

FIXED INCOME EXPERT NETWORK REPORT

Investing to meet the demands of an evolving market

06

SELL-SIDE
TECHNOLOGY
BUDGETS

10

BUY-SIDE FOCUS

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THE ADVANCE
OF ELECTRONIC
TRADING

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Research
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acuiti management
intelligence

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Intro

Welcome to latest edition of valantic FSA's Fixed Income Expert Network Report in association with Acuiti. In an update to the Sell-Side Fixed Income Expert Network, and based on input directly from the network, we have expanded the network to include buy-side fixed income market participants.

Senior sell and buy-side executives now have a platform through which they can submit anonymized questions to each other to gauge their sentiment and expert opinion on market and operational issues. These views and opinions will be published in this report, issued three times a year.

In this edition, we explore how firms performed in 2023, the anticipated implications of T+1 settlement rules in the US and expectations with regard to the growth of electronification across fixed income asset classes.

Elsewhere, we also consider the viability of cleared repo and the size of technology budgets in the coming year, including where they will be directed.

Data in this report is based on a survey of senior buy and sell-side fixed income executives from across the global market. **Thank you to all members of the network that have provided their input into this report, in particular our new buy-side members.**



A stylized, handwritten signature in black ink, consisting of a large, looping 'J' followed by a smaller 'L' and a horizontal line.

Joachim Lauterbach
CEO, valantic FSA



A stylized, handwritten signature in black ink, consisting of a large, looping 'A' followed by a smaller 'B' and a horizontal line.

Andy Browning
Head of Electronic
Trading, valantic FSA

Assessing 2023

Overall, 2023 was a strong year for fixed income desks. Over two fifths of firms in the network had outperformed the budget they set at the beginning of the year. In addition, most firms performed the same or better than they did in 2022, during which performance in the fixed income markets was driven by strong rises in interest rates across the major jurisdictions.

Indeed, the Sell-Side Fixed Income Expert Network Report in Q1 2023 found that 52% of the network had had an exceptional year in 2022 compared to an average year.

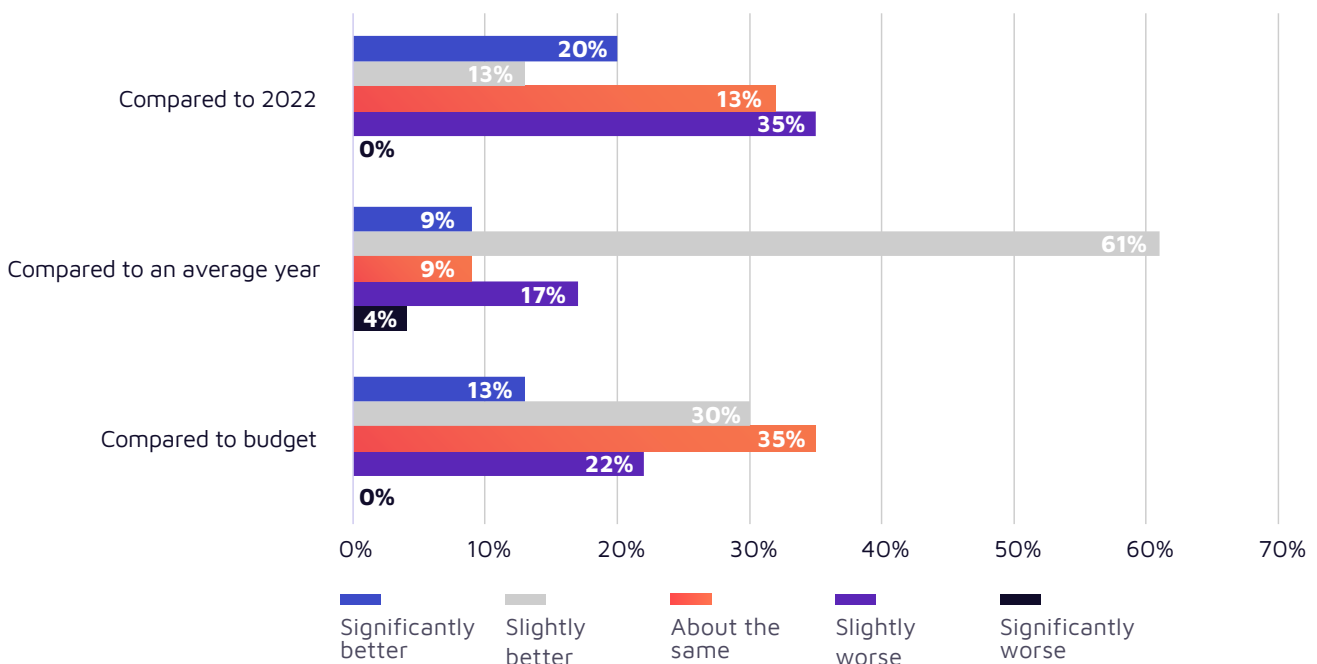
However, in 2022 many firms on the buy-side were caught out by the sudden movements in rates and inflation and suffered during the year as a result. As a consequence, most of the firms in this report that experienced a better

performance last year than in 2022 were asset managers.

2023 had its challenges, principally in dealing with the aftermath of several US bank failures in March. This came in the wake of aggressive interest rate rises from the Federal Reserve as well as inflation expectations and continued monetary tightening in other major jurisdictions.

In the second half of the year, the extreme volatility died down and liquidity improved creating more favorable conditions for the buy-side but the lower volumes reduced revenues for the sell-side. In the last Fixed Income Expert Network report, we found that the sell-side had performed very strongly in the first half of the year. This performance weakened in H2 2023.

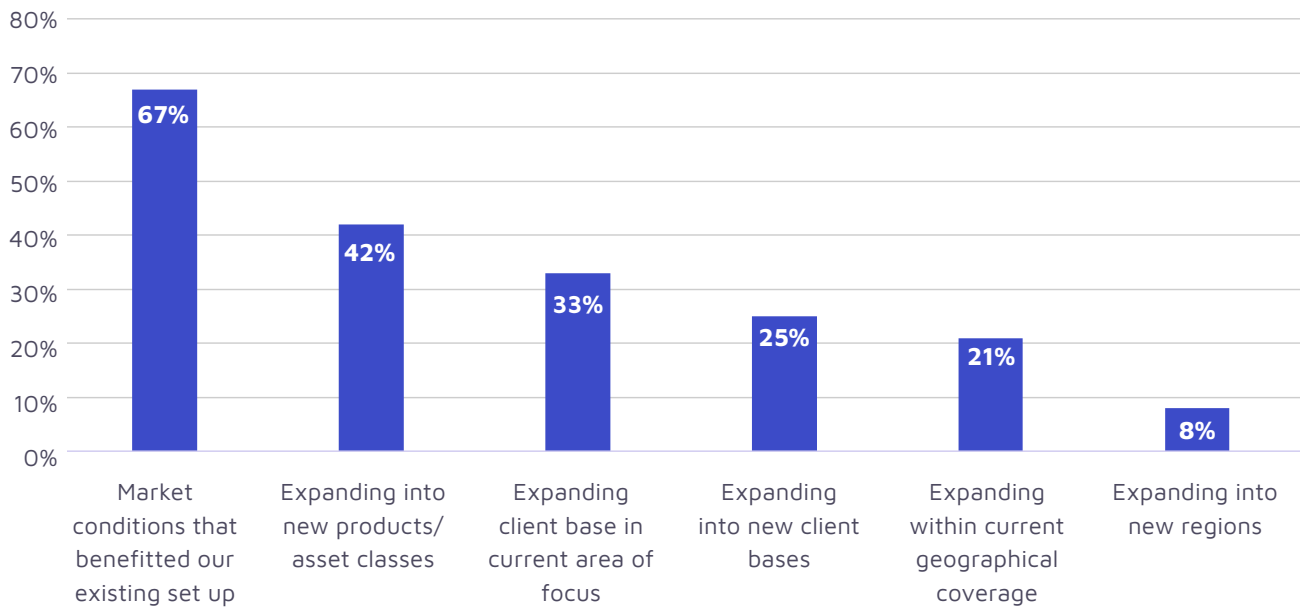
HOW DID YOUR FIXED INCOME BUSINESS PERFORM IN 2023 COMPARED TO 2022, AN AVERAGE YEAR AND YOUR BUDGET AT THE BEGINNING OF THE YEAR?



Network members cited market conditions as the main driver of growth last year. Although notable proportions also profited from expansion into new products and asset classes – a trend

particularly notable among the buy-side where 75% of respondents said that this drove growth. Market conditions were the biggest driver of growth for the sell-side.

WHAT WERE THE MAIN DRIVERS OF GROWTH IN 2023?



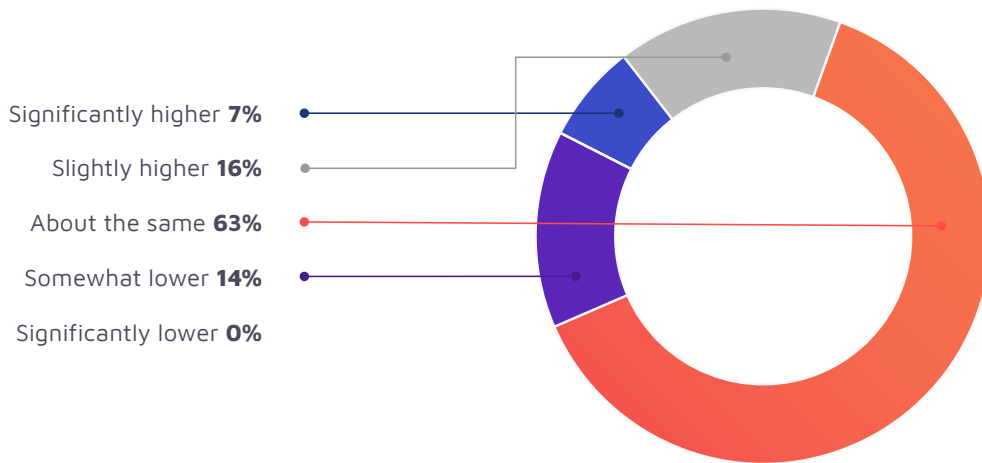
Sell-side technology budgets

Electronic trading in most segments of the fixed income market necessitates investment in technology across the sell-side.

budgets in 2024 compared to an average year, while only 14% were planning a reduced budget.

Around a quarter of sell-side members of the network were planning to increase technology

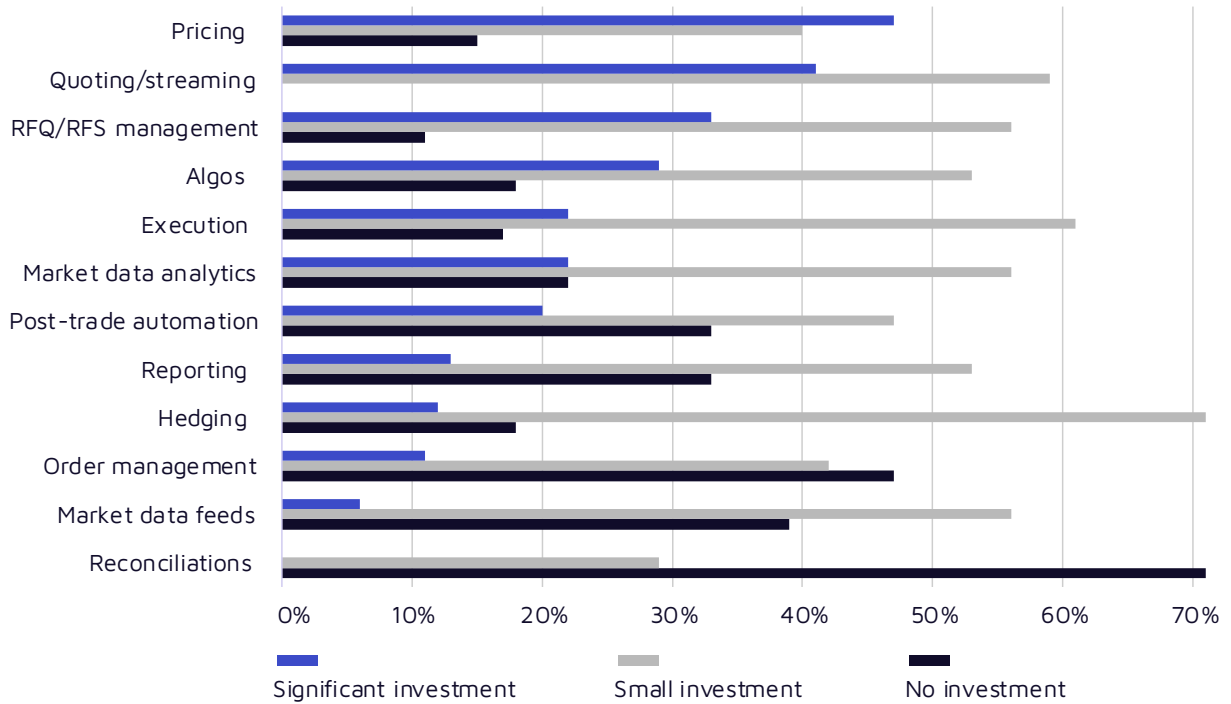
COMPARED TO AN AVERAGE YEAR, HOW BIG IS YOUR TECHNOLOGY BUDGET FOR FIXED INCOME IN 2024?



Investment plans for the year were mainly directed towards pricing, quoting and streaming, as well as RFQ/RFS management. Areas where less investment dollars were being allocated were

order management and reconciliations, both of which experienced major investments in recent years.

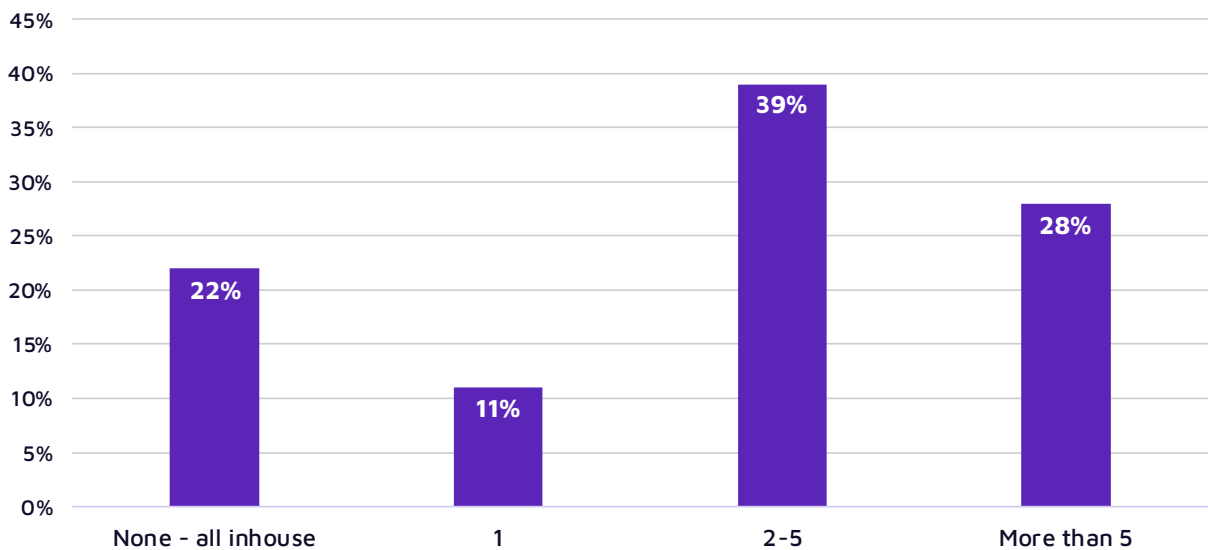
WHERE ARE YOU PLANNING TO INVEST IN 2024 WITH REGARDS TO TECHNOLOGY?



One way of upgrading technological infrastructure, which often proves more cost-effective, is outsourcing functions to a third-party. Nearly

four fifths of the network have at least one vendor relationship. Nearly a third have more than five.

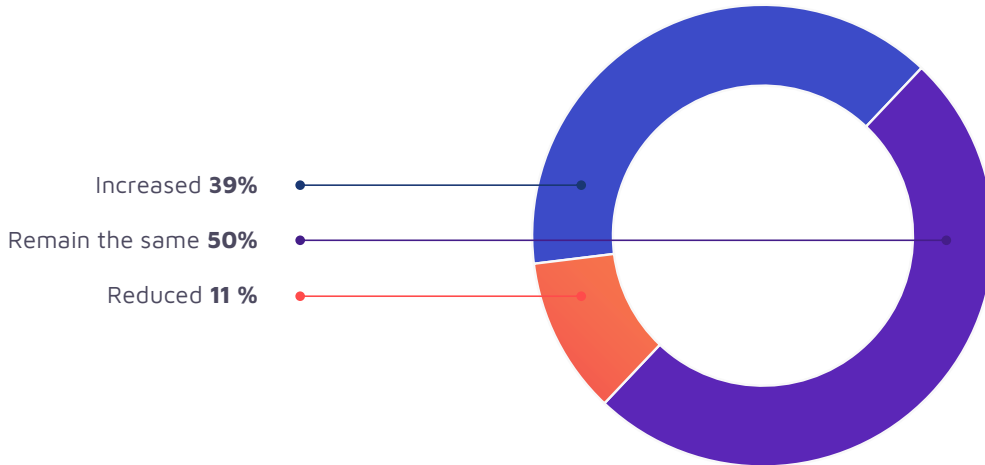
HOW MANY THIRD-PARTY VENDORS DO YOU CURRENTLY WORK WITH ACROSS YOUR FIXED INCOME BUSINESS?



The use of third-party vendors has increased among nearly two fifths of the network over the

past five years, while half of the members had kept their number of relationships stable.

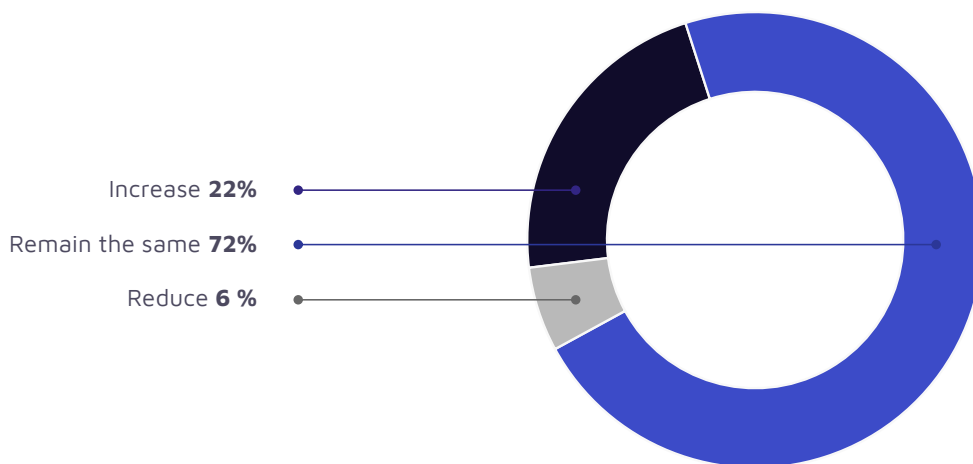
HOW HAS THE USE OF 3RD PARTY VENDORS CHANGED IN THE PAST FIVE YEARS?



While more network members were planning to increase the number of third-party relationships rather than reduce them, the majority were planning to maintain their current number of

third-party relationships. In part, this reflects the desire to reduce complexity within many firms, with a push to consolidate functions onto fewer systems.

HOW DO YOU EXPECT THE NUMBER OF THIRD-PARTY VENDORS YOU CURRENTLY WORK WITH IN FIXED INCOME TO CHANGE OVER THE NEXT FIVE YEARS?

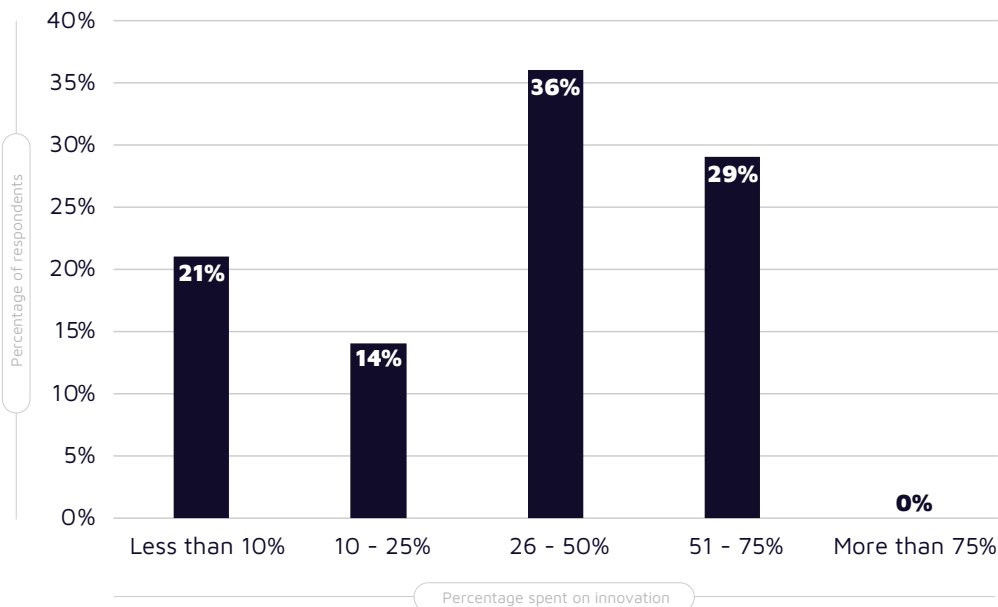


The burden of third-party management is set to increase further as the EU’s Digital Operational Resilience Act (DORA) approaches implementation.

Whether done with a third-party or inhouse, most network members said that the majority

of their technology budget was being spent on compliance and maintenance, rather than innovation — only about 30% of survey respondents were spending most of their tech budget on innovation.

APPROXIMATELY WHAT % OF YOUR TECHNOLOGY BUDGET IS DIRECTED TO INNOVATION (BUILD THE BANK) RATHER THAN COMPLIANCE AND MAINTENANCE OF EXISTING PROCESSES (RUN THE BANK)?



Buy-side focus

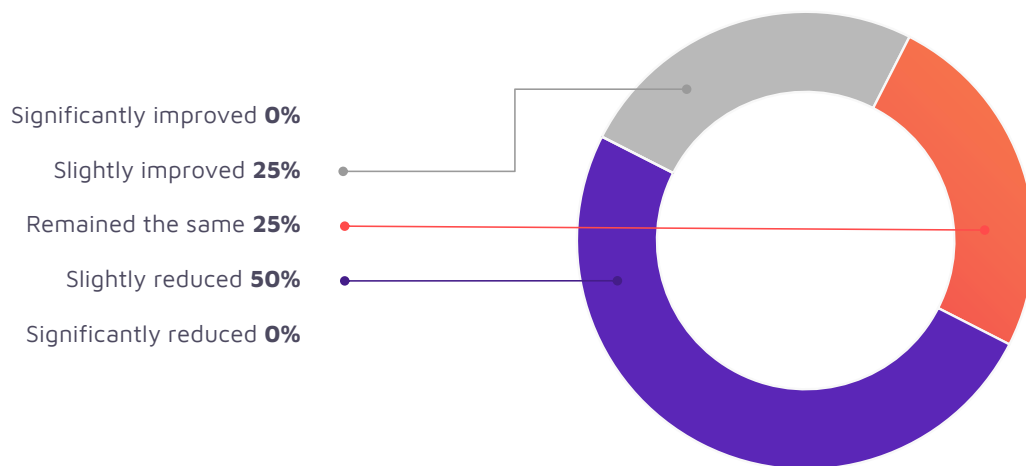
Liquidity

As noted above, the past two years have been challenging for buy-side fixed income desks, with volatile markets and the reversal of quantitative easing from central banks creating a drag on opportunities for returns and often disrupting liquidity.

Half of the buy-side network members said that liquidity had reduced over the past three years, with a reduction in bank liquidity provision the main reason given.

That has not been a uniform picture however, with a quarter saying that it had slightly improved. EM credit was also cited as a market where there had been a noticeable improvement in liquidity — predominantly as a result of a deterioration in the liquidity in 2022.

OVERALL, HOW HAS THE PROVISION OF LIQUIDITY FOR YOUR FIXED INCOME TRADING OPERATIONS CHANGED OVER THE PAST THREE YEARS?



Those markets where the buy-side reported the most significant reductions in liquidity were municipal debt, corporate debt, high yield, and distressed debt — the latter two in particular

being markets where liquidity is known to dry up quickly in volatile conditions.

Working with the sell-side

In this report's survey, we asked buy-side members of the network in which areas they thought that the sell-side could improve their offering.

As noted above, liquidity has been a key challenge for half of the buy-side members of the network. For that reason, this was cited as a key area in which the sell-side could improve their offering.

A greater breadth of trading protocols, such as firm two-way pricing, was also requested from the buy-side as was better algo provision, market coverage and lower fees.

IN WHAT AREAS COULD THE SELL-SIDE IMPROVE THEIR OFFERING TO YOUR FIXED INCOME BUSINESS?

1. Liquidity provision
2. More trading protocols
3. Better algo provision
4. Lower fees
5. Market coverage

The long-term impact of T+1

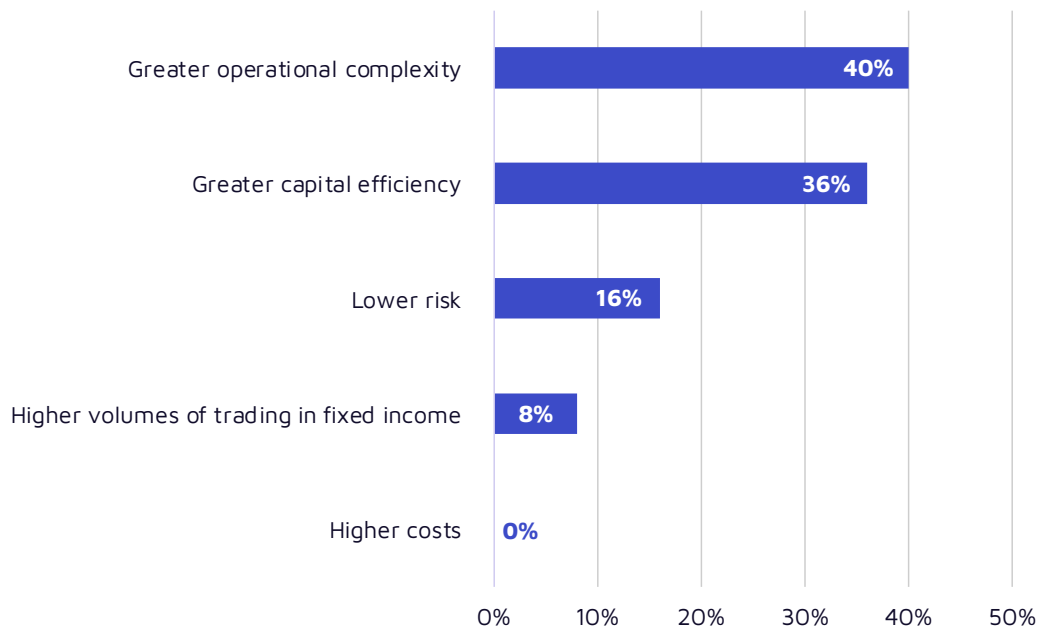
At the time of writing, the US and Canadian markets were in the final stages of the implementation of T+1 settlement for most broker-dealer transactions. These will include stocks, bonds, municipal securities, ETFs, some mutual funds and REITs. US government bonds are already settled on a T+1 cycle.

The shift to T+1 is expected to reduce counterparty risk and increase efficiency. However, some market participants are expecting complications,

especially non-US investors in different time zones who foresee difficulties arising from the shorter settlement timeframe in areas such as FX management.

Indeed, 40% of the network foresaw this complexity as the most significant lasting impact of T+1, although a similar proportion also predicted greater capital efficiency.

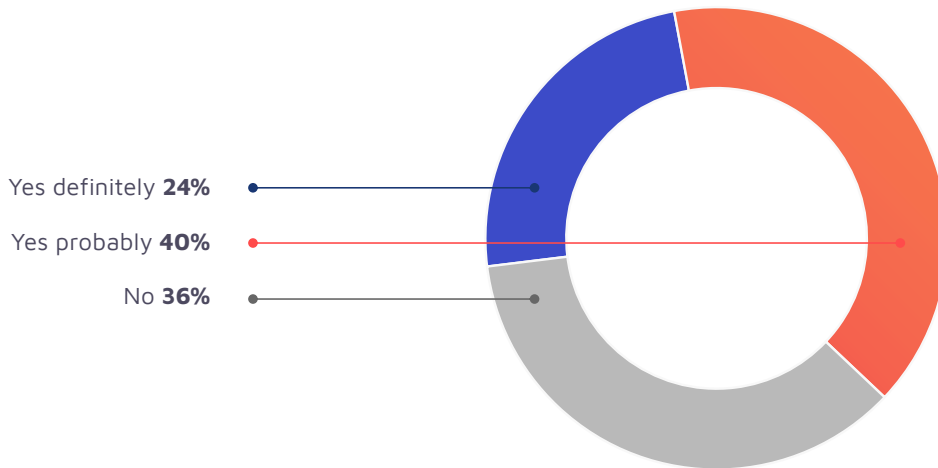
WHAT DO YOU THINK THAT THE BIGGEST LONG-TERM IMPACT OF T+1 IN THE US WILL BE?



While some respondents raised concerns over operational complexity, particularly those on the buy-side, most of the network had a positive

view on T+1, seeing it as likely worth the investment and operational hassle once all is done.

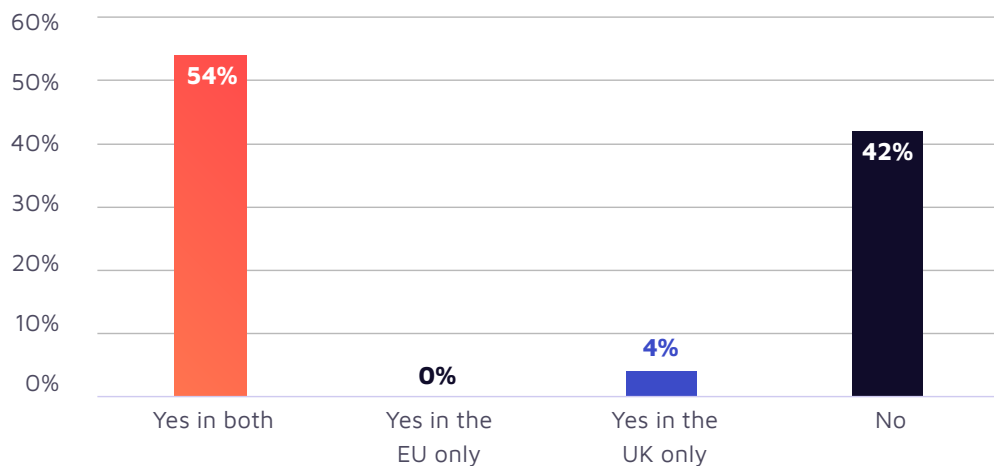
OVERALL, DO YOU THINK THAT THE MOVE TO T+1 IN THE US WILL BE WORTH THE INVESTMENT AND OPERATIONAL HASSLE?



Another sign of positivity came from most of the network supporting the introduction of T+1 settlement in EU and UK fixed income markets. However, a sizeable proportion did not want the

rule introduced in European markets — this was a view that was particularly seen from buy-side respondents for whom the cost and complexity of the shift to T+1 is proportionately greater.

SHOULD T+1 FOR FIXED INCOME BE INTRODUCED ACROSS THE EU AND UK?

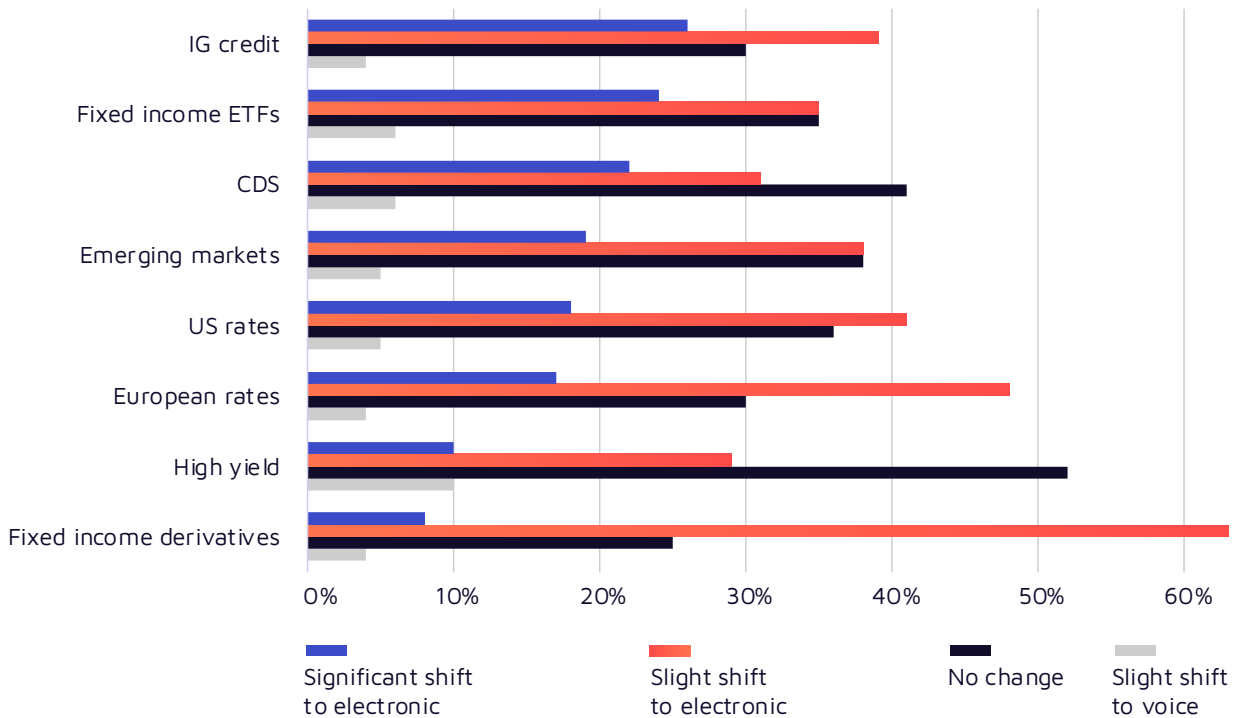


The advance of electronic trading

The progress of electronic trading in fixed income varies significantly by sub-asset class. Looking ahead for the rest of this year, most network members predict an acceleration for most products.

Not only does this include markets where the change is already well under way, such as US rates, but investment grade credit, emerging market credit and CDS. The latter in particular stands out, being a traditionally OTC market.

IN 2024, HOW DO YOU EXPECT THE PERCENTAGE OF ELECTRONIC TRADING VS VOICE TRADING TO CHANGE IN THE FOLLOWING AREAS?



Cleared repo

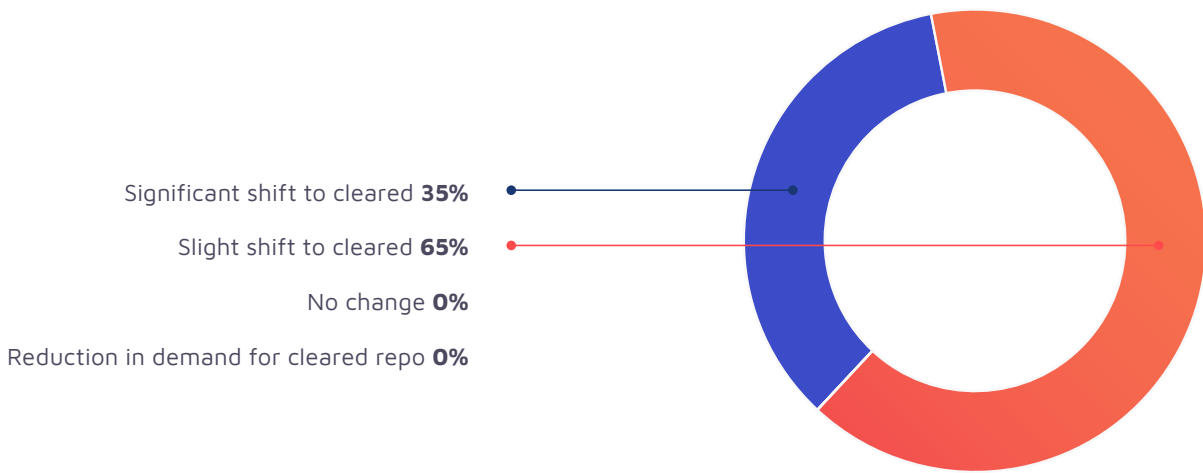
Against a backdrop of tighter funding conditions and continued uncertainty about the trajectory of interest rates, many market participants are looking to the repo market as a funding tool. For those that can access it, the cleared repo market often offers better pricing and more reliable liquidity during volatile market conditions as well as reducing counterparty risk.

Despite these benefits, buy-side firms often face operational barriers to cleared repo. This has led some sell-side firms and CCPs to offer agent services, where a bank takes on some of the

operational responsibilities and costs of clearing for the buy-side. As well as offering benefits to buy-side firms, cleared repo can also offer capital efficiencies for banks.

In the US, the SEC has mandated that all treasury repo transactions will have to be cleared from 2026. While there is little sign of European authorities following suite, the US example is creating a new impetus for market adoption.

HOW DO YOU SEE DEMAND FOR CLEARED REPO IN DEALER TO CUSTOMER FLOW IN EUROPE CHANGING OVER THE NEXT THREE YEARS?



A majority of sell-side members in the network that offered cleared repo saw demand increasing over the next three years in Europe.

Around a quarter of the buy-side respondents currently deployed capital in repo markets and of

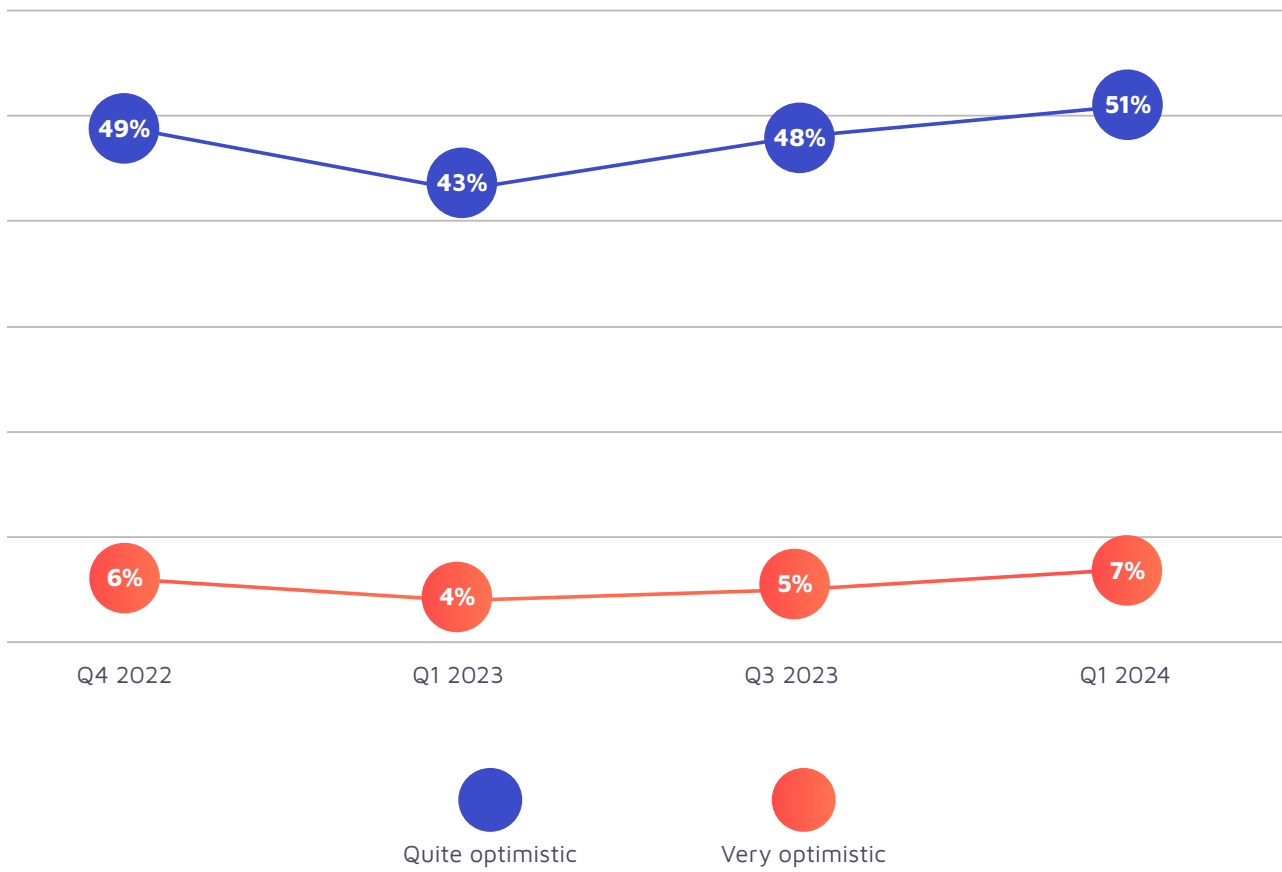
those that did, all were planning to deploy more capital in 2024. This was predominantly a result of trading more in instruments that required collateral to be posted.

Sentiment

This index is calculated as a percentage of the total number of respondents from the Expert

Network that were optimistic about their business performance in the upcoming quarter.

THE VALANTIC FSA FIXED INCOME SENTIMENT INDEX





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