acuiti management intelligence

SPECIAL REPORT

The growing internationalization of derivatives trading

Capitalizing on the opportunities in extended hours trading sessions

Commissioned by:

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The first extended hours trading session in futures markets was launched by the Chicago Board of Trade in 1987. Five years later the electronic trading platform Globex was launched and with that came the opportunity to trade electronically almost 24 hours a day – extended hours trading had truly been born. Today, in response to technological advances and growing demand from international investors seeking to diversify trading portfolios and strategies, derivatives exchanges across the globe are launching extended hours and new trading sessions. These developments are bringing new flows and liquidity to exchanges while also creating a more diversified base of participants for local market participants. In this report, commissioned by TMX Group following the launch of Asian trading hours on Montréal Exchange, Acuiti looks at how firms are approaching extended hours today and the opportunities they bring to the global market.

The Growing Internationalization of Derivatives Trading

In September, Montréal Exchange Inc, the derivatives arm of TMX Group, extended its operating hours to offer trading in Canadian derivatives during Asia daytime trading hours. The move followed the extension of trading to European hours in 2018.

In order to understand the levels and dynamics of demand for extended hours trading and the challenges firms face during these sessions, TMX Group commissioned Acuiti to conduct a study into how firms across the buy-side, sell-side and proprietary trading communities in EMEA and Asia approach extended hours trading sessions, any issues they face and the benefits brought.

Acuiti collected responses from more than 100 senior executives at proprietary trading firms, hedge funds, asset managers and banks and brokers in EMEA and Asia. This report sets out the findings.

Growing demand

Acuiti found strong and growing demand from respondents to trade on markets based outside their time zones during their local trading hours. Unsurprisingly, demand was highest among firms already trading in extended sessions on international exchanges, with 96% reporting some or significant demand to trade during extended hours trading sessions – the 4% reporting no demand were international banks with global desks that traded during local hours.

Interestingly, Acuiti also found strong demand from firms that were not currently trading in extended hours sessions with 18% reporting significant demand and 36% reporting some demand.

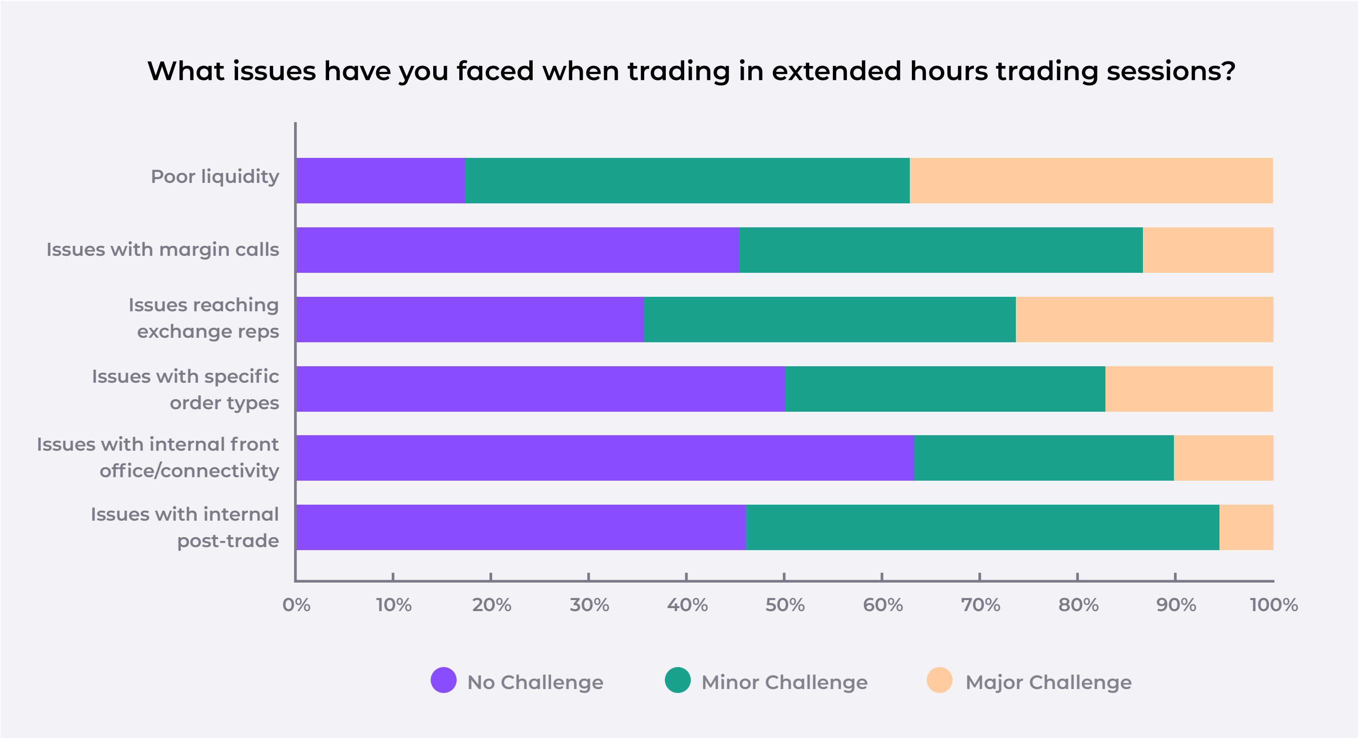
Overall, demand was strongest in Asia. Here, 44% of respondents based in the region traded extended hours and 26% of those that did not reported significant demand. Within Asia, asset managers and hedge funds reported the strongest demand for extended hours - signifying the increasingly global reach of this market segment.

The disruption caused by Covid-19 has set back many plans to join new markets. But as the world emerges into a new normal, the pace of adoption is set to accelerate.

There are myriad drivers for firms to want to trade in extended hours and the motivations vary by company types. Asset managers are driven more by the requirement to hedge exposures while hedge funds and proprietary trading firms were found to be looking to optimise strategies.

Overall, for firms that are trading extended hours, the drivers of demand were broadly split across capturing specific opportunities, the requirements of their trading strategies, the ability to react to events throughout the day and hedging. For firms that are not yet trading, the desire to capture opportunities specific to extended trading hours sessions was by far the biggest driver of demand.

What is driving the demand to trade extended hours sessions within your organisation?



Approaches to extended hours trading sessions

While there is strong demand to trade in extended hours trading sessions, there can be obstacles to overcome.

The biggest challenge is poor liquidity. This was identified as a challenge by 83% of respondents with 37% saying it was a major challenge. Issues reaching representatives of the exchange during local trading hours was the second biggest challenge with 64% reporting this as a challenge and 26% saying it was a major challenge.

Especially at launch, liquidity during extended hours tends to be lower and launching extended hours is in many ways similar to a new contract launch. To mitigate this, Montréal Exchange has developed a new market making programme and signed up local market makers to support the extended hours sessions.

In addition, the dynamics of the market are generally different as new participants enter the market and the news flow that directly impacts price movement is diminished during the night and early mornings. As a result, the performance of the market can be different to that modelled on historical data from core trading hours.

To adjust to this, firms reported that they adapted their strategies when trading in extended hours - two thirds of respondents changed their trading strategies, including 86% of proprietary trading firms. This was generally to account for different liquidity and performance profiles. Firms are also likely to put on less risk during extended trading hours with 74% of firms saying this was the case.

Just under half of respondents made changes to how they hold or process collateral to adjust to margin calls. Most of these changes were related to the timing of margin calls.

Missed opportunities

The challenges firms face, however, are outweighed by the benefits of trading in extended hours trading sessions.

The extension of trading hours to a near 24-hour cycle brings to traders in all corners of the globe the opportunity to trade new products, hedge risk and optimize trading strategies.

Acuiti asked firms whether they agreed or disagreed with a series of statements pertaining to the opportunities in extended hours both for them and the exchange.

Firms that did not trade in extended hours or did not have the ability to do so felt they were at a competitive disadvantage to those that did. The sell-side were most likely to cite a competitive disadvantage from not being able to trade on international markets during extended trading sessions with 76% agreeing with this statement. Overall, the study found that firms are significantly more likely to trade on markets that offer extended sessions in their local trading hours.

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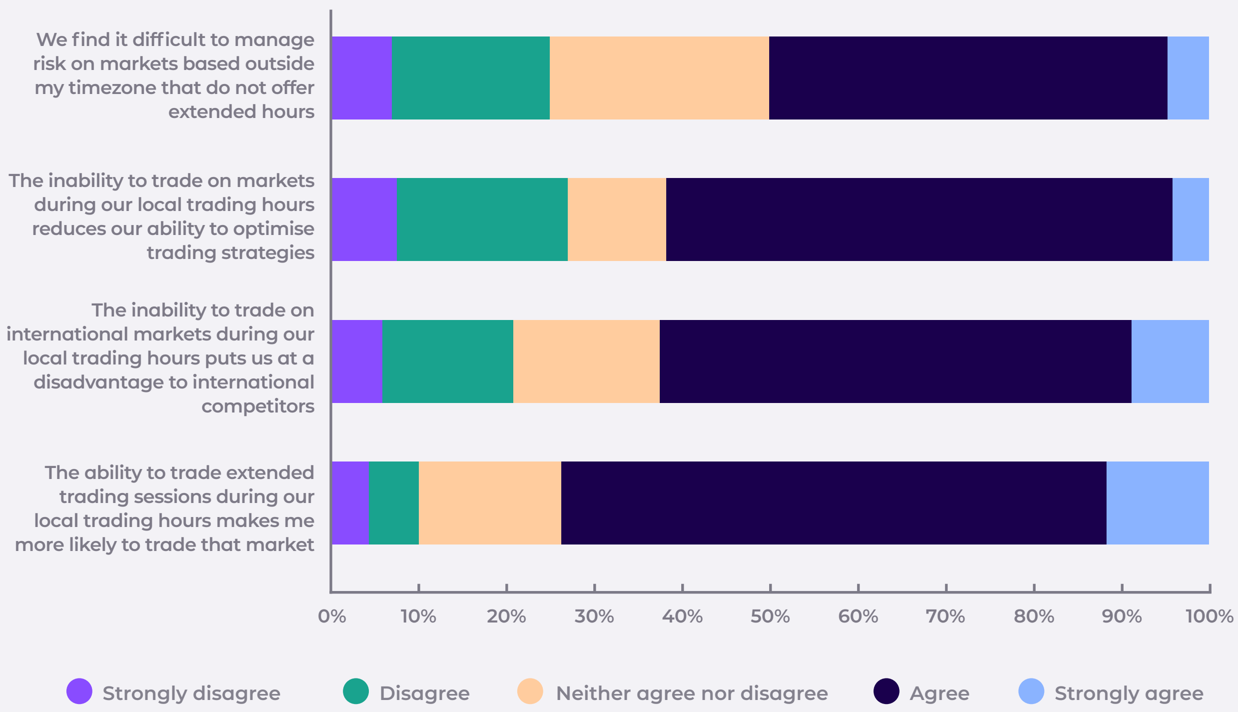
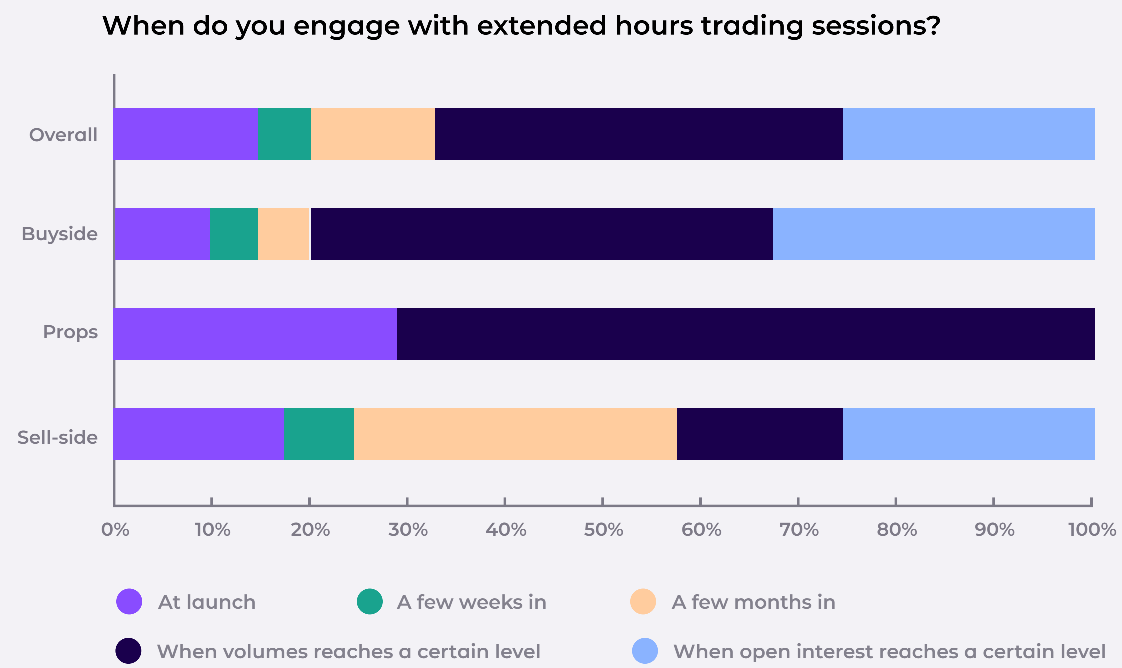
Do you agree or disagree with the following statements?



When do firms adopt extended hours trading?

As with any new venture, liquidity and trading volumes take time to grow and different market participants tend to join at different stages of the build out. The Acuiti study found that proprietary trading firms and bank trading desks tend to be the earliest adopters, with many joining market maker or liquidity schemes. While some hedge funds are there from the launch, most tend to wait until volumes have picked up to the levels needed to be able to trade their strategies with confidence in the liquidity of the market. Asset managers tend to also join later – for these firms, open interest is the key driver for participation over volumes. While volumes and liquidity are specific to trading sessions, open interest is calculated across the overall trading day. This, in theory should ease the adoption of extended trading hours for asset managers focused on open interest levels to evaluate the adoption of new trading opportunities.



Trade Canada on Montréal Exchange

The introduction of extended hours trading on Montréal Exchange both opens the market up to new investors and optimizes the portfolios of firms trading exposures to Canada.

For the latter, prior to the launch of extended hours, their rates or equities cash positions tended to be hedged against US treasuries or indices after exchange hours, leaving them imperfectly hedged and exposed to market moves.

For firms not currently trading exposure to Canada, the full suite of tools in their own time zones, enabled by extended hours, makes the market significantly more attractive to adopt.

The key benefits for firms trading Canada are:

- As the Western world enters a reflationary cycle with expectations of interest rate rises over the coming months and years, different markets will move at different paces and investors with the broadest reach will benefit the most from the expansion.

- Montréal Exchange has expanded its derivatives market significantly over the last five years, building out the yield curve on government bond futures and launching new rates contracts referencing CORRA, the primary risk-free rate in Canada.

- The CAD-JGB spread has been a popular trade historically and the relatively higher yields on Canadian government debt relative to the JGB and other major benchmark rates has increased demand and created alpha for traders in 2020 and 2021. The ability to trade CAD during Japanese trading hours is likely to further increase the popularity of this trade.

- As ESG grows in importance in Asia, asset managers can also trade ESG strategies on Montréal Exchange via the S&P/TSX 60 ESG Index Futures (SEG). The extended hours also bring the opportunity for international firms to interact with local Canadian hedge funds, pension funds and money market funds investing in their domestic economy.

Extended trading sessions are a key development in the continued internationalisation of derivatives trading. The extension of trading hours allows firms in all regions of the world to trade new exposures and instruments without the cost and investment of investing in night desks. For the markets extending the trading hours, they bring new liquidity and counterparties to the market creating a win-win for global derivatives markets.

About Montréal Exchange

Montréal Exchange (MX) is Canada's derivatives exchange, owned and operated by TMX Group, offering retail and institutional investors futures and options products across major asset classes, including interest rates, equities, FX, Canadian stock indices and repos, as well as clearing services. MX serves an important role in Canada's financial markets and is a vital component of TMX's global growth strategy. In September, MX launched the next phase of its extended trading hours initiative, offering investors in the Asia Pacific region the opportunity to trade Canadian listed-derivatives in their local time, almost 24 hours a day. For more information visit www.m-x.ca.

About Acuiti

Acuiti is a management intelligence platform designed to provide senior executives with unparalleled insight into business operations and industry-wide performance. Acuiti helps identify market trends, enhance decision-making and benchmark company performance. The platform anonymises and aggregates information from its exclusive network of senior industry figures to provide insightful in-depth analysis.

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