Today’s low bond market volatility won’t last forever. But knowing whether a correction will come next week or next year isn’t so important. Having an efficient trading strategy that can execute in both tranquil and turbulent markets is.

Trading expertise has always been essential in fixed income because bond markets are highly fragmented. There are far more bonds than stocks in the world, and finding the specific security or block of securities you want requires perseverance and skill.

It has taken on added importance over the last decade, though, because bond markets aren’t as liquid as they were before the global financial crisis. When liquidity is less plentiful, relatively small events can trigger sizable price moves. The US taper tantrum in 2013 and the European variant earlier this year both come to mind (both sparked by central bankers hinting at plans to scale back or wind down stimulatory bond-buying programs).

We’re not saying that one of these events is imminent. What we are saying is that one will happen eventually—they always do—and that humans are notoriously bad at predicting their timing. That’s why it’s important to be prepared. And the best preparation in today’s fixed-income markets comes down to having superior traders and trading infrastructure.

MORE TRANSPARENCY

The good news is that trading is slowly becoming more efficient and transparent—and that should enhance market liquidity. Twenty years ago, bonds were an over-the-counter market. With no centralized exchange, pricing was opaque. And those who wanted to trade could spend hours on the phone trying to find a broker ready to link them with a willing counterparty.

Today, the market has seen the growth of electronic multi-dealer platforms and exchanges that let a bigger pool of buyers and sellers come together, enabling buy-side firms to trade directly with each other.

Still, there are multiple platforms out there today, all varying in quality and reach. But traders only have one pair of eyes. That’s partly why we invested in our own platform, ALFA, which provides a comprehensive, aggregated overview of the entire bond market. This enhances transparency and
efficiency. And with the full market landscape on one computer screen, traders are better able to find relative value opportunities. In order to bring ALFA to the broader market and to develop its ability to support all-to-all trading, we have partnered with ALGOMI,* which will develop, support and market the platform on an ongoing basis.

THE HUMAN FACTOR

Of course, technology is only as smart as the people who use it. That’s why we changed the way we execute trades by bringing in traders with backgrounds at hedge funds and big sell-side banks and with expertise in pricing liquidity.

Then, we ensured that they play a central role in the investment process. In the past, buy-side traders would wait for portfolio managers to provide a list of bonds they wanted to buy or sell, and then execute the trades at the best possible price. That isn’t enough anymore. These days, traders help us determine which securities to buy or sell, and provide valuable insight about when and how to do it.

A successful trader has to dig deeper to find opportunities, and be agile enough to take advantage of them. The best are more than just traders—they’re also idea generators and risk managers.

SHARING THE WEALTH

Over time, we think ALFA could prove a real game-changer. By letting asset managers trade directly with each other, it will enhance overall market liquidity. That will make for a more efficient, transparent and safer bond market, which is to everyone’s advantage.

The further this type of technology spreads in bond markets, the better it will be for overall stability. That’s why making ALFA available to the broader market makes sense in a way that sharing proprietary credit research or quantitative valuation models doesn’t.

What’s more, enhanced trading transparency should be helpful in all conditions—today’s placid market as well as tomorrow’s potentially volatile one. That’s critically important, because not even the most talented trader or portfolio manager can tell you definitively what will spark the next crisis or correction.

*Algomi was founded in 2012, and through its Honeycomb, Synchronicity and Algomi ALFA technology, creates the bond information network that enables all market participants to securely and intelligently harness data to make valuable financial trading connections. Algomi has 120 employees with offices in New York, London and Hong Kong.

The views expressed herein do not constitute research, investment advice or trade recommendations and do not necessarily represent the views of all AB portfolio-management teams.

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