

BondWave 2019 Fixed Income Industry Outlook

The intersection of data science, regulation and market consolidation

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A confluence of factors combined during the past year, which together fueled the expansion of the fixed income industry in 2018. Among the most important of these were; rising interest rates; regulatory-driven market structural changes; improved access to data; application of quantitative methods to bond trading; and advances in technology. The catalyst for this growth was the industry's growing need for greater operating efficiencies in a period of shrinking margins.

A key driver for the fixed income industry's evolution in 2018 was the implementation of the Retail Mark-up Disclosure Rule in May. This coordinated approach by the MSRB and FINRA required the application of the Prevailing Market Price (PMP) Waterfall process to fixed income securities for specified trades with retail investors. Navigating the new regulatory requirements proved to be no small undertaking, leading many firms to seek third-party technology solutions to ease these new compliance requirements. Other firms chose to 'go at it alone' or migrate their retail fixed income business to an All-Agency model, moving away from principal trading with customers to executing with customers only "As Agent" which requires disclosure of sales commissions, without the need to calculate any PMPs. These newly developed measurements led some market participants to further leverage their data through quantitative analytics resulting in additional applications of these calculations. By driving deeper insights through the use of technology and data mining, market participants have recognized the importance and value of data across the fixed income landscape. Additionally, recent consolidations across parts of the industry have focused on one core theme: the value of the DATA.

THE TRENDS SHAPING 2019

Over the past year, we have seen the rapid evolution of the fixed income market through advancements in technology, regulation and industry consolidation. Not only will 2019 usher in continued growth, but it has the potential to be a critical turning point for the future structure of the fixed income industry.



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ARTIFICIAL INTELLIGENCE, MACHINE LEARNING AND DATA SCIENCE

Unbeholden to any one industry, the current power of machine learning (ML) and artificial intelligence (AI) stretches across all major sectors and markets. Whether it's an order on Amazon, IBM's Watson analyzing securities or an advisor harnessing the latest financial analytics platform to better analyze the market, ML and AI are here, and it has only just begun. A growing and powerful trend within artificial intelligence is its application and use across the fixed income industry's middle and back office. Bond traders and investors are just now beginning to apply these powerful new tools to help the entire fixed income landscape leap forward.

The desire for transparency and innovation in fixed income has become prominent over the past decade, leading many firms to attempt to find their niche in this technology-driven environment. With a strong desire to consistently drive innovation and electronification in the industry, BondWave has had the opportunity to implement machine learning into its existing suite of solutions such as QTrades™ and QScores™. Utilizing a set of proprietary algorithms, the firm has developed methods that enrich corporate and municipal bond trade data. QTrades™ has bolstered pricing confidence and mitigated the impact of time-consuming trade burdens. Similarly, QScores™ provides a quantitative approach to identifying comparable bonds based on machine learning algorithms first utilized by technology companies needing to find "nearest neighbors" in large sets of unstructured data, encompassing a flexibility that allows for each firm to define their own comparable bonds criteria.

The ongoing enhancements and successes seen alongside various applications that harness machine learning and artificial intelligence is forever changing the way financial firms do business, interact with partners and service clients. Fixed income automation has come a long way from phones and faxes. With the ongoing adoption of artificial intelligence and data science, the industry is being propelled into the next wave of electronification and growth.

CONSOLIDATION: A CHANGING LANDSCAPE

As technology and regulation continue to drive evolution within the middle-to-back office of firms, market stakeholders are revolutionizing the fixed income industry's landscape as they continue to identify consolidation opportunities. These consolidations within the industry have shifted the overall fixed income market structure and highlighted the growing importance of data control and analysis as the underlying themes of this mergers and acquisitions (M&A) activity. One result of this consolidation is that key players can increase their ability to collect, store, package and use industry participants' data through a growing number of venues and channels. Some of the largest fixed income execution venues have been acquired by global data providers at significant valuations. These acquisitions point to the fact that the industry is quickly consolidating, and that data is king on the path to continuing its reign.

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Information that has traditionally been used to automate and electronify security transactions is now being aggregated, mined, repackaged, and monetized. Market participants must now assess how much of their proprietary information they want to share. Similar to our personal lives, balancing privacy and convenience is starting to come into play in the capital markets.

REGULATION: A CATALYST FOR FURTHER CHANGE

Regulation has been a catalyst for further changes across the industry. The MSRB's and FINRA's Mark-up Disclosure Rule, along with the now-required calculation of a PMP, have caused many to reevaluate their firm's requirements that work to support the rule and provide more precise measurements for best execution and transaction costs analysis (TCA) processes. With continued regulatory focus on fixed income trading, a greater need exists for pre- and post-trade data to demonstrate best execution, leading many firms to employ automated platforms that generate, capture and mine this data. The data surfaced through this process is becoming a critical trading, risk management and regulatory metric.

Equity markets underwent their market structure revolution almost two decades ago, which resulted in Reg NMS. Looking at fixed income markets, we see that we are now at a similar inflection point that may be signaling the start of similar changes in fixed income. Given recent M&A activity and advancements in data and technology, combined with the acceleration of regulation breaking down traditional barriers, market stakeholders are facing an ever-evolving and challenging landscape.

FIXED INCOME MARKETS WILL CONTINUE TO GROW

Navigating 2019, fixed income traders will continue to hang up their legacy tool-sets as they harness emerging quantitative and algorithmic tools to drive deeper market insights and more efficient trading. Relying more on data science and analytics than ever before, fixed income traders will have deeper transparency into the fixed income market and the ability to better assess real value. Advancements in, and adoption of, technology will continue to empower market participants. Industry leaders will continue to focus on consolidation with the underlying goal of data control and their use of data analysis. The importance of fixed income data has never been higher and will continue to grow in value as technology, market regulation, and consolidation collide to further drive the industry forward.

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To learn more, please visit www.bondwave.com,
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ABOUT BONDWAVE LLC

BondWave is a financial technology company specializing in fixed income solutions. We serve a wide range of customers, from small independent RIAs to some of the largest broker-dealers and custody providers in the financial services industry. Traders and advisors use our tools to provide a superior fixed income experience to their clients. By creating sophisticated, yet simple solutions for all stakeholders in the investment process, we help traders and advisors better leverage individual bonds as they work to achieve the investment objectives of their clients. Our tools enable strategy-based investing – including portfolio creation, monitoring and rebalancing – while greatly enhancing the communications between the trading desk, advisors and their clients. BondWave is liquidity and trade agnostic and our sole focus is to provide a simple, sophisticated user experience around individual bond investing.