

Algo Trading A Level Set

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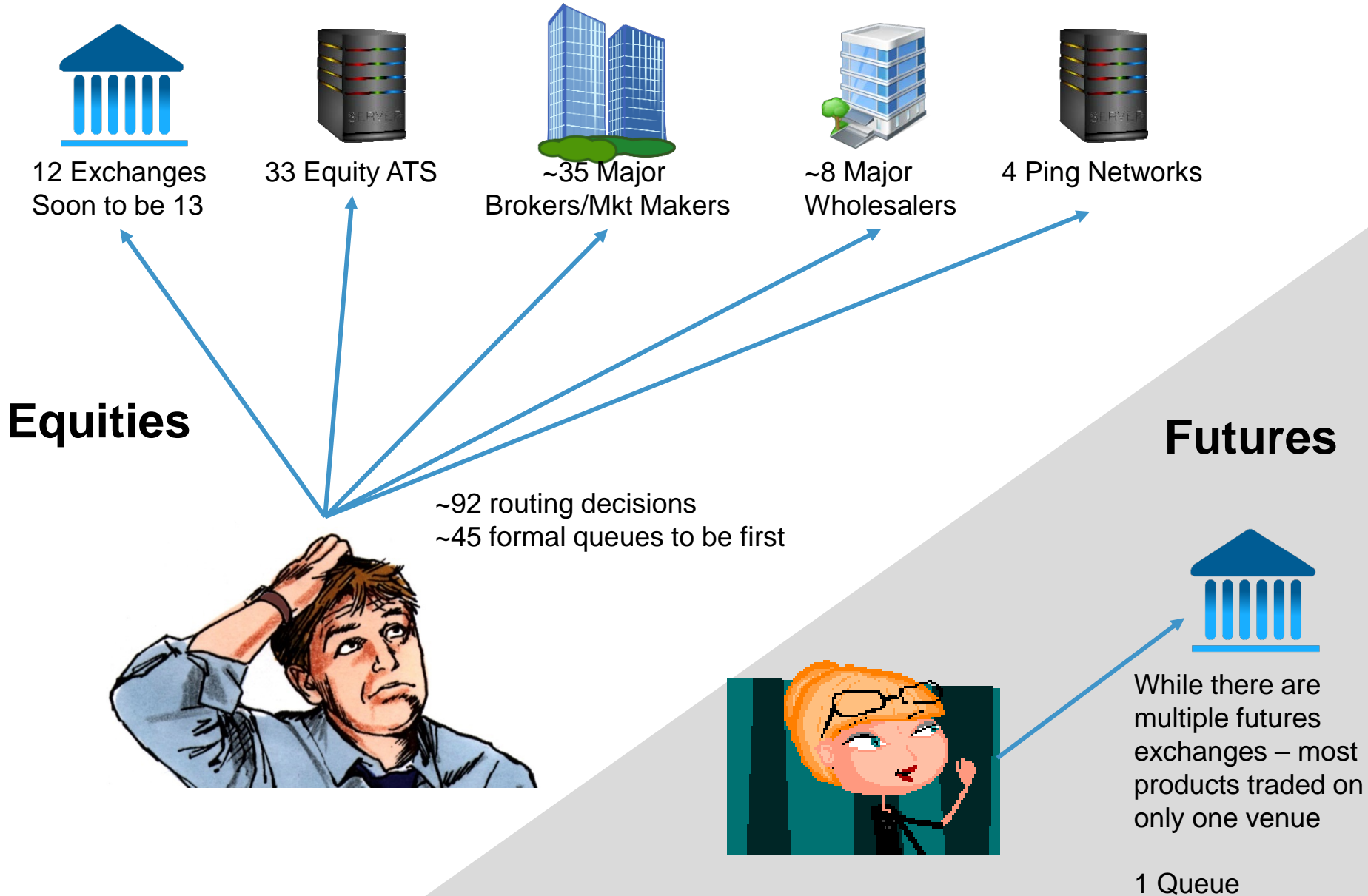
Agenda

- Types of Algos
- Difference between futures and equities
- The need for speed
- How MiFID 2 will impact US markets
- Algo regulation

Three types of algos

- Alpha generating algos
 - (~54% of total equity volumes)
 - Liquidity provisioning (market making)
 - Opportunity seeking (pick off)
 - Arbitrage algos
- Quantitative strategies
 - (~16% of total equity vols (~5% HFT/11% non-HFT))
- Execution Algos
 - (~45% of buy-side flow – (buy-side flow ~24% of total equity volumes))
 - Buy-side algos

Difference between Equities & Futures

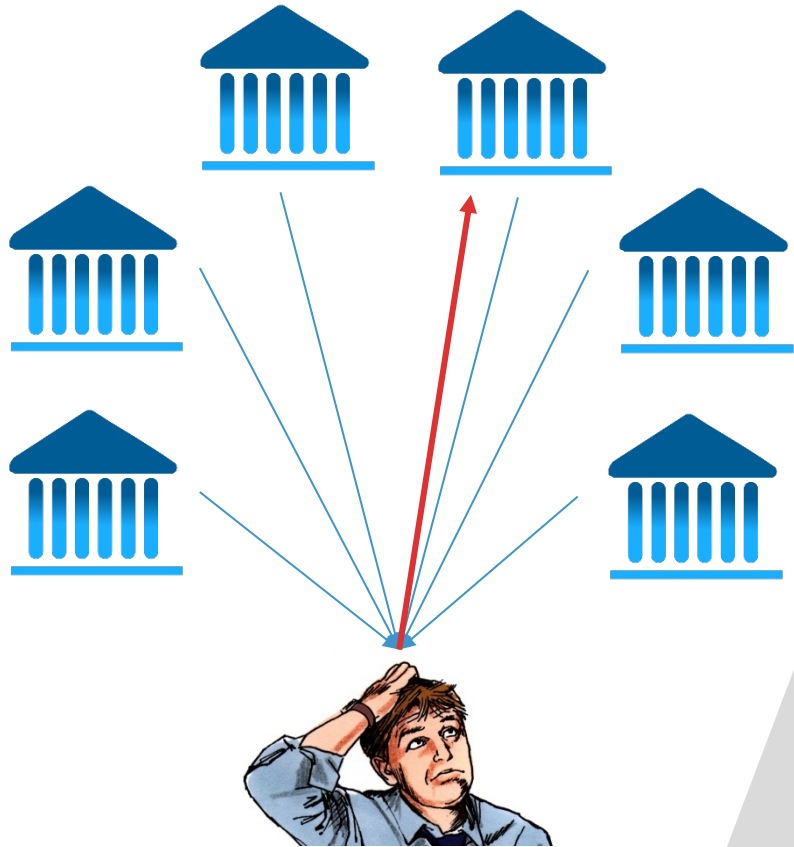


When liquidity is fragmented & tick size small, speed becomes important

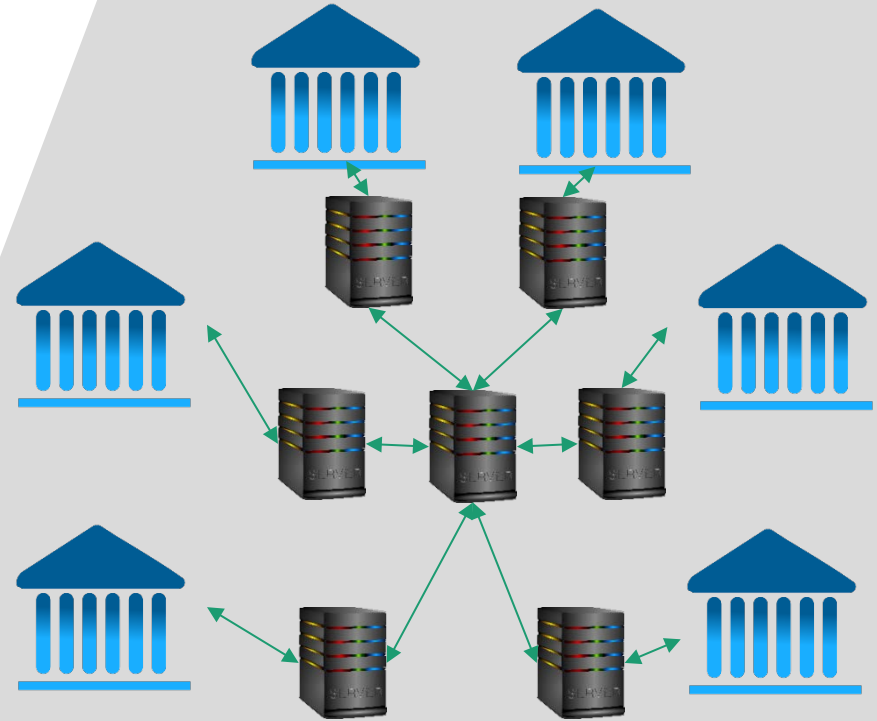
- When there is a single venue (queue), and tick size is large, size is important
 - Need to pay up to jump queue
- When there are multiple venues (queues), speed becomes important
 - Can just go elsewhere to match price (or pay up a *de minimis* amount)
- In fragmented world – speed is about managing queue priority (and picking off stale quotes)

Execution algos are typically slower than proprietary algos

Execution Algo Architecture



Alpha Algo Architecture



MiFID II will impact US – Key Provisions

- Fully unbundled research
 - Research treated as inducement (bribe)
 - Creates research payment accounts or pay out of P&L
 - Includes fixed income
- Best execution regime pivots from more of an agreed upon process to...
 - “Take all sufficient steps to obtain..., the best possible result...”
 - Bans payment for order flow
 - Pre-trade price discover for liquid fixed income products
- Significant change in market structure
 - Bans broker dark pools
 - Limits MTF dark trading to 4/8%
 - Implementation of Large in Scale waver to incentivize blocks
- Requires buy-side firms to report trade
 - Real time & end of day
- Requires exchange-traded derivatives clearing “open access” (postponed till July 2020)

Regulation



My thoughts on regulation

- Regulators should try to create level playing field
 - Not pick winners, losers, or business models
- Focus on transparency, fairness & systematic risk not how buyers and sellers meet
 - Focus on market manipulation, clearing, margin, and safety
 - By defining how buyers/sellers meet – traders will find alternatives/loopholes
- Hyper-transparency is becoming increasingly important
 - Allow traders to measure their performance and the performance of their agents
 - Time stamps, clock synch, and data normalization are critical
 - MiFID 2 got it right here (1mili for execution algos, 100 micros for venues/HFT)
- Hyper-transparency enables traders to measure effectiveness of markets and providers

My bottom line on market structure regulation

- Markets are symbiotic
- Hard to say who is more important – provider or taker
- Investors don't like to post liquidity
- Best to allow investors to measure performance and change behavior/service providers
- Making regulation without fully understanding the data / impact is dangerous

Measure twice / regulate once

