SPECTRUM®

WHY A FOCUSED PRODUCT RANGE IS A WIN-WIN-SITUATION

Kyp Zoumidou, CEO of Brightpool, speaks to Thibault Gobert, Head of Liquidity Pool at Spectrum Markets

In this issue of Spectrum Spotlight, I have the pleasure of talking with Kyp Zoumidou of Brightpool, a multi-asset market-making service provider and close partner of Spectrum Markets.

Kyp, the difference between a single-asset and a multi-asset maker may appear as trivial as the names suggest – but is that really all there is to it?

The difference is actually quite big, trading a variety of asset types means that there are many more variables to take into consideration. The complexity for multi-asset arises from using the information flows across the variable asset classes to derive a strategy – including balancing the different risks. Markets don't always trade logically, they can be driven by many factors that change depending on the type of asset class. Combining all the data and setting up strategies while making sure that we have fair prices and enough liquidity across all our offerings is a real balancing act.

This is a significant challenge even during normal trading hours. As a market-maker for securitised derivatives traded on Spectrum Markets – which operates on a 24/5 schedule – how do you facilitate this?

We decided on the 24/5 model after looking at the client demand and thinking about what our best products set would look like. If we think of things from the point of view of retail investors trading through their broker on Spectrum, they expect that that they can buy or sell at any time.

There are of course logistical challenges to operating 24/5. But it does allow our team to follow the markets as they open and close around the world and to price in all the news in real time. For anyone trading a leveraged product, price transparency is important, but for retail investors even more so. Our aim is to provide liquidity support through competitive bid-ask spreads around the clock. By having a 24-hour desk we always have staff on hand to manage things the right way and this is important in providing the right price in the right size. If we had wide spreads or limited open interest this would make the on-venue trading of securitised derivatives a challenge for clients. I believe the flow and turnover figures on Spectrum today show that clients are pretty satisfied with the quality of market-making. Of course, watching the markets 24 hours a day means we work in shifts, but for me it means my phone is never far away.

Can you please explain why?

Being a market-maker on Turbos with a KO barrier, one of the biggest risks we have as a market-maker is when the market is shut. If we are holding a position in the underlying when news comes and the product jumps in price – that could create a gap loss for us. We manage this risk by using mathematical modelling to adjust our book accordingly through hedging instruments.

During periods of very high or even extreme volatility – which have been more frequent in recent years – the occurrence of statistically-driven gaps increases and there is less chance to protect against these events. One big issue is that these events aren't very predictable and the other is that, under severe stress, there is little continuous liquid trading in the relevant underlying of a derivative. These gaps have had an impact on the market structure and participants have changed too as a result of both regulatory developments and technical progress – meaning that liquidity patterns have changed as well.

The interesting thing for a market-maker is that we are different to prop desks in that not every trade must deliver a positive return and not every trading day can be profitable. We have an obligation to provide liquidity come what may and to make sure that the clients have liquidity to trade.

With a view to volatility and risk management in general – has it been an advantage that Spectrum is focused on a very select range of instruments?

Absolutely. I would say that's one of the main reasons trading has been able to continue smoothly throughout what we have experienced since March of 2020. And concentrating on the most-traded instruments has multiple advantages in normal times, too. In order to be able to determine the fair value of a securitised derivative, you need to determine the fair reference value of the underlying asset. The more liquid the trading in the underlying the greater the price formation benefits and the narrower the bid/ask spreads we can quote for it at the Spectrum order book. What seems trivial in the case of a major currency pair can become very relevant for an emerging market index. On the contrary, in illiquid markets, risk management becomes much harder. Trying to be delta-neutral when making a market necessitates taking positions on the book.

You have mentioned a changed landscape for market-makers and liquidity providers due to regulation and tech – can you please elaborate on that?

Enhanced technology has revolutionised trading with most of the changes being for the better, in my opinion. Without technological progress we wouldn't have the level of access and availability disposable to the retail trader today. Spectrum is a good example of that. For professional market participants, technology has lowered entry barriers, too. The advances in computing capacity and the ready availability of hardware and software (well apart from the pandemic and Brexit!) has led to the emergence of a new breed of brokerage services, trading platforms and electronic liquidity providers. On the other hand, much of the pre-crisis market-making activity has evaporated. One effect of the financial crisis of 2008/09 has been that the significance of single stock trading has decreased – a secondary effect of the rise of ETFs which was only possible because of the ultra-low interest rate environment, in turn, a result of the crisis. Another effect has been a change in the regulatory stance which demanded more responsive risk management by those market-makers that continued the activity and greater protection of the retail investor.

As long as they can access sufficiently liquid markets, market-makers have a number of alternatives for hedging or netting out their positions resulting from client activity. Some hedging strategies that were effective once are no longer appropriate, available or affordable.

Thank you very much!

Get in touch today to discuss how the seamless market access that our venue provides, can help to grow your retail client business.

Please don't hesitate to get in touch if you wish to receive further detail.

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Spectrum is the trading name of Spectrum MTF Operator GmbH. Headquartered in Frankfurt, Germany, we offer a new way of dealing in securitised derivatives for the European retail market; introducing a purpose built 24/5 lit trading venue, with complete transparency, increased choice and maximum control.