

FIXED INCOME EXPERT NETWORK REPORT

# Meeting the challenges of H1 2024

04

H1 2024 –  
THE YEAR SO FAR

07

SELL-SIDE  
TECHNOLOGY  
INVESTMENT

12

BUY-SIDE CORNER:  
EXECUTION  
PROTOCOLS

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# Intro

We are delighted to bring you the latest installment of the valantic FSA Fixed Income Expert Network Report, published in partnership with Acuiti. The network offers senior executives at sell and buy-side firms in fixed income the opportunity to ask each other anonymized questions about how they are identifying opportunities and dealing with challenges in the market.

In this report, we take stock of the year so far, assessing firms' performance during H1 2024 and the challenges they have faced. We also look at current conditions, and see where network members are identifying the greatest risks for their businesses.

A constant theme of our reports is technology and the electronification of fixed income markets. In this edition, we examine cloud technology and how sell-side firms are engaging with third-party providers when they adopt it.

For our buy-side focus, we look at execution protocols and which ones firms are increasing their use of, as well as their engagement with non-bank liquidity providers.

Elsewhere, we cover concern around levels of government debt, views on the nearing arrival of consolidated tape in the EU and UK, as well as an assessment of the T+1 transition.

As ever, our thanks to all members who have contributed to this report. Please do not hesitate to reach out to us should you want to pose a question to the network.



  
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# H1 2024 – the year so far

Looking back on H1 2024, most of the valantic FSA Fixed Income Expert Network has enjoyed a positive six months. 69% of network members had performed better than budget, while 57% had posted slightly or significantly better results than an average year. 71% had performed better in the first half of this year than in H1 2023.

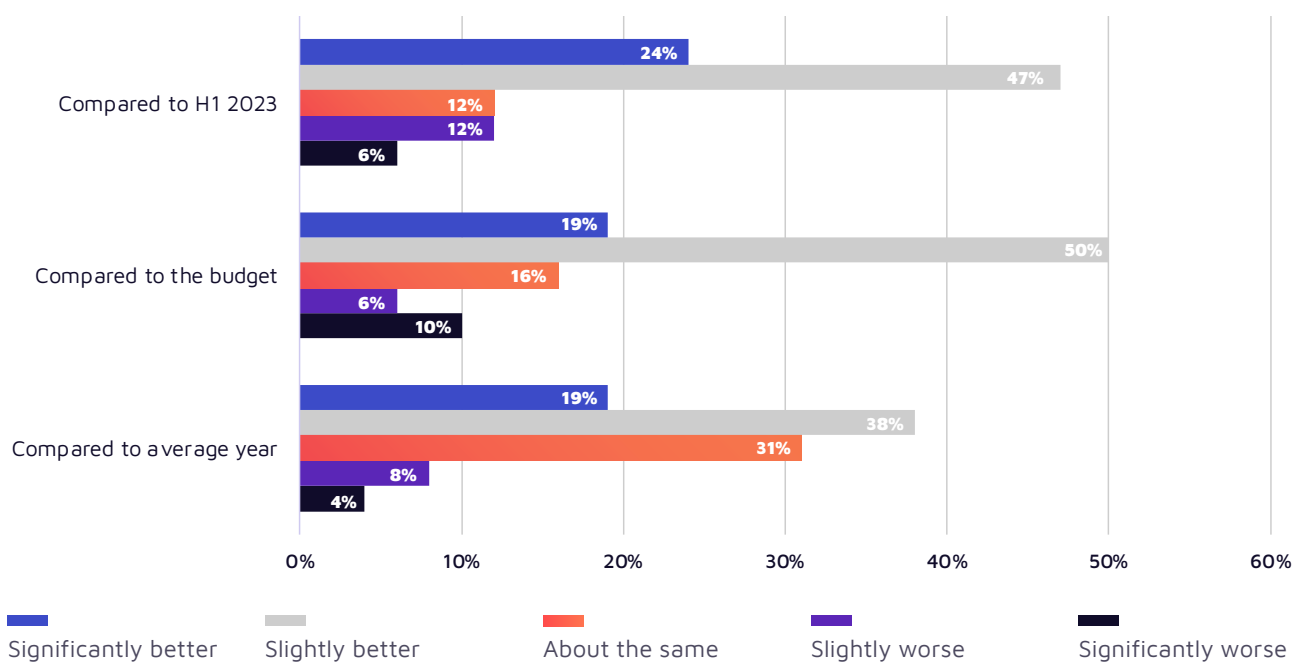
After a two-and-a-half-year rate-hiking cycle and the associated volatility that has resulted in fixed income, market participants today face a reversal of fiscal tightening and rate cuts.

However, the anticipated pace of those cuts is more tempered than at the beginning of the

year, which began with many analysts predicting five or more rate cuts in the US. The Fed’s first rate cut since March 2020 surprised some with its depth (50bp), but the number of cuts in 2024 is still set to come under many beginning-of-year predictions. Furthermore, an uncertain macroeconomic outlook has led many market participants to adopt a cautious approach to forecasting the future trajectory of US rates policy.

This contained uncertainty provides sufficient volumes for the sell-side to capitalize on and sufficient volatility for the buy-side to profit from, without risk of the significant losses seen during the extreme volatility of spring 2023.

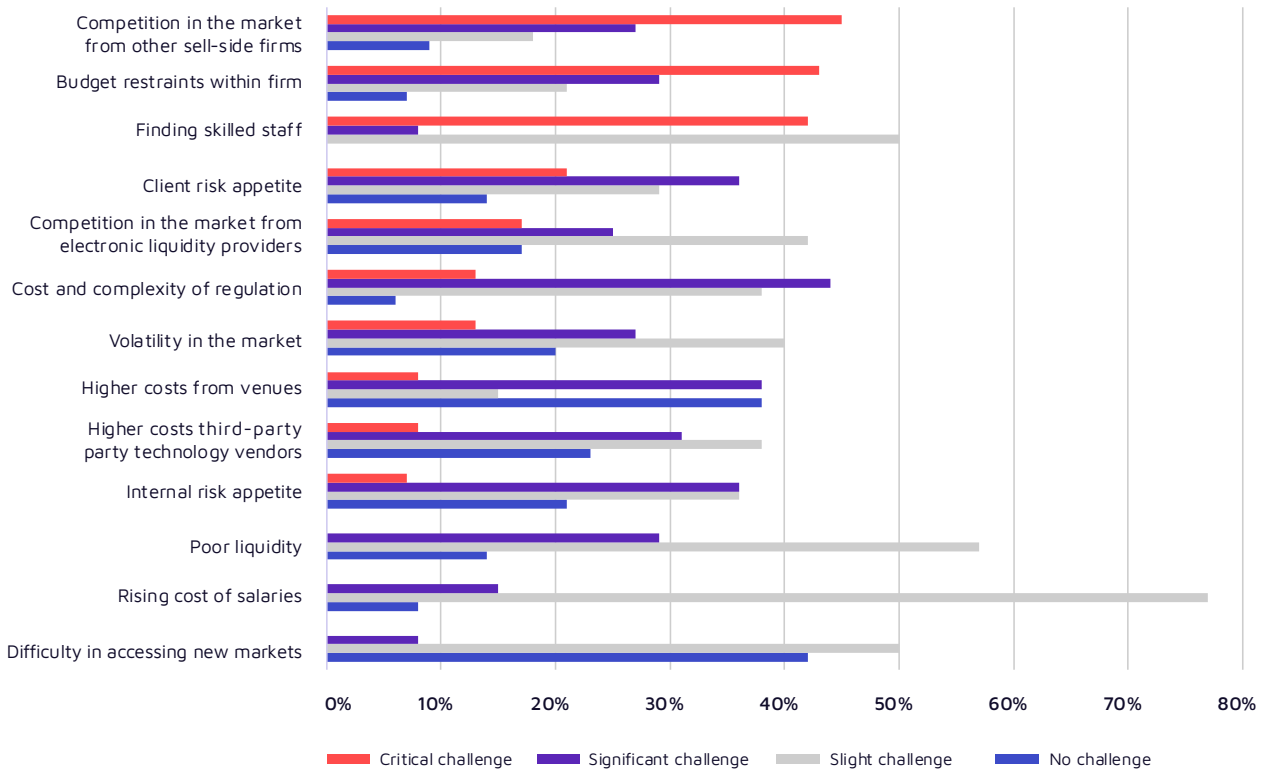
IN TERMS OF PROFITABILITY, HOW STRONG A YEAR WAS THE PERFORMANCE OF YOUR FIXED INCOME BUSINESS IN THE FIRST HALF OF 2024 COMPARED TO H1 2023, TO WHAT YOU EXPECTED AT THE BEGINNING OF THE YEAR (BUDGET), AND TO AN AVERAGE YEAR?



There is evidently still a fear of extreme moves in the markets though, with 21% of the network citing client risk appetite as a critical challenge in H1 and market risk remaining the biggest risk for firms (see below).

However, far bigger challenges for banks and brokers in the network were seen in the form of competition from other sell-side firms, as well as more operational concerns such as budget restraints and finding skilled staff. These were identified as the second and third most critical challenges faced by network members.

**DURING THE FIRST HALF OF 2024, HOW MUCH OF A CHALLENGE DID THE FOLLOWING POSE TO YOUR FIXED INCOME BUSINESS?**



As noted above, market risk is still foremost in network members’ minds and was cited as the most concerning risk by buy and sell-side alike.

While there is greater confidence about the lowering of interest rates, the days of zero interest rates and QE are firmly in the past, and markets are still adapting to the shift from that long period of loose monetary policy – as evidenced by the recent unwinding of the Yen carry trade. Traders have good reason to be

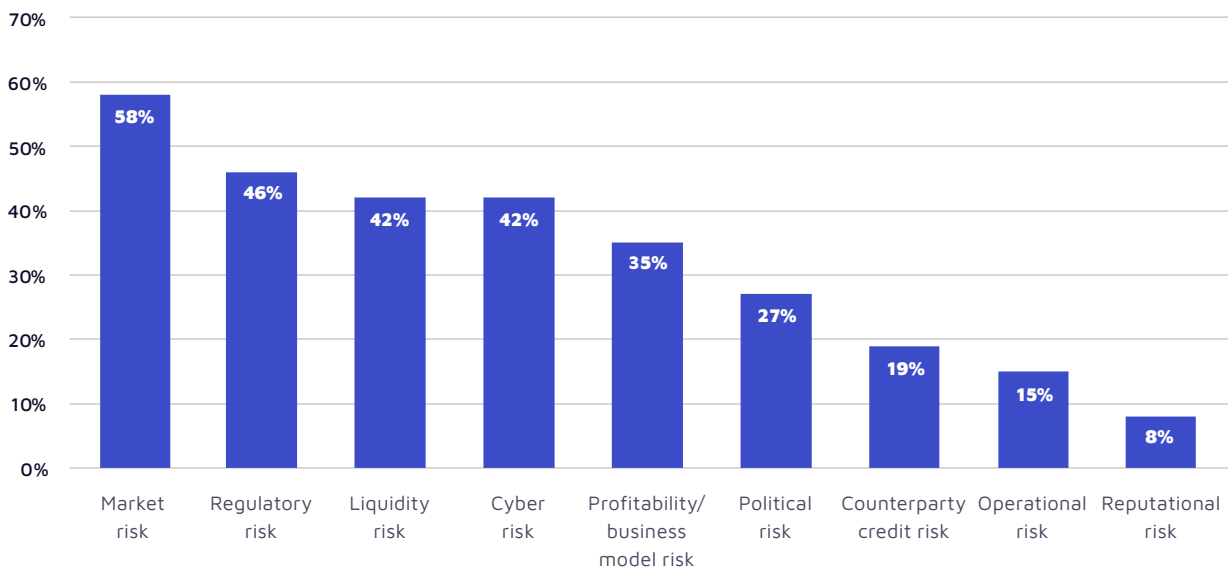
cautious based on their experiences during the 2020s to date.

Other risks high in network members’ minds were regulatory risk (more of a concern for sell-side members), cyber and liquidity risk. Cyber risk has been increasing as a concern across financial firms in recent years, with some high-profile attacks over the past two years resulting in outages across the market.

Since the reforms that followed the 2008 financial crisis, liquidity risk has been a widespread concern in fixed income markets. A stricter regulatory environment that increased the cost of holding inventory for dealers has restricted liquidity provision from banks, especially in stressed market conditions. Coming at a time

when the supply of government debt is increasing in many markets (see hot topics for more on this theme), more market participants are voicing concern about this imbalance between volume and the intermediary capacity that can smooth out transactions.

### AS OF TODAY, WHAT ARE THE TOP RISKS THAT YOU ARE MOST CONCERNED ABOUT WITH REGARD TO YOUR FIXED INCOME BUSINESS? (SELECT TOP 3)



#### TOP 5 RISKS FOR THE BUY-SIDE

1. Market risk
2. Liquidity risk
3. Political risk
4. Cyber risk
5. Counterparty risk

#### TOP 5 RISKS FOR THE SELL-SIDE

1. Market risk
2. Regulatory risk
3. Liquidity risk
4. Cyber risk
5. Profitability/business model risk

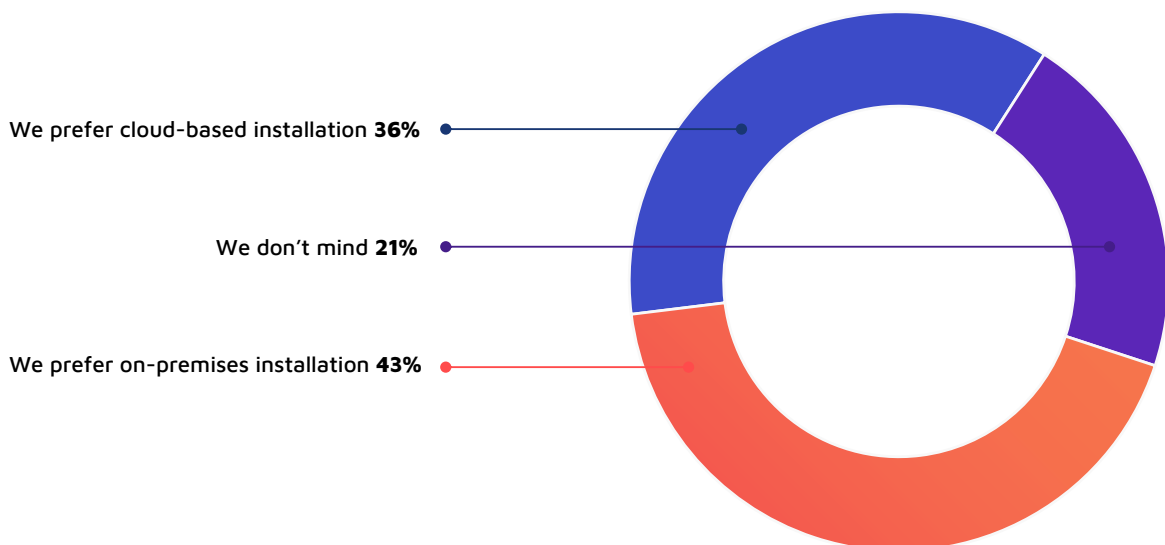
# Sell-side technology investment

While dealing with market conditions and other challenges, fixed income market participants also have to stay competitive with rivals in terms of the electronic offerings they present to clients.

A key foundation of these platforms has been cloud technology, which allows for more powerful computing capacity and greater scalability.

Traditionally, firms had engaged with the cloud cautiously, mainly due to security concerns. However, attitudes are rapidly shifting, with nearly 60% of the network now comfortable engaging with cloud-based offerings.

## WHAT BEST DESCRIBES YOUR ORGANIZATION'S ATTITUDES TO THE CLOUD WHEN IT COMES TO **THIRD-PARTY TECHNOLOGY**?



Alongside their growing confidence in the security of cloud offerings, banks are increasingly seeing advantages to a hosted platform. This creates a single point of accountability with the third-party software provider and puts that provider in charge of maintenance and upgrades, as well as the initial development and installation.

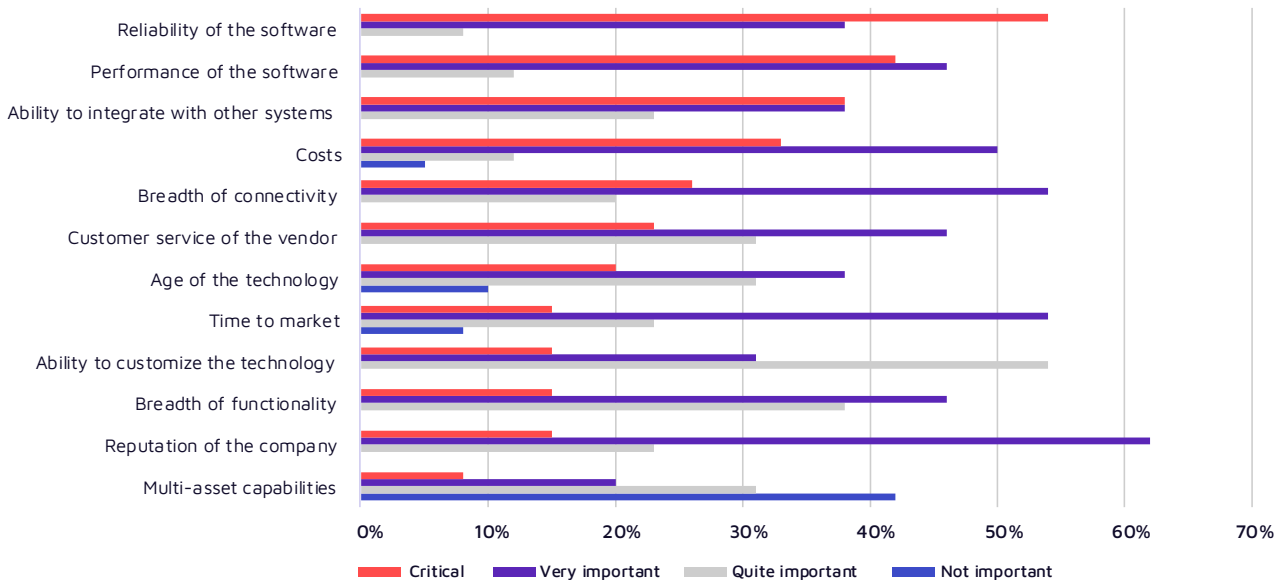
These advantages also apply to other parts of the front office where firms outsource. However, there are other considerations for firms that are exploring third-party options.

For those who do partner with a vendor to provide front office functions, the most critically important factors influencing network members' choice were performance and reliability of the software. While this is true for middle and back office functions too, for the front office,

the pressure to maintain an impressive platform can be particularly acute because this is where client interaction takes place.

Also critically important was the vendor's ability to integrate with other systems. This applies not just to middle and back office systems, but to other vendor systems that might be used in the front office. It is a common feature among sell-side firms to have built up multiple systems within an organization due to acquisitions and restructurings. This creates complex infrastructures that are hard to overhaul and often don't communicate efficiently with each other. Systems that can integrate with existing systems are therefore prized.

## WHEN CONSIDERING A THIRD-PARTY FRONT OFFICE TECHNOLOGY PROVIDER, HOW IMPORTANT ARE THE FOLLOWING FACTORS:





# Hot Topics

In addition to regular updates on performance and challenges in fixed income, each quarter we survey network members on the hot topics in the asset class — based in part on questions submitted by other network members.

This quarter, we cover government debt levels, consolidated tape in Europe and the transition to T+1.

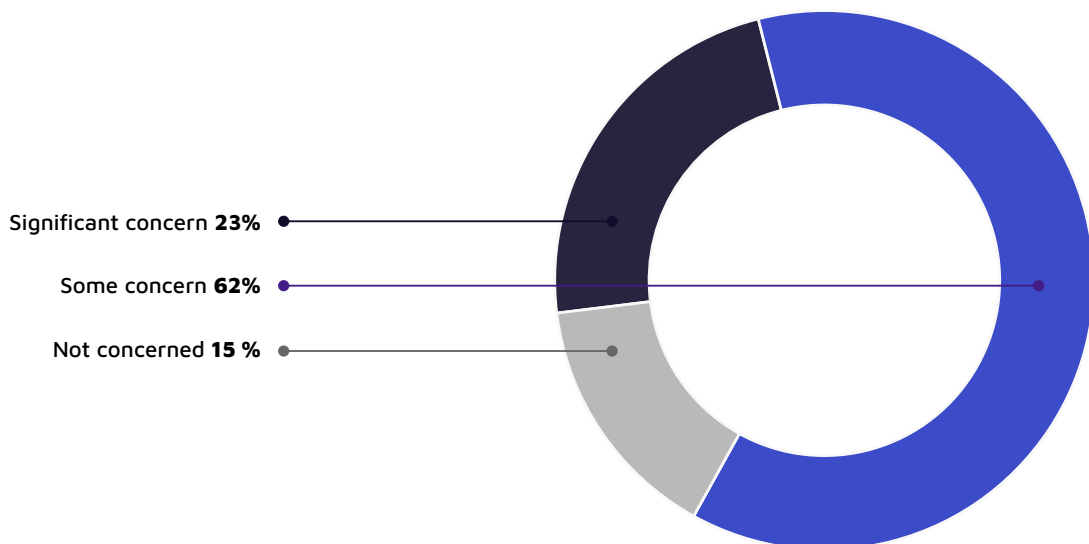
## Government debt

During the Covid-19 pandemic, governments across the world increased their debt issuance to fund economic support programs. This ramped up a decades-long trend of rising government debt in Western and emerging market economies to new levels. In Western economies, the pressure to increase public spending and cut taxes has led to greater questioning of the sustainability of

their debt piles. This has implications not just for serviceability but also market stability (as detailed in this report’s discussion of liquidity risk).

Most of the network showed some concern over the level of debt that Western governments have built up and are planning to increase, although far fewer saw significant concern.

### HOW CONCERNED ARE YOU ABOUT THE HIGH LEVEL AND POTENTIAL INCREASES IN GOVERNMENT DEBT ISSUANCES IN THE MAJOR WESTERN ECONOMIES?



## Consolidated tape

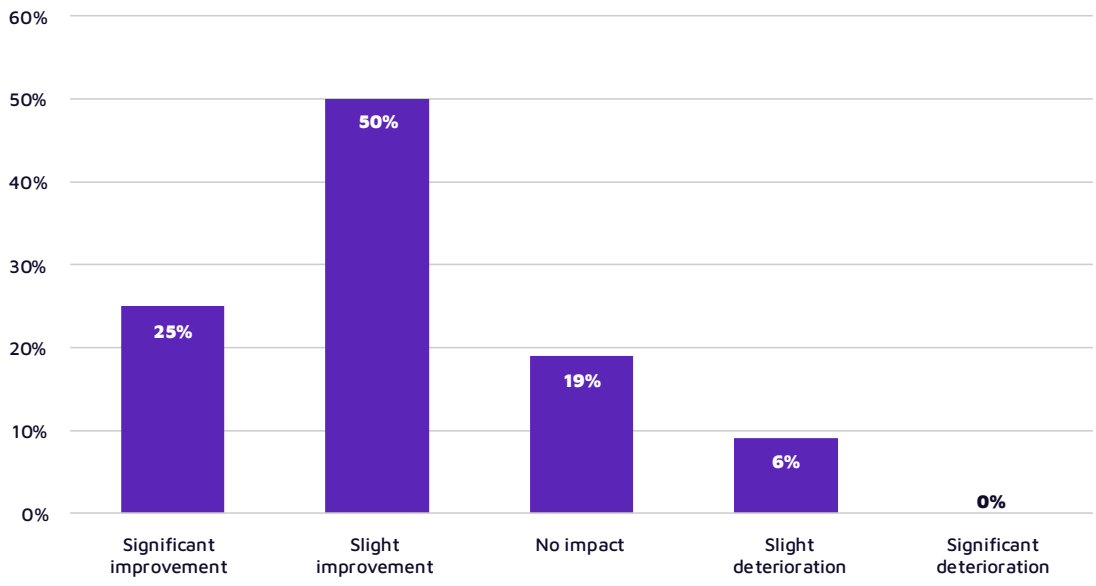
The long-awaited introduction of consolidated tape in Europe’s fixed income markets is finally approaching. This will provide EU traders with consolidated data on the pricing and volumes of markets which, in the case of fixed income, have hitherto been opaque on these features.

The UK’s FCA is making similar preparations, with a tender process for the consolidated tape provider role due to open before the end of this year. The authority has confirmed that the eventual bond CTP will not have to make payments to data providers.

This reform promises significant changes in the market, especially in the form of greater transparency and real-time pricing. This has not been welcomed by all, with some market participants voicing concerns about a negative effect on the transaction costs of larger trades.

However, most are welcoming the change. Three-quarters of the network thought that it would improve European fixed income.

### WHAT IMPACT DO YOU THINK THE INTRODUCTION OF CONSOLIDATED TAPE IN EUROPE WILL HAVE ON LIQUIDITY?

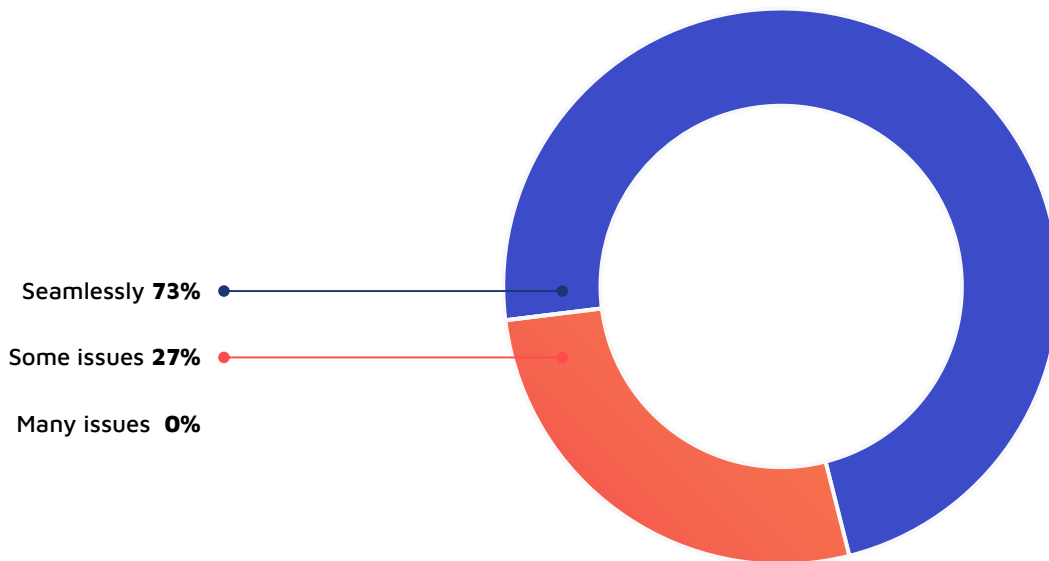


## T+1

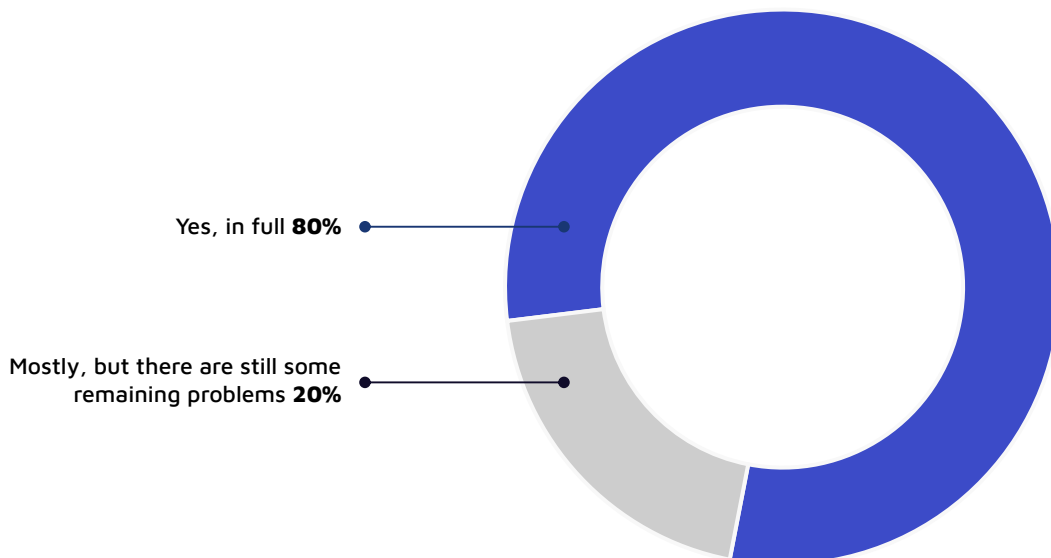
In the run-up to implementing T+1 settlement for compliance with US markets, there had been some concern in Europe around operational issues such as FX hedging. However, nearly

three-quarters of the network felt their transition had been seamless. Among the 27% who had experienced some issues, 80% said these had now been fully rectified.

### HOW DID THE TRANSITION TO T+1 IN THE US GO FOR YOUR FIXED INCOME BUSINESS?



### HAVE THOSE ISSUES NOW BEEN RECTIFIED?



# Buy-side corner: Execution protocols

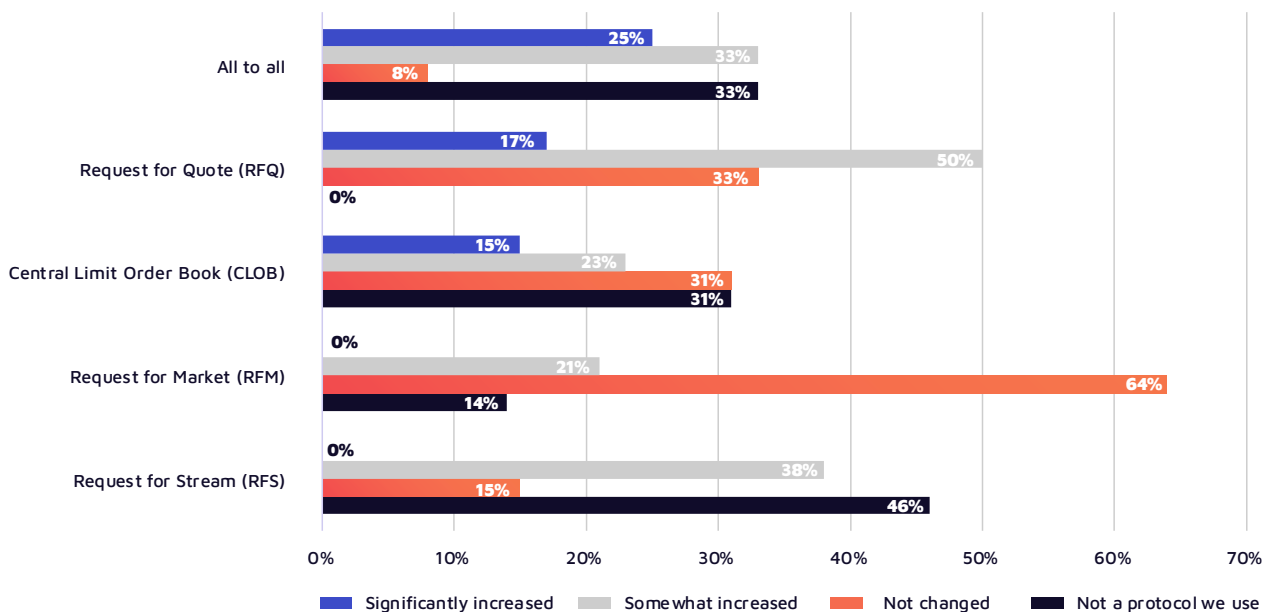
The past decade has witnessed a significant transformation in the fixed income execution landscape, driven by technological advancements, regulatory changes, and evolving market dynamics.

Several key trends have driven innovations in execution protocols in recent years. The increase in electronic trading has resulted in the launch of electronic platforms offering central limit order books and automated RFQs. At the same time, an increased focus on best execution and

pre-trade transparency has mandated that firms seek a range of bids and offers before executing a trade.

This quarter, we asked the buy-side members of the network how their use of execution protocols had changed over the past three years. Respondents reported significant increases in RFQ and all-to-all trading, while use of a central limit order book had also risen.

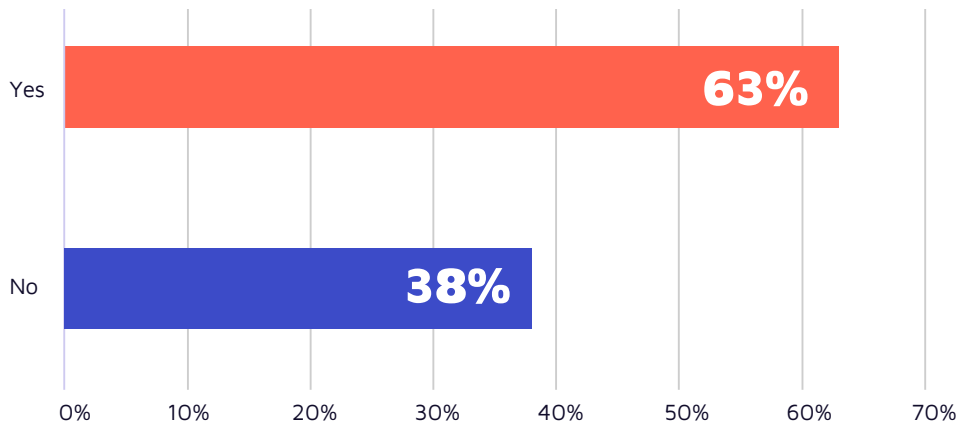
## HOW HAS YOUR USE OF THE FOLLOWING PROTOCOLS CHANGED IN FIXED INCOME TRADING OVER THE PAST THREE YEARS?



Another key addition to the execution toolbox of buy-side fixed income investors has been the growth of non-bank liquidity providers into the

market. These high-frequency market makers have developed execution offerings for buy-side firms.

### ARE YOU ENGAGING WITH NON-BANK LIQUIDITY PROVIDERS (I.E. ELECTRONIC MARKET MAKERS)?



Of the buy-side firms in the network, 63% engaged with non-bank liquidity providers. Those respondents that did reported that they could

typically achieve better fill rates and pricing when non-bank liquidity providers were included in their outreach.

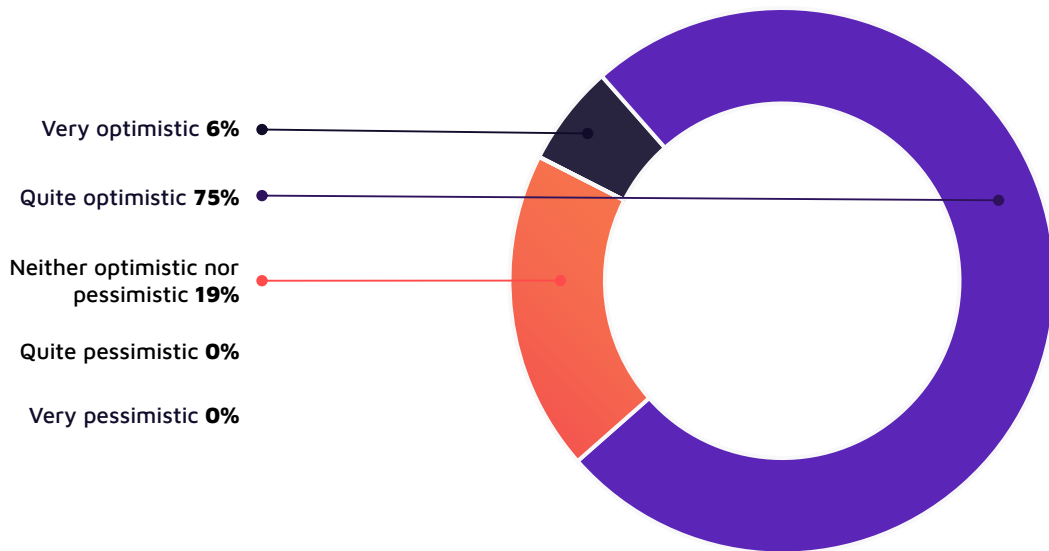
# Sentiment Index

In this report's installment of the sentiment index, 6% of network members were very optimistic about the three months ahead and 75% were quite optimistic. Overall, this was an improvement on the results for Q1 2024.

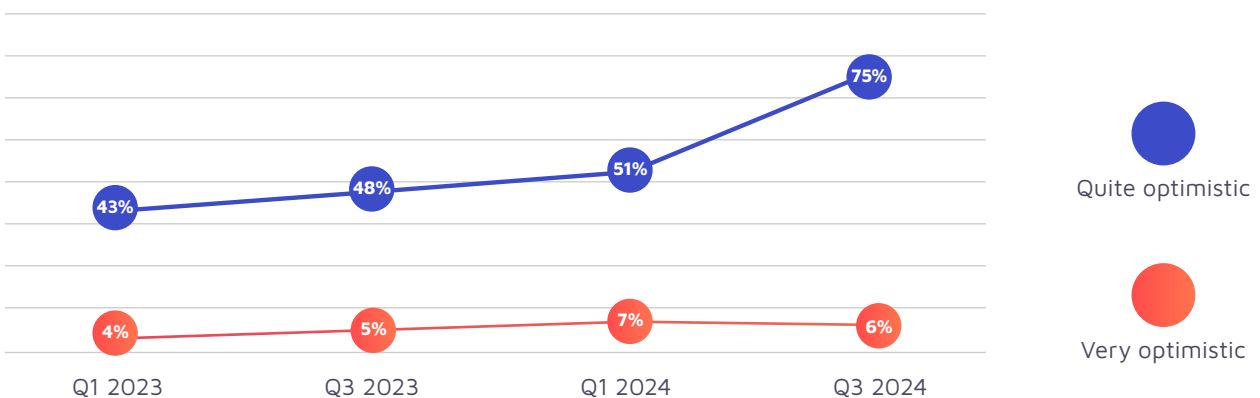
first part of this report. As the likelihood grows that the Fed will join the ECB and Bank of England in cutting rates this year, fixed income markets are raising expectations about the benefits this will bring to market activity.

The significant leap in optimism can be attributed to the improving rates outlook detailed in the

## HOW OPTIMISTIC ARE YOU ABOUT THE PERFORMANCE OF YOUR BUSINESS OVER THE NEXT THREE MONTHS?



## THE VALANTIC FSA FIXED INCOME SENTIMENT INDEX





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