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THE FINANCE HIVE LIVE

Singapore Global FX Meeting

Singapore
September 2017

Summary of the day..

We were delighted to welcome so many senior Buy Side professionals to our first Finance Hive Live meeting in Singapore, which was chaired by David Clark, Chairman of The Wholesale Markets Broker's Association.

This report details summaries of the 7 roundtable discussions which focused on the key issues affecting FX today:

1. Algos & Technology for the Buy Side (State Street).
2. New FX Platforms (Currenex & FX Connect).
3. Emerging Markets of Russia & China (Moscow Exchange).
4. Geo-Politics (Prof. Gunter Dufey).
5. Regulation (WMBA).
6. Market Structure (Via FX).
7. Currency as an Asset Class (Hunter Burton Capital).

With thanks to all who participated, our friends and partners (Currenex, FX Connect, Moex, State Street and Via FX) and we look forward to seeing you at our next Finance Hive Live: Global FX meeting in London on 5th December 2017. For more information please contact Julie or any of the Hive team.

Warm Regards

Noj, Sally and Julie.

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Thank you to our partners:

1

ALGOS & TECHNOLOGY FOR THE BUY SIDE

State Street

"The more dynamic the market the harder to have robot learning and for AI to make contributions."
"Adoption of Blockchain technology is some way off; no evidence of being used."

Artificial Intelligence (AI)
The overall conclusion was that there is a place for AI in trading Algos however the challenge is increasing the value of AI in the dynamic environment of the financial markets.

AI works well in a structured situation such as the game 'GO' where it can beat humans. Areas such news learning (e.g. Bloomberg) can be utilised into Algo trading and AI will become more useful over time. Furthermore Algos can run in the background rather than having to focus on execution. This leaves that time to be more productive, with a clear focus on revenue production. However in more dynamic environments such as markets AI is much more challenged.

One downside of AI based Algos is it's hard to explain 'black box' returns. This is OK where the returns are positive but Investors do not take kindly to negative returns that can't be explained!

Flash Crash and Liquidity
There was general concern of Algos part in flash crashes and general reduction in liquidity. The fact is regulations have made Banks more accountable to present their electronic trading models/controls to regulators such as FED and FSA. As the controls are similar, i.e. reduce liquidity, widen prices and stop pricing in times of stress, as a whole it creates a systemic risk to the FX market.

There has been a move away from aggregator type platforms with many LP's in some cases, single bank platforms and fewer LP's who provide deep liquidity, less information leakage and less trade footprint.

Regards volumes on electronic trading: is it still growing? Current figures put electronic trading at 70-80%. However one hedge fund has put it back to 25% as they have found liquidity, pricing, info leakage has been impacted.

Platforms
There were questions about what is the right trading platform where we discussed, criteria for choosing a platform and measuring the quality of liquidity provided by an LP. Participants, looked a bit disappointed that the onus of selecting platforms and LPs is on them and that it is a complex process that very much depends on the buy side business model e.g. Nestle and BlackRock have very different needs.

Bank vs Non-bank Liquidity
There was a debate over how has this affected liquidity and a general agreement that distinction between Bank / Non-bank would be better described as Liquidity provider vs agent, identifying who warehouses risk and who doesn't Some banks act as agents, whilst some non-banks act as true liquidity providers i.e. taking risk and internalizing flow.

2

NEW FX PLATFORMS

Currenex & FX Connect

“Platforms are now required to provide ever increasing degrees of sophistication.”
“The need for increased transparency creates problems for TCA and ‘Best Execution.”

In a post MiFIDII world there is no ‘one size fits all’ for a platform
Platforms are required to support a complex web of relationships between EU and non-EU legal entities and therefore the requirement for flexibility, is vital as a platform provider.

From a legal entity perspective, there are three different requirements for platform providers in order to satisfy customer demand for best execution globally in all regulatory jurisdictions:

1. As a legal entity under Dodd-Frank.
2. As a legal entity under MiFIDII.
3. As a legal entity under neither of these regimes.

Under MiFIDII there is an intention and drive for more electronification and more transparency, yet this does increase conflict around TCA and best execution particularly as there is no clear definition or clear practices about exactly what constitutes ‘best execution’.

What is clear is that doing any amount of TCA exposes any issues one has with liquidity which then requires more management of liquidity providers by the Buy Side and the need for more innovative ways to execute their FX requirements.

In summary there is no doubt that the world is becoming more complicated and therefore requires platforms to provide ever increasing degrees of sophistication in terms on how FX execution is delivered whether handling Algo, RFQ or CLOB execution. This also highlights how regulation has a significant role to play in driving innovation in this respect.

“*Exceptional format that really encourages serious peer-to-peer networking and candid discussion regarding subjects to participants.*”

3 EMERGING MARKETS OF RUSSIA & CHINA

Moscow Exchange

"Why are some people fearful of the sanctions without knowing what they were?"

Russia
A significant amount of time was spent allaying people's fear about Russia and breaking down misconceptions regards Russia and the Russian market. By confirming that the Russian Rouble is free floating and there is provision of access to Russia provided real understanding and knowledge transfer to demonstrate that Russia is a safe marketplace and safe marketplace to trade, regardless of the geo-politics.

Many Buy Side traders who actively trade RUB gave examples of how it is easy to trade and access the market and, importantly how profitable it is to trade the market.

Russia has a real interest rate of 3% and despite sanctions, there are many USA banks and clients investing in Government bonds and the Russian market. Russia has a stable infrastructure which provides settlement and good liquidity. During the crisis of December 2014/ January 2015, Russia was a hugely popular market for settlement.

"Lots of evidence on how active China is in the RMB marketplace."

China
There is significant evidence that confidence behind the RMB is growing and clearly China aims to strengthen and globalise the currency, demonstrated by the Central Bank's intervention over the summer and the fact that Chinese companies are making more RMB-dominated investments overseas to increase the international usage of RMB.

Concern remains over how long-term the RMB's growth will be considering the changing geo-political landscape as well as compliance and regulatory obstacles regards making payments in RMB. That being said, the RMB certainly leads the way in terms of Asian currencies, particularly given China's dominant position in the Global Commodities market.

"*Well done on such an innovative format of organising an event - definitely a breath of fresh air!*"

4

GEO-POLITICS

Prof. Gunter Dufey, Chairman CFO Forum, IMA Asia & Management Consultant

"This was a highly revealing discussion, why have the markets not reacted more to the battery of risks such as North Korea?"
"Europe, for the time being is in decent shape. Political issues have dissipated on the continent & extreme parties are playing no significant role."

The discussion stated with a puzzle: why are financial markets reacting so calmly in the face of considerable geo-political risks?
Regarding Asia, participants agreed that the markets were probably too sanguine on the North Korea situation. Either there may be a consensus that the risk of escalation is low, or alternatively, that the potential risk is so big that everybody is discounting it. Bottom-line: some geo-political risks are hard to price as 'binary events'.

China will obviously play a decisive role in managing the conflict. The longer term outlook for the country dependent on its ability to manage the rapid rise of debt and its ability to reform an SOE sector that still comprises 40% plus of the economy. This will require deep political reforms as the Communist Party now controls all appointments and policies in that sector.

Regarding the county's international ambitions, there was consensus that China will not be ready for global leadership. For one, China has very little 'soft power', and the RMB will take a long time to make an impact on the international use of currencies as it is currently not-convertible, will have a reputation of control risk, and is in the wrong time zone. It will be difficult to pinpoint characteristics that make the RMB the preferred transaction currency, relative to the USD and the EUR for transactions outside of China.

Turning to the US, and associated protectionist tendencies for world trade: the consensus of the group emerged that real dangers to the intl trade system can be discounted, largely because of the disconnect between Trump rhetoric and the reality of the US President's powers being quite limited within the very stable US political system of 'checks and balances'. The US economy currently is going very strong with labour shortages emerging in many sectors.

Another positive aspect of the geo-political environment was Europe, where even the Southern countries show strong recoveries, while populist parties have not gone anywhere on the Continent. Thus, another positive factor for financial markets.

"
100% worth attending! Highly engaging and interactive discussions.
"

5

REGULATION

David Clark - Chairman, WMBA

"It is the complexity of MiFID II, which means in 4 months' time, people won't be prepared"
"General agreement that Basel III has had the biggest regulatory impact since the financial crisis."

The major focus of attention was on MiFID II which is proving to be problematic for buy side firms as well as many banks. It was clear that a majority of firms were not prepared for MiFID II and were not sure whether they would have LEIs in place before January 2 or whether their banks would be in a position to help them.

If internal capacity is not sufficient, then many would look for ways to trade outside the EU and create a non-EU business model which would cause worry that they would not be able to hedge positions effectively.

Delegates generally felt that MiFID was too complex and that there were still too many issues not decided by ESMA or NCAs.

Delegates were aware of the Global Code of Conduct (GCC) but were not sure how to demonstrate compliance with it or what the expectations of their counterparties would be.

Several had already started internal implementation and some would appreciate there being suitable courses or CPD possibilities to be able to roll the GCC out with trading personnel. There was widespread approval of the objectives of the GCC but delegates were not sure how far it reached into their own business models e.g. would a statement of commitment to the GCC be required?

Generally, it was thought that the changes in regulation since the financial crisis had been essential but that many of the more granular changes had gone too far and were too expensive to put in place. There was agreement that the changes in the Basel prudential capital and liquidity ratios were more important than changes in regulation. The question now is can Asia learn the lessons from the US and EU, when it comes to regulation, and avoid their mistakes?

> *Great stage for peer interactive and intelligent discussion and debates.*

6

MARKET STRUCTURE

Via FX

"Electronification of the market means there is better liquidity"
"Minor currencies and those trading 'out of hours have benefited from eFX'
"Keep upgrading and managing your modes dynamically to adjust to the market"
"Is Hybrid liquidity provision the way forward, particularly if facing a crisis?"

"This has been the most effective networking event I have ever attended."

eFX

The amount of platforms and options has made the market more efficient, but to a certain point. Where it was 5s, then 10s, now up to 20mio approximately eFX platforms are the more often than not the best source of liquidity, above that amount they occasionally struggle, and then the voice option kicks in.

Shifting large risk via voice remains the preferred/most reliable method and consensus was one voice option per large flow, no clear advantage giving pieces to different shops even if 500mio/1bio and beyond.

Electronification of the marketplace is at the saturation level. Most platform offerings are almost identical, with the same Liquidity Providers streaming prices across most portals anyway. Recycled liquidity galore.

Windows on when to Execute

A big theme during this discussion was windows on when to execute; it was accepted that a lot of crosses were simply more liquid when Asia was asleep or not in the office USDKRW, USDIDR, USDCNH etc. A large part of this owing to London end of day benchmarking as well as bigger market participants being active in UK/North America hours thus more liquidity.

Benchmarking

It was understood that benchmarking was a necessary evil. The WMR Fixing scandals hurt the market, but there was a consensus they are not going anywhere, potentially growing stronger in due course. Benchmarking initiatives like Working Groups, Committees, MiFID II, all the regulatory attention making the benchmarks more attractive in the medium to long term.

Cryptocurrencies

The consensus was they're not going to get much more momentum in the actual use/ transacting but, Blockchain & Distributed/ Shared Ledgers are the future of data/ record keeping in financial services. This was unanimous - all firms regardless of Fund or Bank will be using Distributed/Shared Ledgers in the very near future.

7

CURRENCY AS AN ASSET CLASS

David Campbell - MD, Hunter Burton Capital

"Currency is its own asset class and still has a lot of benefits."
"There is definite potential for alpha returns from Currency."

To truly understand currency as a stand-alone asset class it is important to distinguish currency from foreign exchange. In a nutshell FX is just the mechanism we use to invest in currency as it is the mechanism to hedge risk from commerce or investing in other assets such as equities, bonds or property.

The currency market is the largest in the world and offers deep liquidity, operating 24 hours a day 5 days a week. There is a need to increase education among investors that currency can operate as a stand alone business.

Positive returns are achievable through currency, but very dependent on the quality of the manager as it is pure alpha in nature, it is uncorrelated to other asset classes and thus is a great alternative asset to provide diversity to a portfolio.

Returns are generated principally through 3 main strategies - carry trades, momentum trades and relative value trades.

In summary, currency as a stand-alone investment can be valuable, but important to consider its use as a way to achieve potential diversification gains.

> *"Excellent opportunity to have genuine discussion with buy-side peers about challenges and opportunities in the FX market."*

Future Hive Live Meetings...

Finance Hive Live: London Global FX

December 5, 2017

This is the only meeting created by and designed for fully engaged senior buy side professionals and focuses on topics of common interest from shifting market structure, TCA and best execution to algos, non-bank market makers, accessing new liquidity and Emerging Markets.

Finance Hive Live: London Buy Side Fixed-Income

March 21, 2018

The Fixed Income meeting in London is part of a series of Buy Side-to-Buy Side forums created to foster dialogue and collaboration among the Buy Side in response to rapidly evolving market conditions.

Finance Hive Live: USA Private Liquidity & Market Structure

May 3, 2018

Held in Boston with 150 leading Finance professionals meeting to discuss the evolution of the FX market structure and financial technology.

For more information on any of these meetings or to become a member of The Finance Hive please contact
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