

Sören Steinert, Quoniam Asset Management

Photos: Thorsten Jansen



Bringing trades home

What proportion of buy-side trading should be self-directed? At Quoniam Asset Management in Frankfurt, head of trading Sören Steinert believes that liquidity fragmentation and the recent market turmoil will bring more trading within the buy-side trader's ambit.

Approaching two thirds of your trading is self-directed and you stand out amongst your peers as a prolific user of algorithms. What drove the decision to take on so much of the trading in-house?

In hindsight, no one here expected such a high level of self-directed trading. In 2006, when I joined the company, algorithmic trading was in its infancy compared to now. We were a 'greenfield' site as far as trading internally was concerned. The portfolio managers sent orders straight to the broker. There was no dedicated trading desk and the trading expertise of portfolio managers was limited by time resources.

The company took the decision to establish its own trading desk at the beginning of 2006 and I arrived in September. We took a collective step forward. A lot of new funds had been

established and the decision to have a dedicated desk was taken to improve efficiency and free up the portfolio managers to focus more on the investment side. It was also a cost decision, because if you have trades with higher ADV (average daily volume) it makes sense for a professional trader to handle these rather than a PM.

There is a huge difference in the market costs between trading ourselves and using the agency program trading desk of a broker. That has been and continues to be a major driver of our commitment to trading in-house. People ask, 'Why do you trade 60-65% yourself?', and I explain that on average that covers one or two baskets a day. A broker's PT desk meanwhile has to focus on between 10 and 20 baskets each day and can't possibly exercise the same level of attention as we do.

Has market fragmentation validated the decision to establish a dedicated desk?

Market fragmentation has made it increasingly important for us to trade on our own behalf. A lot of people complain about the difficulties of trading in a fragmented market because you lose sight of liquidity. From my point of view, a professional trader must overcome these challenges. If you develop the skill set to trade effectively using algos and connect to all the dark pools and multilateral trading facilities (MTFs), backed by a good execution management system (EMS), this approach will deliver significantly lower costs than a competitor that trades the traditional way.

You achieve crossing rates of up to 25% in dark pools. This seems high at a time when many buy-side traders remain

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Top-tier performance

What's in a name? A good deal according to Quoniam Asset Management, which changed its name from Union PanAgora in February of this year. 'Quoniam' is taken from the Latin (causal) for 'since, whereas, because' and is intended to reflect the company's investment process built on the causal principles of transparency, objectivity and reasoned investment decisions.

As of August 2009, the company had a record number of mandates (108), representing some €10 billion AUM, split between equity, fixed income and multi-asset-class strategies.

Based in Frankfurt, Quoniam Asset Management considers itself a leading quantitative investment boutique; a claim backed by recent independent client surveys that place the company in the first quartile of performance for institutional asset management (FERI Institutional Management Segregated Accounts Survey, 2007 and Greenwich Associates, 2008).

Quoniam's top-tier performance extends to the trading side. With 12 bps average market impact costs, Quoniam achieves trading costs approximately 40-50 % lower than its peers. The company conducts internal and external audits of its transaction costs and was awarded a 'best execution certificate' in a peer group study conducted by XTP Transaction Partners in 2008.

"We are achieving a higher level of performance by trading for ourselves rather than giving the trade to the broker's agency desk," says Steinert, who joined Quoniam with five years' buy-side trading experience, including a spell as head of European equity trading at Close Brothers Seydler. As the range and quality of broker algorithms improve and more dark pools are connected, will Quoniam's level of self-directed trading rise further from its current high level? "From 60-65% there's certainly upside potential to do more," confirms Steinert.



cautious. Why have you chosen to be such a prodigious user?

If one considers the German market alone, dark pools are used less for interacting with orders than in the UK, for example. The

key word in this context is trust. There is still a common fear that if an order is placed in a dark pool everyone on the broker's sales desk is going to know about it. But just imagine if that happened and it became

public knowledge. The broker's agency business would be defunct. It simply wouldn't happen.

Once you have dispelled this notion of mistrust, the reward gained from interacting with dark pools is meaningful. The high crossing rates we achieve contribute significantly to lowering our transaction costs and reducing our market impact costs.

Of course, were we to go to a single broker's dark pool that wasn't connected to competitors' liquidity, then I would most likely experience crossing rates of only 2-3%. We specifically look for dark pools with the highest crossing rates, which tend to be the broker pools connected to other dark pools.

The ability to connect to disparate pools of liquidity seems to lie at the heart of your approach to self-directed trading. How vital is this aspect?

It has become increasingly important. Access to nearly all the broker dark pools has been established through our EMS. We are connected to 10 brokers, of which two are agency only. Contrast that with a competitor, for

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example, who sends an order to a single broker and is then limited to that broker's dark pool. In the same vein, we are also particularly interested in utilising liquidity-seeking algorithms that interact with other dark pools.

One year ago, I told our brokers that they will need to combine their dark pools in future, adopting the type of model that was originally championed in the US through the alliance between UBS, Morgan Stanley and Goldman Sachs. It was only a question of time before this pattern took hold in Europe. On the other hand, some brokers are unwilling to share their flow with competitors. That's the wrong decision in my opinion.

Who's driving the process of connecting the brokers' pools of liquidity?

Despite our stance on this, the process is being driven less by German asset managers and more from regions such as Scandinavia and the UK in particular. Eighteen months ago, there was also pressure being exerted from hedge funds, which as a group had more influence at that time.

It is also being driven by the sell-side, where there has been a palpable change of sentiment. Five years ago, for example, no one could have imagined competitors coming together to create Turquoise. If the brokers can work together on

Turquoise it should also be possible on dark pools.

Are you satisfied with the level of connectivity offered by the sell-side?

Definitely not. You have a lot of brokers out in the market still refusing to connect their dark pools. If you take the 'big three' alliance of UBS, Morgan Stanley and Goldman Sachs, they don't see why they should open their alliance to others. I can understand the position they're taking. What we really need in the market is a second major bloc. I imagine that something will happen this year.

Does current smart order routing technology support your desire to achieve best execution?

Every broker needs to develop better algos for smart order routing. The difficulty for the buy-side is that you can't easily and consistently compare one smart order router with another in the same situation. Post-trade we often see huge differences in brokers' use of MTFs for order fulfilment. Some brokers will execute 20% on Chi-X, while for others the rate's less than 3%. In general, the differences are not so marked if you are trading

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aggressively, but if you are pursuing a passive strategy there can be huge differences.

How do you use algorithms within your trading strategy?

The algo structure we deploy depends on a number of variables, from the price level of a stock or news in a particular name or sector, through to the market volume. Once we have determined these factors and taken account, not least, of the trader's opinion, we create a strategy with the help of different algos.

Commonly we use implementation shortfall (IS) and volume algos, as well as algos designed for more aggressive trading. However, we are not limited to one type of algo with each trade. If, for example, we have IS as the benchmark, we don't only use a standard IS algo. We might decide at the outset of the trade that an IS algo is the best strategy to reach our trading objective, but we also realise it may not work every time, so it is better to be creative with the algos in determining how best to reduce market impact.

When we are trying to pick a good strategy we look

at the names that have the most influence on the market impact costs, which might include small- and mid-cap stocks with a wide spread, for example. If you are trading 70 names in a basket and can identify 10 stocks that create on average 80-90% of your market impact, it makes sense to focus on these names and use a standard IS algo for the remaining 60.

Often, however, I will create my own algo structure. For instance, while I might start with a standard IS algo, if the price of the stock being traded were to reach 50 basis points below the targeted execution price, at that point I may well opt for a more aggressive approach. Faced with highly illiquid stocks, I tend to use 'Guerrilla-type' algorithms that buy more aggressively on the bid. For some names, I can use up to five different algos. On another occasion, it may suit me to use two algos from different brokers for one name.

What lessons have been learned from the period of extraordinary volatility that the market has ridden out? Obviously, counterparty risk has entered the lexicon of the trading desk.

As fund advisers, we are fairly conservative and have strong risk controls in place. One important lesson from Lehman is probably that payment against delivery is not protecting you 100 % as it may remain unclear whether trades are going through. We have a relatively small broker list of 10 names. After the Lehman bankruptcy, we implemented a regime of strict risk assessments and applied it to every broker we use. This is based on criteria including the credit default swap (CDS) spread, the broker's rating and recent stock performance. From these factors, we calculate a relative risk standing for each counterparty. During the height of the market turmoil, on some days three or four brokers would be on the 'red list' as a result of wide moves in CDS spreads, for example. In that event, we stopped trading with the broker concerned for the entire time it remained on the red list because the counterparty risk was perceived as too high.

The other big change at this time involved our use of algos, which increased. It made sense to trade on our own behalf as much as possible, because we could

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cancel or hold an order much faster than the broker. During the period of high volatility in the market, we worked closely with the portfolio managers to determine whether it suited our aims to hold off on an order or trade aggressively.

Has the strong focus on counterparty risk led to any material change in your broker list? For example, have you developed a preference for agency brokers?

That period of exceptional volatility proved a win-win for the agency brokers, who gained trust. In general, agency brokers have also shown that they are more flexible in creating new algos. In my experience, if you have an idea for an algo, you get a quicker decision and arrive at an end product earlier if you go to an agency broker rather than a major global broker.

On the other hand, agency brokers recognise that they are too small to have their own dark pool, but get around this hurdle by being more flexible in terms of creating new partnerships that allow them to offer liquidity aggregation.

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Capital commitment traditionally marked the major global brokers apart from their agency rivals. Are attractive risk prices making a return?

After the Lehman bankruptcy, capital commitment was virtually dead. Since the beginning of the year, one or two major firms have started offering risk capital at good prices. More and more are now providing a risk price at an attractive level. It may be down to the fact that if liquidity is low, as can happen in the summer months, some brokers are setting out to win a risk basket to give themselves something to do.

From what we are currently experiencing, there’s not a big difference now from the risk prices being offered pre-Lehman. However, a distinction needs to be made. On program trading, it’s virtually the same, but it’s still difficult for us to get a good risk price on single stocks. Our baskets are practically cash neutral and therefore it seems to be easier for

brokers to trade out of that than have to deal with a big position in a single name. There is still high volatility in individual stocks and brokers remain risk averse.

Has the withdrawal of risk prices when they were needed most caused any long-term damage to the relationship between the buy-side and sell-side?

I can only speak for this company. The fact remains that we trade only around 10% of our baskets at risk, so the absence of competitive risk prices didn’t have such a great impact. The way major brokers retreated from offering risk prices is understandable in my opinion; they simply lacked any risk capital, while the buy-side was still able to bear limited trading risk. At the end of the day, we want a fair and equitable relationship with our brokers. It wouldn’t have been in my long-term interest to exert pressure on brokers at a time when everyone knew good risk prices were not available. I need to work with them in the future. ■