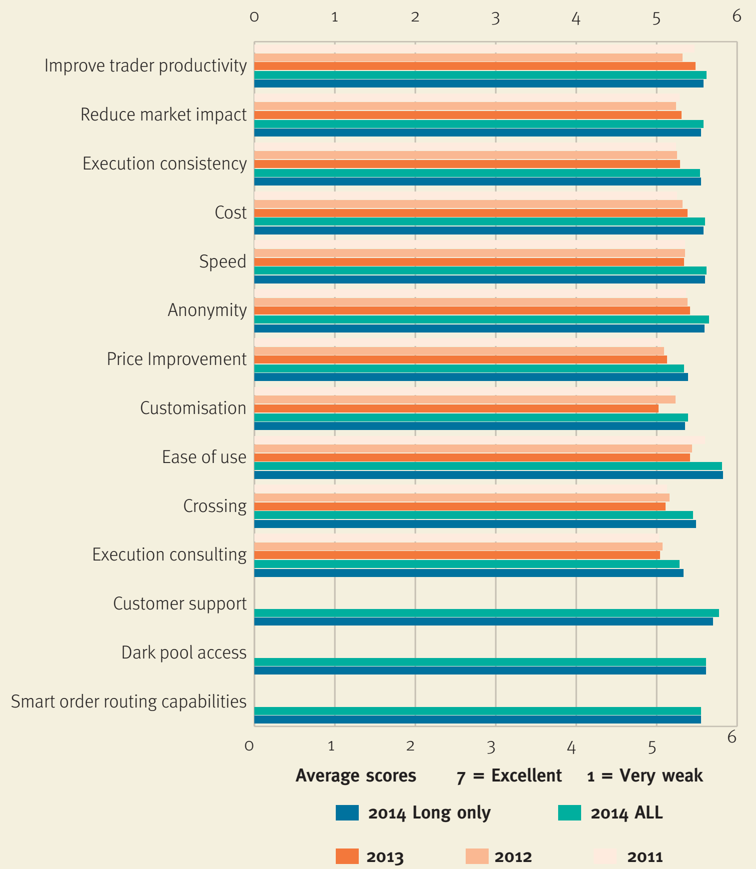
For the first time, we are presenting the survey results in two parts this year. In this issue, the focus is on the responses from long-only clients. In the Q2 2014 issue of The TRADE, our analysis will concentrate on hedge funds and other institutions that make extensive use of algorithmic trading capabilities. In some areas, opinions and usage patterns are similar across both groups, but there are also more than enough differences to justify a separate treatment.

In 2014, we also added for the first time questions

The willingness to try everything and everyone has been replaced by a more selective approach.

relating to customer service, use of dark pools and smart order routing capabilities; giving fourteen areas of service evaluation. One question was amended to incorporate the growing role of execution consulting. Overall, for the ten directly comparable questions, scores were well ahead of those seen in 2013. Across all questions the average weighted score in 2014 was 5.59 compared with 5.27 in 2013; a level of scoring virtually unchanged over three years. Worth noting is that long-only clients scored at almost the same level as the overall survey (5.54 vs 5.59). Figure 1 shows the progress of scoring in recent years across the survey and the message is the same: in all aspects of service, clients are definitely growing happier.

FIGURE 1: RATING OF ALGORITHM PERFORMANCE



Source of all charts: The TRADE Annual Algorithmic Trading Survey

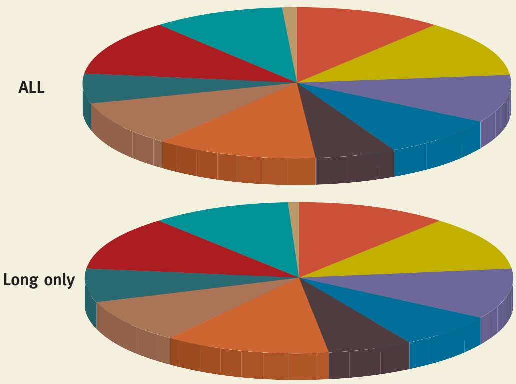
A new era

So what has prompted this broad-based improvement in client perceptions? The main factor appears to be a growing maturity among both providers and users of algorithms. The rate of growth in usage, measured by how many trades use algorithms, has slowed from the heady days of early adoption. Having experimented with many providers, users appear more willing to concentrate their activity. At the same time providers, having offered an apparently endless level of innovation and new products in previous years, are concentrating on delivering core products in ways better suited to client needs.

No doubt part of the motivation is commercial. With commissions under

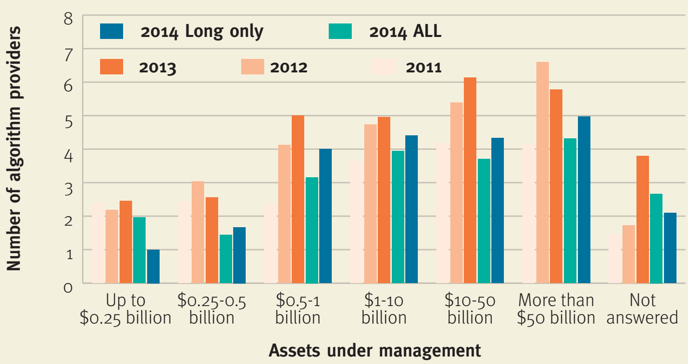
Market review: long-only firms

FIGURE 2: REASONS FOR USING ALGORITHMS



2014	ALL	Long only
Trader productivity	11.2%	11.4%
Reduced market impact	12.4%	11.9%
Execution consistency	10.2%	10.7%
Commission rates	8.9%	7.5%
Speed	6.1%	6.4%
Anonymity	12.1%	12.6%
Price improvement	9.9%	9.4%
Customisation	6.4%	7.2%
Ease of use	11.8%	11.7%
Internal crossing	10.0%	10.5%
Match pre-trade estimates	1.1%	0.7%

FIGURE 3: AVERAGE NUMBER OF PROVIDERS USED BY AUM

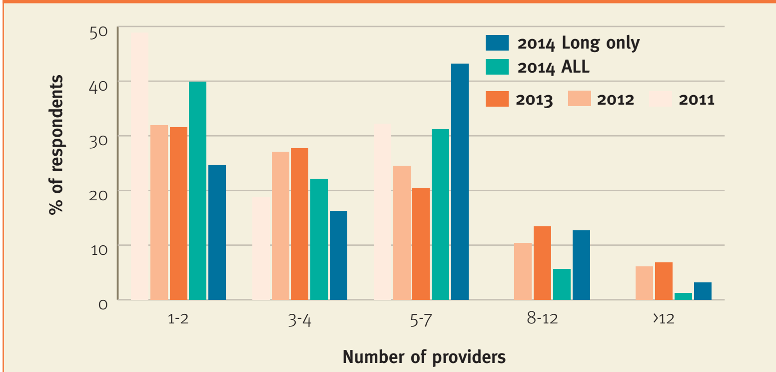


The future will be about winning a bigger share of a slowly expanding market, not a 'land grab'.

constant pressure and closer regulatory scrutiny, the pool of funds available to support innovation is no longer growing quickly and in some markets may even be in decline. However, there is also perhaps a sense that the key phase of product innovation has passed. Changes caused by the introduction of dark pools and smart order routing are now a well established part of the landscape. The focus for many providers is on using existing techniques in different asset classes and different markets. Making existing services work better is also important to clients, as their dependence on algorithms is now considerable.

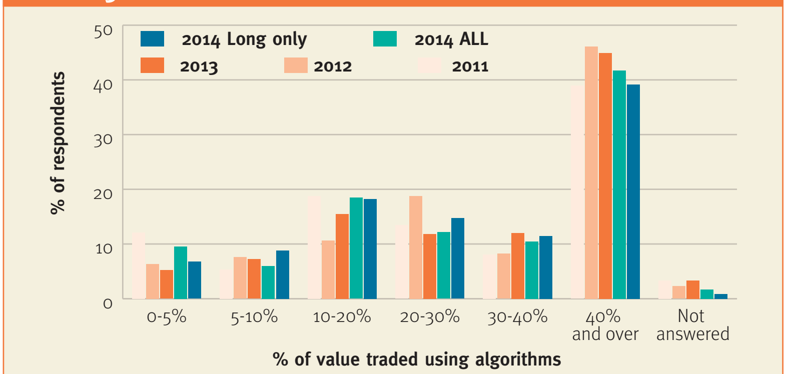
As the business matures, the reasons for using algorithms have begun to undergo some subtle changes, as illustrated in Figure 2. For long-only clients, anonymity is now the single most important reason cited for using algorithms. The associated goal of reducing market impact still ranks top across all clients and second for long-only respondents. Increasing trader productivity has now been replaced in the top three across all clients and the

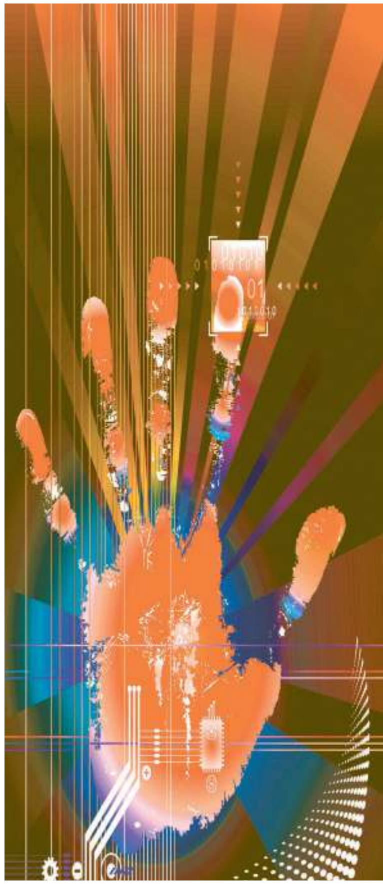
FIGURE 4: NUMBER OF PROVIDERS USED



** In 2011, respondents could only specify a maximum of 'five or more' algo providers*

FIGURE 5: ALGORITHM USAGE BY VALUE TRADED





long-only group by ease of use. Algorithms by their nature should improve productivity. However if they are too complex then many of the gains may be lost. Scores for ease of use were up by 0.40 points compared with 2013, the largest gain of any question.

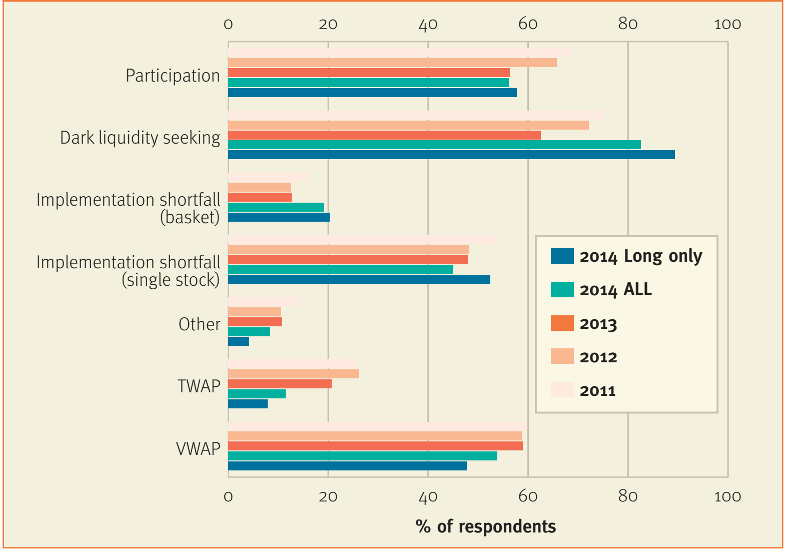
Room for improvement

Among the new questions posed this year, excellent scores were seen in the area of customer support. The average scores were 5.70 for long-only clients and even higher across all respondents. These scores were second only to ease of use and confirm the generally positive view of providers held by clients. Dark pool access and smart order routing capabilities showed a more mixed picture, ranking around midway among the various questions posed. By contrast execution consulting did not score highly among any group. Whether this reflects lack of availability for some clients or concerns about the actual delivery is not clear.

Excellence in execution consulting may become a rich source of differentiation in light of the overall trend toward concentration of business with fewer

Market review: long-only firms

FIGURE 6: TYPES OF ALGORITHMS USED



Respondents call for "visibility on my routes in the market" and "smart algos that switch strategy by market performance automatically".

algorithm providers, although the impact is perhaps less clear with long-only clients. The changes are reflected in the statistics shown in Figures 3, 4, and 5. Asset managers of all asset sizes appear to be using fewer providers than before. While a wider number of providers may be on an approved list and getting trades from time to time, the majority of activity is being concentrated within a smaller number of providers.

The willingness to try everything and everyone, prevalent in survey responses two or three years ago, has been replaced by a more selective approach. For long-only customers the change is less pronounced, in part because algorithmic trading is increasingly treated as simply a part of an overall relationship with executing brokers – reducing average commissions being paid, but within an overall relationship rather than as a special component.

Outside of long-only funds, 90% of respondents use less than a handful of providers. Large long-only funds have a broader range of providers, but even for them concentration seems to be taking place. Across the entire survey, the number of respondents showing use of just one or two providers is back up at 40%, having declined to a little over 30% during the last three years.

Providers are of course worried about a concentration that might keep broker lists shorter. Equally they care greatly about the proportion of business being done using algorithms. Here once again the survey results raise potential concerns. Across all respondents, the proportion using algorithms for more than 40% of their business fell for the second year in a row and is now little more than 40%. Among long-only clients it is even lower still. While these high-volume users are still by some way the largest group of clients, their numbers appear to have stopped growing.

The implication of these figures seems clear enough. The era of rapid growth in the number of providers being used and the proportion of trading being done using algorithms has come to an end. The future will be about winning a bigger share of a slowly expanding market, not a 'land grab' to exploit a new and fast growing opportunity. The skills needed to thrive in this new world are not the same as those needed before. The 'roll of honour' section that follows, gives some clues as to who the future may belong to, and it is not necessarily those who have done well in the past.

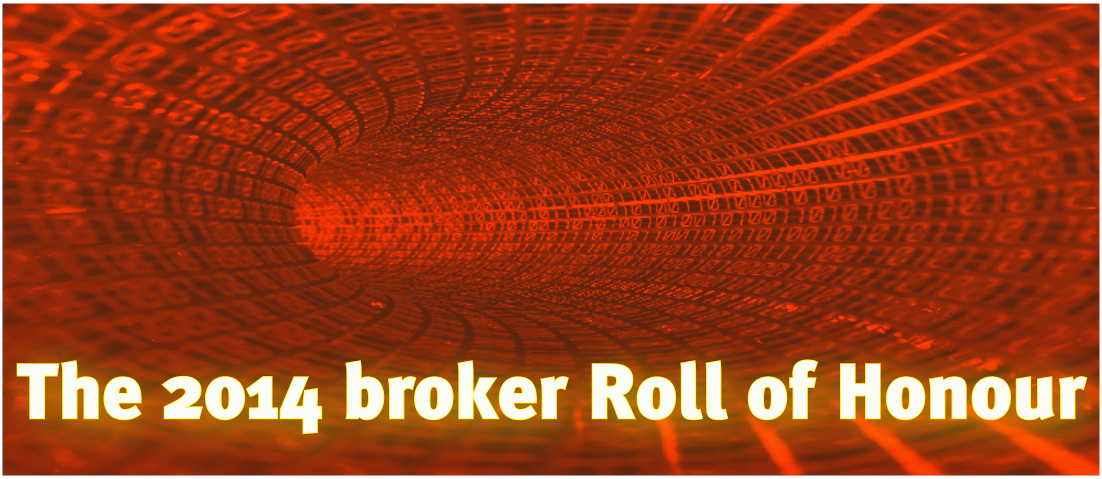
Feedback from survey respondents suggests an appetite for further insight, analysis and customisation. A sizeable proportion of respondents are looking to their brokers to deepen their own understanding of routing logic and venue toxicity. Calls for "visibility on my routes in the market" and "smart algos that switch strategy by market performance automatically" reflected the interest of algo users in further refining their execution strategies.

Slow to fade

In terms of the type of algorithms being used (as in Figure 6), by some way the most widely used are those designed to access dark liquidity, consistent with the overall priorities noted above. Having declined in relative importance over the last two years, the dominance of this type of algorithm has been reasserted with a vengeance in 2014. Almost 90% of long-only firms use these algorithms, and more than 80% across the survey as a whole. The long-predicted demise of VWAP and TWAP algorithms is slowly but surely being realised, though the pace of decline is slower than many thought likely. Almost half of long-only respondents and a higher proportion overall still use VWAP algorithms. It is a similar story, at a similar level for in-line participation algorithms, though use of TWAP is falling away quickly.

In summary, sell-side institutions are offering better algorithms that are closely aligned with the needs and priorities of clients. Gimmickry has ceded ground to professionalism, and ideology has given way to effectiveness. For all concerned The TRADE welcomes the opportunity to record that greater happiness all round, albeit with somewhat less excitement, is the result.

Illustration: iStockphoto



Functional capabilities

MEASURING FUNCTIONAL CAPABILITIES

Survey respondents were asked to provide a rating for each algorithm provider on a numerical scale from 1.0 (very weak) to 7.0 (excellent), covering 14 functional criteria. In general 5.0 is the 'default' score of respondents. In total nearly 30 providers received responses and the leading banks obtained dozens of evaluations each yielding thousands of data points for analysis. Only the evaluations from clients who indicated that they were long-only managers have been used to compile the provider Rolls of Honour described below (other evaluations will feature in our Q2 2014 issue).

Each evaluation was weighted according to three characteristics of each respondent: the value of assets under management; the proportion of business done using algorithms; and the number of different providers being used. In this way the evaluations of the largest and broadest users of algorithms were weighted at up to three times the weight of the smallest and least experienced respondent.

In arriving at the overall Roll of Honour the scores received in respect of each of the 14 functional capabilities were further weighted according to the importance attached to them by respondents. The aim is to ensure that in assessing service provision the greatest impact results from the scores received from the most sophisticated users in the areas they regard as most important. Finally it should be noted that responses provided by affiliated entities are ignored and a few other responses were also excluded where the respondent could not be properly verified.

As in previous years, the 14 functional capabilities are grouped into three categories: those that impact actual execution performance; those that affect direct and indirect costs of trading; and capabilities that are of a qualitative and more subjective nature.

REDUCING MARKET IMPACT

ROLL OF HONOUR[1]

J.P. Morgan
Liquidnet
Sanford C Bernstein

Scores for reducing market impact were consistent across the survey between different client groups. The overall average of 5.58 across all respondents was 0.27 points higher than in 2013. While this score is good, it only merited a middle ranking position among all 14 areas being evaluated. As far as long-only respondents were concerned, the scores and ranking were very similar. The range of scoring across all the major players was the largest compared with the other questions

1 Roll of Honour recipients are listed in alphabetical order throughout the survey.

Broker Roll of Honour: long-only firms

with a difference between best and worst of 30%.

Reducing market impact remained the single most important factor for clients' evaluation of services. Almost half of respondents considered it to be one of the top four aspects of service to be considered. While slightly lower in importance than in 2013, this remains a key aspect of service delivery for providers, though one that remains hard to demonstrate with tangible data, but important for analysis and consulting. Given the range of scoring and the importance accorded by respondents, this would seem to be an area where competitive differentiation is a possibility and one that can drive trading activity.

Among the Roll of Honour names, Liquidnet appears again in 2014. The firm has a traditional following among long-only managers and that probably helps its positioning in terms of Roll of Honour ranking this year. J.P. Morgan and Sanford C Bernstein are new names to the Roll of Honour this year, again perhaps reflecting their business focus.

EXECUTION CONSISTENCY

ROLL OF HONOUR

Bank of America Merrill Lynch
J.P. Morgan
Morgan Stanley

One of the key strengths of algorithmic trading is that the execution performance achieved is consistent. This is an important advantage when demonstration of superior performance is not easy to achieve. As such it would be expected that the majority of providers would perform well in this category. This held true this year for both long-only clients and more generally. Among the former group, the average score achieved was 5.55. This was statistically identical with the overall survey score of 5.54. The latter was exactly one-quarter point higher than the average recorded in 2013, consistent with the improvement seen broadly across the survey.

While execution consistency may not be as important as reducing market impact, it nonetheless accounted for more than 10% of all mentions by respondents in relation to key factors in evaluating providers' performance. The proportion of mentions has been fairly consistent in each of the last five years. For long-only clients, this area was marginally more important than in the survey sample as a whole but the difference was not significant.

All three of the Roll of Honour names this year, when looking at responses from long-only clients, are different from 2013. While the number of responses received by J.P. Morgan was less than that seen by both the other Roll of Honour providers, scores were good and there appears to have been a successful effort made to deliver the kind of execution performance this client group is looking for. The range of scores was quite narrow compared with some other questions within the survey and one implication of that is the difficulty in establishing competitive differentiation.

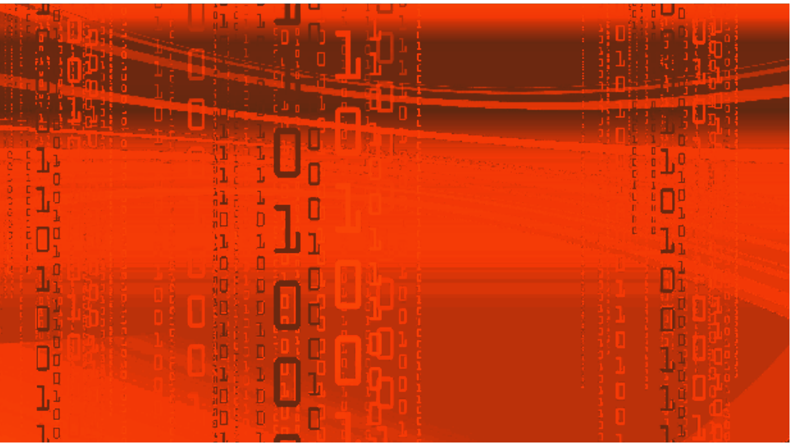
DARK POOL ACCESS

ROLL OF HONOUR

Instinet
ITG
Sanford C Bernstein

As markets around the world have fragmented, dark pools have become a key part of the algorithmic trading process. In a number of cases, major brokers have set up their own dark pools, while others are operated independently. Each has its own unique characteristics; both strengths and weaknesses. The ways in which broker algorithms access these pools is an important source of competitive differentiation. The conflicts between open access, competitive differentiation and possible concerns of 'gaming' make this an area of growing relevance. As a result, 2014 saw inclusion of

Broker Roll of Honour: long-only firms



coverage of this area for the first time, with interesting results.

What was clear from the survey among all clients was the generally high level of scores achieved. The average score was a very respectable 5.61 with an identical score seen across long-only clients. In the latter case this represented the third highest score among the 14 questions. No doubt to some extent this reflects the fact that algorithms are the only way to access dark pools in a meaningful way. But the level of scores suggests they are happy with the way that the process works, not simply that it exists.

None of the Roll of Honour names is a bulge bracket firm operating its own dark pool. It would appear that clients value openness where dark pool ownership is in place and wide access where the broker is not operating its own capability. The extent to which this approach becomes the norm or is gradually displaced by the large broker controlled pools remains a question for future years.

PRICE IMPROVEMENT

ROLL OF HONOUR

Citi
Credit Suisse
UBS

The area of price improvement remains one that is fraught with difficulty from an evaluation perspective. Of course all providers want to demonstrate that the execution prices achieved using their algorithms represent a better outcome than that achieved either by competitor algorithms or by non-algorithmic trading. However, proving this outcome is hard, not least since there is no way to conduct a 'control' experiment.

The gap between marketing rhetoric and proven delivery appears to be something of a concern for all parties involved. Within the survey, this question saw a weighted average score of 5.34. Among long-only clients the average score was slightly better at 5.39. These scores were a definite improvement over 2013 (5.13). Even so, scores for the question were second lowest among 14 questions within the survey as a whole.

The Roll of Honour names reflect providers who enjoy a large measure of support among long-only clients in terms of response numbers. By virtue of widespread activity and longstanding relationships, these firms appear to have been able to better satisfy their clients that algorithms really do deliver. The range of scores among major long-only clients was quite large (nearly 20%), perhaps reflecting difficulties in showing quantifiable performance gains. The positioning of the question around the mid-range in terms of importance may also reflect the same issues.

SMART ORDER ROUTING CAPABILITIES

ROLL OF HONOUR

Bank of America Merrill Lynch
J.P. Morgan
Morgan Stanley

The proliferation of dark pools has highlighted the need for algorithm providers to develop effective and sophisticated smart order routing capabilities. These ensure that trades are sent to the venue most likely to achieve an execution. They also have to reflect the fact that certain venues may be precluded by client preference. So flexibility is a consideration for users as well as sophistication. Flexibility is easier for users to assess, and scores for this question may reflect this. We will be monitoring the development within the survey over the coming years to see to what extent views and evaluations change.

For 2014, the question recorded generally satisfactory scores among all respondents. The average score of 5.55 was the same for long-only clients as well as across the survey overall. That level of scoring placed the question in the third quartile across the questions asked. Such a level of performance is perhaps to be expected in an area that is new and a basis for evaluation may not be easy to establish for some clients.

The difference in scoring between best and worst among the major providers was around 16%. Again this is around the average in the context of the whole 2014 survey. The Roll of Honour names achieved good scores but as noted above levels were not as high as those seen in some other aspects covered in the survey.

EASE OF USE

ROLL OF HONOUR

Citi
Deutsche Bank
ITG

For the second year in succession Citi achieved Roll of Honour mention. This year long-only clients added Deutsche Bank, moving up from last year's 'one to watch' rating, and ITG to the Roll of Honour. They replaced Bank of America Merrill Lynch and Goldman Sachs from the overall results in 2013.

Among factors that indirectly impact on costs, ease of use is important. If clients find systems hard to use, the gains in operational efficiency will be less noticeable. While these areas generally are not as important as elements that have a direct impact on execution performance, few clients ignore them completely. Ease of Use was the third most important factor for long-only clients, mentioned by 45% of respondents as an important element in their assessment of capabilities. It achieved a similar ranking across all respondents and was mentioned more frequently in 2014 than in 2013.

It should be encouraging to providers that the average level of scoring was the highest in the survey overall and among long-only clients. The score of 5.81 in the survey was fully 0.40 points higher than the 2013 score. The lowest average score among all major providers was above 5.50 and the range of scoring was relatively narrow. It would appear that everyone has recognised a need to improve in this area and has responded effectively. Growing maturity among users probably helps explain part of the performance in that familiarity will help people become comfortable with using the systems and capabilities provided. In spite of this and the fact that scoring in this area is necessarily largely subjective, the performance among all providers is excellent.

CROSSING

ROLL OF HONOUR

Bank of America Merrill Lynch
J.P. Morgan
Liquidnet

The importance of internal crossing has increased in 2014 compared with last year's survey. It achieved 10% of mentions across all respondents, up from 9.0% in 2013. With long-only clients conscious of the beneficial effects internal crossing can have on anonymity and market impact, its importance among this group was even higher. In addition commission savings can have a direct impact on the costs of doing business.

It is interesting to note that both Bank of America Merrill Lynch and Liquidnet featured as 'ones to watch' in 2013 and in 2014 have moved into the Roll of Honour. They are joined by J.P. Morgan, a firm which generally performed more strongly within the long-only client group than across the overall survey in 2013. Liquidnet also has a long history of developing services for traditional long-only managers.

Scores generally in this area were adequate but not distinguished. The

Broker Roll of Honour: long-only firms

weighted average among all respondents was 5.45, a gain of 0.34 points from 2013. This is better than the average gain across the survey. However the question still ranked only 11th out of the 14 questions asked. Scores were marginally higher among long-only clients where the average was 5.49 and the ranking among questions identical.

TRADER PRODUCTIVITY

ROLL OF HONOUR

Bloomberg Tradebook
Credit Suisse
Morgan Stanley

For the first time in four years, trader productivity was not among the top three most important aspects of service mentioned by respondents. With 11.2% of total mentions and 11.4% among long-only clients, it remains very relevant, but its decline is interesting. Clients are increasingly familiar with how to use algorithms as a productivity tool; the big gains have been made and in future are likely to come from improving ease of use (where scores did well, see above). Respondents now seem more interested in how algorithms perform as measured through execution quality.

Scores were strong in 2014. The weighted average across the survey was 5.62, comfortably ahead of the 5.48 returned a year ago. However, with other questions performing better, trader productivity fell down to equal fourth among all questions, compared to first in 2013. The range of scores among all major providers was very narrow. The difference between best and worst was 0.70 points or less than 13%. Only two questions saw a closer scoring range.

Among the Roll of Honour names, Morgan Stanley repeated their position from 2013 with long-only clients in 2014. Bloomberg Tradebook and Credit Suisse replaced Deutsche and Instinet from a year ago. With all providers scoring well it is difficult to translate good performance into sustainable competitive advantage. Trader productivity may be seen as a 'given' in terms of its integral role in the greater use of algorithms. As such it is a necessary but not sufficient element through which to win business.

COSTS AND COMMISSIONS

ROLL OF HONOUR

Goldman Sachs
J.P. Morgan
UBS

With overall commissions under constant downward pressure, algorithmic trading is seen as a key part of an overall commission management process by many buy-side firms, especially among long-only clients. However, commissions are not the only cost incurred by buy-side traders when using algorithms, simply the most obvious. The cost of implementing and maintaining the relevant technology can be significant, not to mention integrating systems internally. Some of these costs are covered by brokers, but that avenue is less widely available than it was and those costs are anyway recovered by brokers one way or another.

In many surveys, costs are regularly among the lowest scoring, not least because clients never want to be seen as being happy with the price they pay. That has never been the case in algorithmic trading. This no doubt reflects the fact that commissions and other costs are lower than alternatives and the indirect benefits are tangible if sometimes hard to quantify with precision. As a result clients are indeed generally happy with costs. The average scores seen in 2014 reflect this. All clients scored costs at an average of 5.60, up from 5.38 in 2013. Long-only respondent scores were marginally lower and in both cases the question was ranked around halfway among the areas surveyed.

Roll of Honour nominees are sometime ambivalent about winning in this category. However it is all about the total cost of ownership, not simply explicit fees. On that basis, all banks seem to do well. The range of scores at 0.58 points across major providers was the lowest among all 14 questions and represented a difference of 11.2%.

Broker Roll of Honour: long-only firms

CUSTOMER SUPPORT

ROLL OF HONOUR
Bloomberg Tradebook
Deutsche Bank
Morgan Stanley

Part of the financial appeal to providers of algorithmic trading services is that once installed clients should be able to trade without being in direct contact with their broker. However, technology is not 'foolproof' and contact has an important role to play in developing good working relationships over time. Providers have therefore recognised that customer support, whether technical, trading or operational in nature, cannot be avoided and should be embraced.

What is clear from the scoring is that providers are indeed embracing this challenge, and doing so very effectively. The average score in the survey was 5.77 and among long-only clients 5.70. In both cases the question ranked second among the 14 covered. There were virtually no scores of less than 4.0 (satisfactory) and a high proportion of 7.0 (excellent scores) received by many providers. Comments from clients were also generally positive, particularly about the individuals involved. Some negative feedback related to some technical response and support services but even these were rare. As a result, the range of scoring on this question was narrow. The difference of 14.4% between the highest and lowest scoring providers was among the smallest in the survey.

Without any comparison from 2013 it is hard to tell whether the Roll of Honour names have always done well in this area or whether improvements have been seen. Bloomberg as an institution enjoys a good reputation for service and both Morgan Stanley and Deutsche Bank are well respected and experienced providers of algorithmic services.

ANONYMITY

ROLL OF HONOUR
Citi
Credit Suisse
Instinet

For long-only clients in particular, the ability of algorithms to protect the anonymity of trading is an important feature and benefit. In the early days, stories of gaming were common enough to cause concern. While these are less frequent now, the role of high-frequency trading and the risk of dark pool gaming still raise issues from time to time among traditional buy-side traders. While not necessarily a direct impact on reduced market impact and costs, anonymity incorporates other less tangible savings.

One great difficulty in evaluating the ability of algorithms to preserve anonymity is the fact that it is only really noticeable when they fail in this task. As a result, scores should be good unless 'bad things' have happened to a particular order. Such events will likely be anecdotal rather than regular not least because regular under-performance would jeopardise business.

The fact that the scores are generally good should not be a surprise. The average across the survey was 5.65. For long-only clients the level of 5.59 was very similar. In each case, scores ranked in the top quartile among the questions. However the range of scoring was relatively wide with a difference of more than 20% between the best and worst of the major providers.

All Roll of Honour names are new this year. This may in part be explained by our focus on long-only clients in this quarter, but also reflects the fact that the area is one that is difficult to evaluate in an easily quantifiable way.

SPEED AND LATENCY

ROLL OF HONOUR
Bank of America Merrill Lynch
Barclays
UBS

UBS once again achieved Roll of Honour status in this area. The firm was joined this year by Barclays, which was among the 'ones to watch' in 2013, and Bank of America Merrill Lynch. As in other qualitative areas, assessment of latency is notoriously difficult. In terms of speed of execution, users in many cases control the process through the settings they choose. Flexibility in adjusting speed in response to changing market conditions is important in making sure execution performance meets expectations.

It is interesting to note that speed and latency derived slightly more mentions from long-only clients than across the survey as a whole (6.4% of total mentions against 6.1%). It is also the case that the proportion of mentions did increase

Broker Roll of Honour: long-only firms

slightly this year, maintaining a trend. However relative to other aspects of service it remains fairly unimportant as a consideration, leaving limited scope for competitive differentiation.

Scores among long-only clients were quite narrowly spread. Only cost and commissions had a narrower differential between best and worst, which for speed was just under 12%. Scores overall were good, ranking fifth equal out of 14 with 5.62. The 5.60 recorded by long-only clients was a little stronger but not in a statistically meaningful way.

CUSTOMISATION

ROLL OF HONOUR

ITG
Morgan Stanley
UBS

Among long-only clients, customisation rated 7.2% of total mentions in terms of areas of importance. This was higher than the figure of 6.4% across all respondents but still low and declining. As long-only clients in particular integrate into their own systems and become more familiar with capabilities, interest in customisation seems to become less important. This is good news for providers in terms of reducing the ongoing levels of investment they need to make for individual clients. However it also limits scope for distancing themselves from their competition.

2013 saw scores in this area fall quite dramatically, but 2014 saw a solid pick-up, albeit from a low base. The long-only average score was 5.35, while across the survey scores improved by 0.37 points to 5.39. Even so, scores were among the three lowest covered by the survey. This suggests that respondents still see scope for improvement among some providers. The range of scores was also among the most pronounced. The best providers saw average scores almost 25% better than the worst.

Against this background, it is worth noting that UBS achieved Roll of Honour status to repeat its position in 2013. ITG moved up from the 'ones to watch' category to a position in the Roll of Honour. They were joined by Morgan Stanley whose performance with long-only clients was particularly strong.

EXECUTION CONSULTING AND ANALYTICS

ROLL OF HONOUR

Bank of America Merrill Lynch
Citi
ITG

In previous years, the survey question focused on the quality of pre-trade cost estimation. This remains a factor in looking at the broader capabilities of execution consulting services, but the latter involves a wide array of cost analysis tools as well as detailed reviews of performance of individual trades using specific algorithms in particular ways. The goal of execution consulting is to enable providers to help customers optimise their use of the tools being made available. It has the added benefit of giving providers the opportunity to present the strengths of their algorithmic trading suite. However provision of such a service is not cheap, involving as it does much data analysis and professional expertise.

In view of the change to the question this year, any comparison with the Roll of Honour in 2013 is not especially relevant. However ITG did repeat its Roll of Honour position, while Citi and Bank of America Merrill Lynch also scored well.

Perhaps reflecting the specialised nature of the service, scores were quite widely dispersed. The range between best and worst scores among major providers was more than 20%. Scores were also disappointing overall. The average of 5.28 was the lowest of all questions in the survey. Long-only clients gave slightly higher scores (5.33) in contrast to most other questions where scores were lower. Even here however scores on this question were lower than any other. Clearly work remains to be done in aligning client perceptions with what providers regard as an important part of their service. It may take some time for it to gain complete acceptance among users, but the effort, especially by the Roll of Honour names and some others, seems likely to be worthwhile.

Ones to watch

In previous years, The TRADE's Algorithmic Trading Survey has highlighted names to watch in each category of service. With the greater number of questions in this year's survey and the presentational split between long-only respondents and hedge funds, continuing previous practice would have risked dilution of the value of the Roll of Honour mentions.

As a result, and following the example of the awards presented by The TRADE each year, Ones to Watch have been divided into two simple categories. First are those firms that seem, based on response numbers, to be winning clients. Second are those that, based on scores achieved, appear to be highly regarded by the clients that they have.

RESPONSE NUMBERS

ROLL OF HONOUR

- Jefferies
- RBC Capital Markets
- Société Générale

Clearly there are providers of algorithmic trading services who may not see the totality of their business reflected in survey responses. Some clients simply do not choose to respond and others are prevented by internal policies or procedures. As such it is difficult to assess whether a growing but still relatively small number of responses, reflects a growing business or merely a higher participation level across a static client base.

In any event, based on responses received this year and comparisons with prior years it seems relevant that the survey should seek to recognise institutions who appear to be successful in the marketplace but who have not generated responses from a sufficiently broad base of clients to qualify for Roll of Honour status outside the 'ones to watch' category. In that context, the three names listed are very much ones to watch, whether by the competition or by clients looking to expand their algorithmic broker list.

CLIENT SCORES

ROLL OF HONOUR

- Fidelity
- Jefferies
- Weeden

While fewer responses does not necessarily mean fewer clients, there is a clear correlation in the survey between the number of responses received and market presence. Having a smaller number of clients does not always make service delivery easier, but it can help, particularly if clients are concentrated in more specific regions or type of business.

The Roll of Honour names here did achieve scores in a number of categories that were similar to those seen by the best providers. However they did so across a smaller number of respondents. Hence their inclusion in a 'ones to watch' Roll of Honour. If scores are maintained and client response numbers grow, then they will doubtless feature in the Roll of Honour in one or more categories in future years.

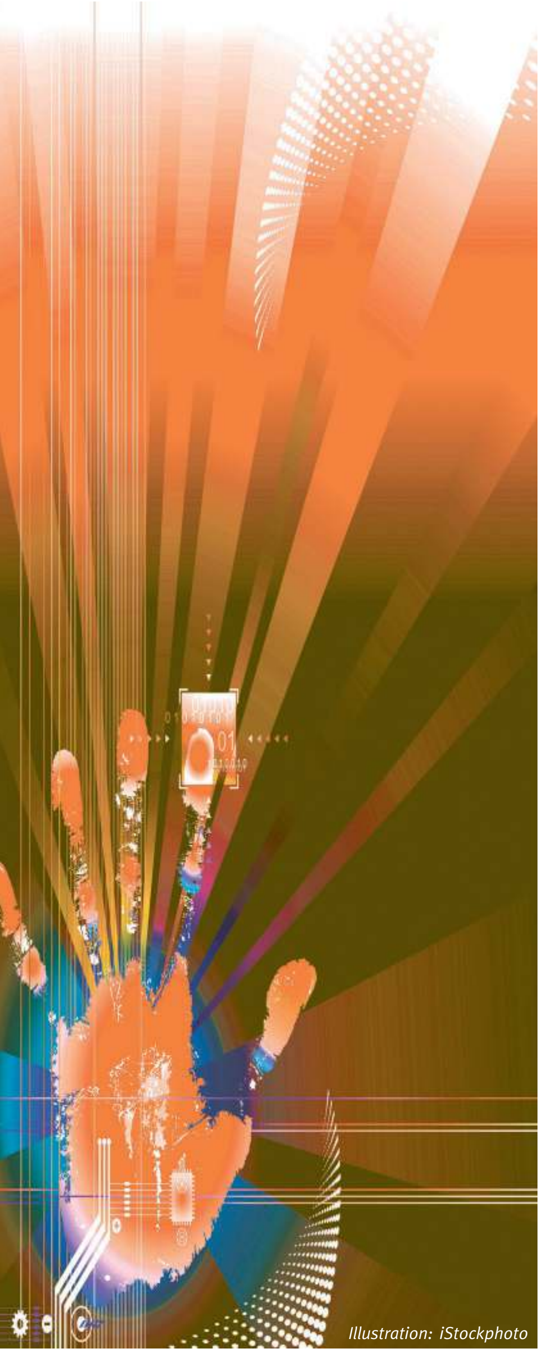


Illustration: iStockphoto

A stability and growth pact for algos

Helped by comparatively benign market conditions, growing buy-side sophistication is driving competition and innovation among brokers.

The evolution of algorithmic trading from a niche technological innovation to a major execution channel for cash equities over the past decade has created new challenges for brokers as their clients – notably institutional investors – have become far more sophisticated and demanding in their use of algorithms.

The increased satisfaction with the performance of algorithms that is evident from the results of this year's Algorithmic Trading Survey is a positive sign that brokers are delivering a good quality of service, and participants believe the market is in good shape as brokers have succeeded in evolving their offerings to meet the changing needs of clients.

"Algorithmic trading went through an innovation stage when brokers were coming out with really new products and then investment flattened off and buy-side demand for new products declined. What we have seen more recently is increased demand for customisation of algorithms, which should lead to increased satisfaction," says Mark Goodman, head of quantitative electronic services for Europe at Société Générale Corporate & Investment Banking.

Balancing act

Delivering the right level of functionality is a fine balancing act for brokers. It requires them to tailor their technology to meet the specific needs of individual clients while also maintaining ease of use. Goldman Sachs, for example, has invested heavily in its 1Click suite of products over the past year with those two priorities in mind.

"A major challenge for brokers is that clients always want a tool that is simple to use, but they often want a lot of control as well. We have seen a big pick-up in clients using 1Click, which is a very simple-to-use suite of algorithms but has a great deal of complexity embedded within it," says Michael Seigne, co-head of EMEA electronic trading at Goldman Sachs.

Meanwhile Exane BNP Paribas is on the point of launching a new algorithmic product, having invested considerable resources in its development. Antoine Bisson, head of execution, joined the firm last year from Deutsche Bank and echoes the view of other brokers that customisation is the key to success in current market conditions.

"Transparency and the need for the buy-side to take increasing control of orders was a top priority as we developed our new algorithmic product. With transparency comes the ability to better measure execution quality and that drives greater demand for customisation. That customisation eventually leads to increased satisfaction as the algorithms can do what the traders want," says Bisson.

Picking partners

The positive report card in this year's survey might appear to be good news for brokers, but as buy-side firms continue to fine-tune the way in which they use algorithms, the field is becoming more competitive and brokers have to work harder to retain business. "Buy-side firms are generally well past the stage of using large numbers of providers and are now much more selective, but they still won't typically use a single provider as a catch-all for everything they do," explains SocGen's Goodman.

The move to use fewer providers is less prevalent among long-only firms than hedge funds that might typically concentrate on just one or two brokers, adds Owain Self, global head of algorithmic trading at UBS. "We have seen clients become more particular in fine-tuning their use of algorithms, whether that means trimming down the number of providers they use or only using certain algorithms or certain providers that they have found to work well with their strategy."

As to where demand for innovation in algorithmic execution originates, Self believes the most significant

"The dark pools that give you a large number of fills don't necessarily have the best reversion profile or prices."

Thomas Bourgeois, head of electronic trading, Exane BNP Paribas

growth is coming mainly from quantitative and systematic funds that trade predominantly electronically, while use of algorithms among long-only asset managers has plateaued and even declined in some cases over the past year.

But that is not a view that is shared universally. Duncan Higgins, head of electronic sales in EMEA at agency broker ITG, still sees more significant flow from traditional asset managers. "Generally long-only institutions are

Market feedback: long-only firms

"Clients always want a tool that is simple to use, but they often want a lot of control as well."

Michael Seigne, co-head of EMEA electronic trading, Goldman Sachs

"Asset managers are much more focused on liquidity-seeking algorithms that allow them to access the market more dynamically."

Owain Self, global head of algorithmic trading, UBS

using algorithms for a greater proportion of their business than hedge funds and have been doing so for longer. Hedge funds tend to use a smaller number of providers for a smaller part of their business but that will change as they become more comfortable with algorithms."

Different strokes

Whether or not the demand for algorithms from quantitative hedge funds will in time outstrip that of traditional asset managers, brokers must cater for the needs of both client types to remain competitive. That means offering a broad range of tools, of varying levels of sophistication.

"The more systematic quantitative funds or index funds are still predominantly using VWAP because they want to control the market impact of their trades and speed of execution in a very defined way. More traditional hedge funds and asset managers are much more focused on liquidity-seeking algorithms that allow them to access the market more dynamically," says UBS's Self.

That observation tallies with the survey results, which found the sharpest rise in usage was attached to dark liquidity seeking algorithms, while reported use of both VWAP and TWAP decreased year-on-year. But some brokers still see significant demand for VWAP.

"TWAP has never been a very popular algorithm; it is generally used by people who are slicing an order against another instrument or basket that has a

"Clients are continuing to make greater use of dark-liquidity-seeking technology."

Duncan Higgins, head of electronic sales, EMEA, ITG

different volume profile. We still see the most value traded on VWAP because it fulfils a range of purposes, but liquidity-seeking algorithms have seen the highest increase in usage as clients look to effectively source liquidity from a fragmented market," says Rob Crane, co-head of EMEA electronic trading at Goldman Sachs.

While the advent of MiFID II will herald changes to the way in which dark liquidity is accessed, the value of executing in dark pools – where the intention to trade is not revealed to the market – has not changed in recent years. In fact as participation in dark pools has increased, there is better liquidity available, which in turn attracts more participants, fuelling a "virtuous circle", says ITG's Higgins.

"We have seen consistently over the past few years that traders want to have their problems solved for them. If they deal with a number of different broker dark pools, for example, they want a tool that is going to manage that process for them. Clients are continuing to make greater use of dark-liquidity-seeking technology," he says.

Staying in the dark?

But in interacting with dark liquidity, the buy-side is increasingly differentiating between quality and quantity of liquidity, and algorithms need to recognise that, warns Thomas Bourgeois, head of electronic trading at Exane BNP Paribas.

"There are dark pools that will give you a large number of fills but not necessarily the best reversion profile or prices. Firms are paying increasing attention to what happens after the trade and they will be more aware of who they are facing in certain dark pools," he says.

One reason for the uptick in use of dark-liquidity-seeking algorithms could be the lower volatility that pervaded much of the equity market in 2013, making dark liquidity more attractive.

"We sometimes see an inverse correlation between volatility and dark usage – in more benign environments, people will be willing to wait longer to find the right liquidity. So we do see that in a passive environment some firms will leave a larger part of the order in the dark for longer," says SocGen's Goodman.

Seigne of Goldman Sachs agrees, adding that a less volatile market encourages participants to experiment with new strategies and algorithms. "As the market gets more volatile, execution strategies tend to become very polarised, with users either trying to get everything done as quickly as they can close to arrival price or trying to achieve a result closer to the average price over time. As volatility declines, traders are more patient and take more market risk, which leads to them using a greater variety of products."