US Futures Trading 2012:

Buy-Side Demands in an Evolving Marketplace

February 2012

Executive Summary

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Futures markets are about to become a lot more competitive. As buy-side portfolio needs evolve and managers integrate futures into their strategies, trading futures becomes a battle between trading smart and trading efficiently. With high-frequency strategies and market-making firms using low-latency tools to trade, the competition between size and speed is evolving.

Hedge fund speculators are also once again on the rebound. Traditional investment managers facing increased competition from hedge funds and passive investment strategies are running more-complex portfolios. And pension funds are increasing their allocations to CTAs, as investing in futures has the potential to provide better alpha returns as well as capital preservation.

Larger buy-side firms will invest in automated solutions that help them to trade more efficiently, using tools that can both minimize trading costs and help them execute more-complex strategies. For the sell-side and vendor community, this translates into new opportunities to provide powerful tools for trading, analytics, research and related services that help to support their trading activities.

All of these factors are contributing to volumes. US futures exchanges announced record volumes in 2011 and TABB expects this momentum to carry forward into 2012. Rising volumes will result from a number of factors, including more widespread adoption by investment managers, more complex investment strategies by existing users and increased trading of futures based on new indices and asset types.

The regulatory push for centrally cleared and exchange-traded instruments is also adding to volumes, as will provisions within the Dodd Frank Act (DFA) that are transitioning OTC swaps trading to more transparent swap execution facilities (SEFs). As swaps trading becomes more automated, the ability of traders to use interest rate futures and other related instruments as part of overall strategies becomes attractive, especially for true correlation and relative value strategies that look to profit from price changes in other asset classes.

Historically, trading US futures traditionally required little execution expertise or special tools. Traders could simply pick up the phone to place an order valued at millions of dollars and get executed nearly instantaneously with minimal market impact. However, as trading increases, volatility fluctuates, and products evolve, the emphasis on having the right set of tools is more critical.

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For this year's buy-side trading study, TABB Group spoke with 51 head traders of US institutional equity management firms. The interviews were conducted during October and November 2011. We included in many conversations the impact of volatile markets, MF Global, and FCM coverage; commission structures and rates; algorithmic providers and product needs; order allocation across the high- and low-touch trading channels; domestic and foreign trading venues; and liquidity demands.

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