

# ANB

Assurance | Business Advisory

## Current Trends in Global Financial Market

August 2011



# Flow of Presentation

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**Financial Turmoil**

**Global Financial Opportunities**

**Global Market Structure Drivers**

**Broking in India**

**How do we do better?**

# Financial Turmoil

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- First time in seven decades, the US's credit rating was downgraded from AAA, the highest rating assigned by rating agencies, to AA+ by Standard & Poor's. The move, a knock-on effect from America's spiralling £14 trillion deficit and its lawmakers' inability to agree upon raising the debt ceiling in time, rattled markets throughout the world. However, markets have bounced back on the news of lower than expected unemployment figures in the US and the highest retail sales figures in four months.
- However, rating not changed by other 2 rating agencies
- **Impact:** Standard & Poor's (S&P) sacked Deven Sharma as President
- Do we need rating agencies? At all



# Financial Turmoil

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- Europe's economy appears to be in an fragile state. Industrial production has declined in every large euro-zone economy, including France and Germany, which are usually considered as the bulwarks of the European economy. Production dropped by 1.7% in France and 0.8% in Germany.
- Analysts warn against a possible default of Italy, one of Europe's biggest economies, from its sovereign debt.
- **Impact:** Not Sure

# Financial Turmoil

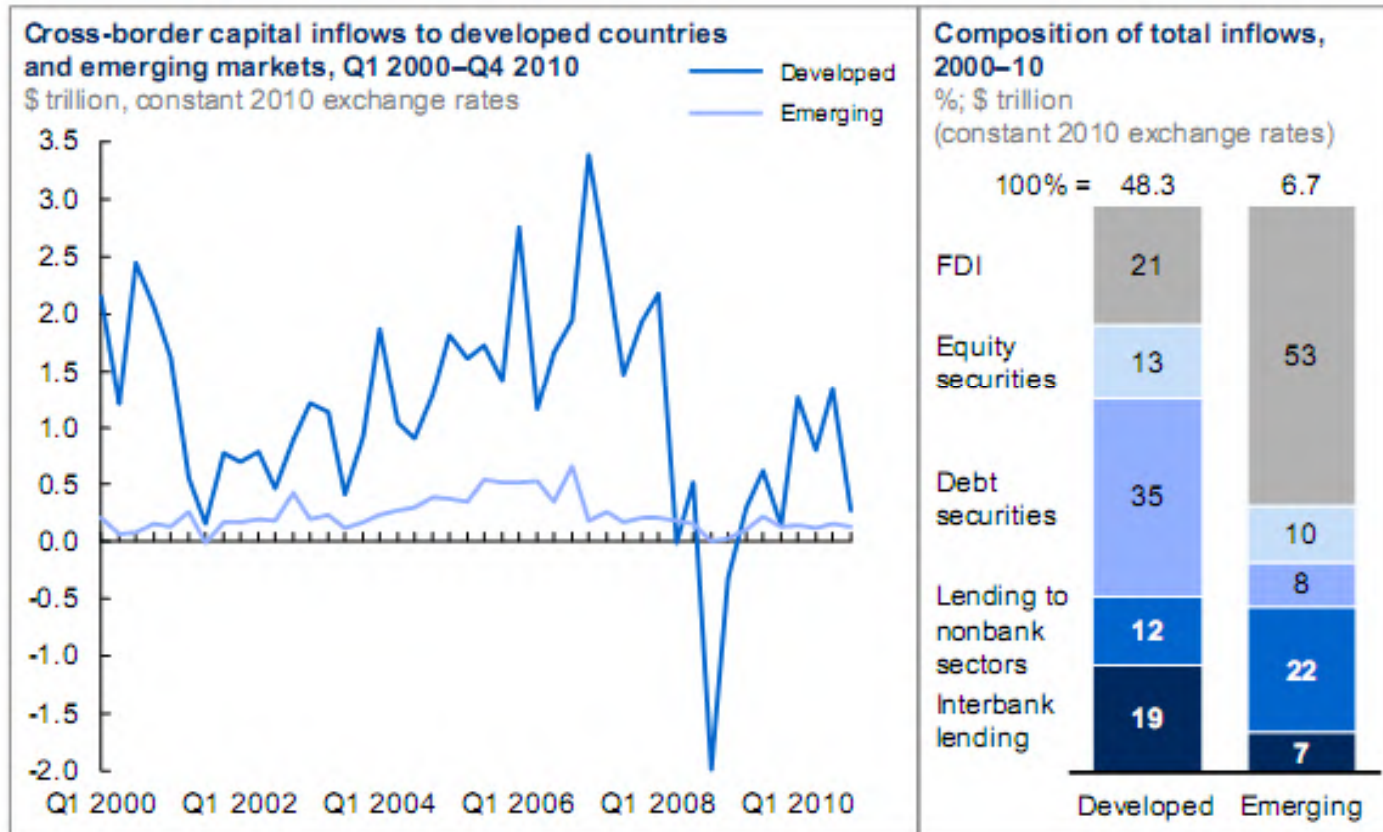
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- Protests started on Tuesday, January 25, when -- inspired by the successful revolution in Tunisia -- thousands began taking to the streets to protest poverty, rampant unemployment, government corruption and autocratic governance of President Hosni Mubarak, who has ruled the country for 30 years. These were the first protests on such a large scale in Egypt since the 1970s.
- Impact: President Hosni Mubarak resigns as President



# Global Financial Opportunity

**Capital flows to emerging markets are smaller but more stable than flows to developed countries**



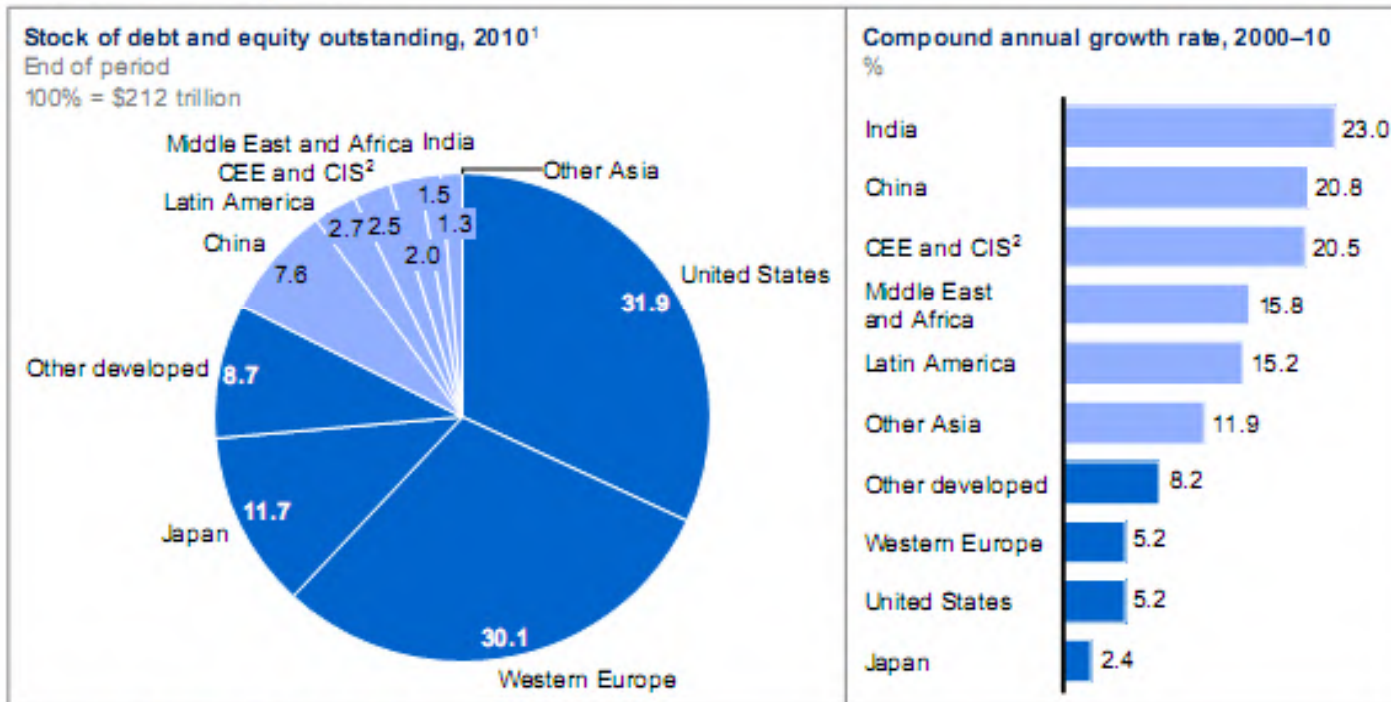
SOURCE: International Monetary Fund; McKinsey Global Institute analysis

# Global Financial Opportunity

**Emerging markets account for the smallest share but also the fastest growth in the global financial stock**

■ Developed countries  
■ Emerging markets

Stock of debt and equity outstanding, 2010<sup>1</sup>  
% of total, end of period



1 Based on a sample of 79 countries.

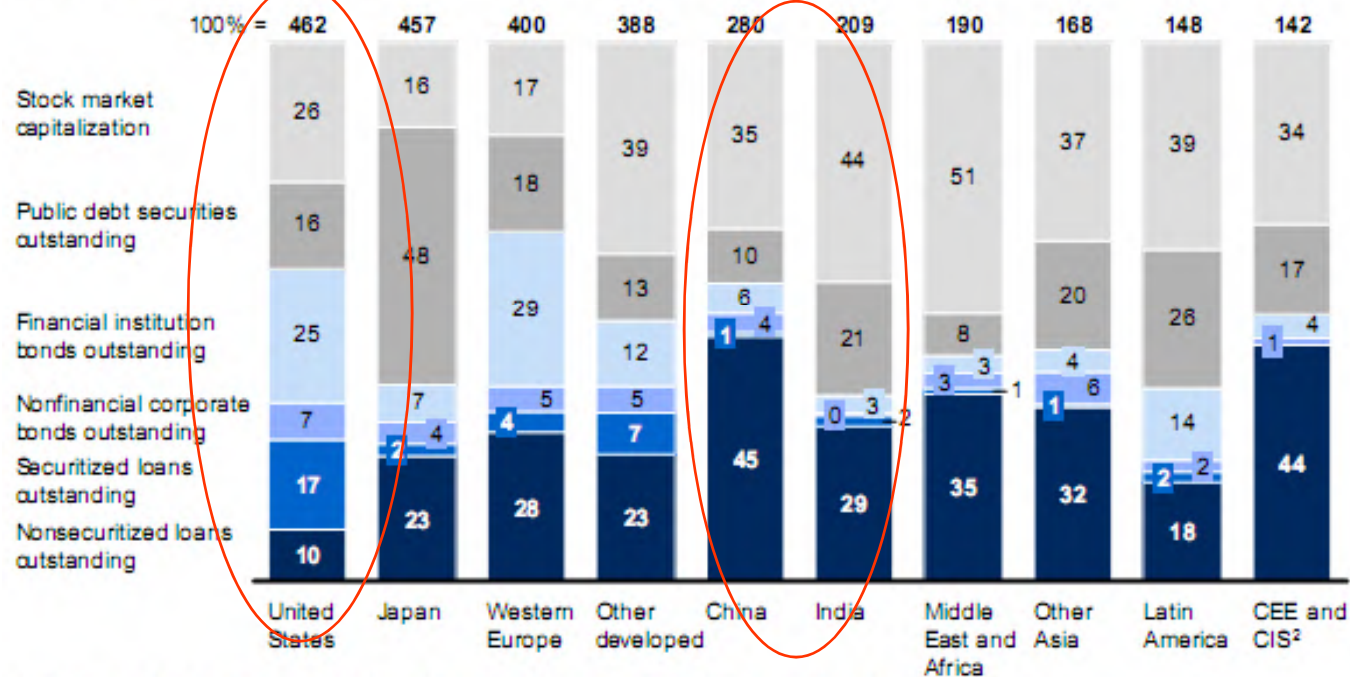
2 Central and Eastern Europe and Commonwealth of Independent States.

SOURCE: Bank for International Settlements; Dealogic; SIFMA; S&P; McKinsey Global Banking Pools; McKinsey Global Institute analysis

# Global Financial Opportunity

## The structure of capital and banking markets varies widely between countries

Financial depth, year end 2010<sup>1</sup>  
Percent; % of regional GDP



<sup>1</sup> Calculated as total regional debt and equity outstanding divided by regional GDP.

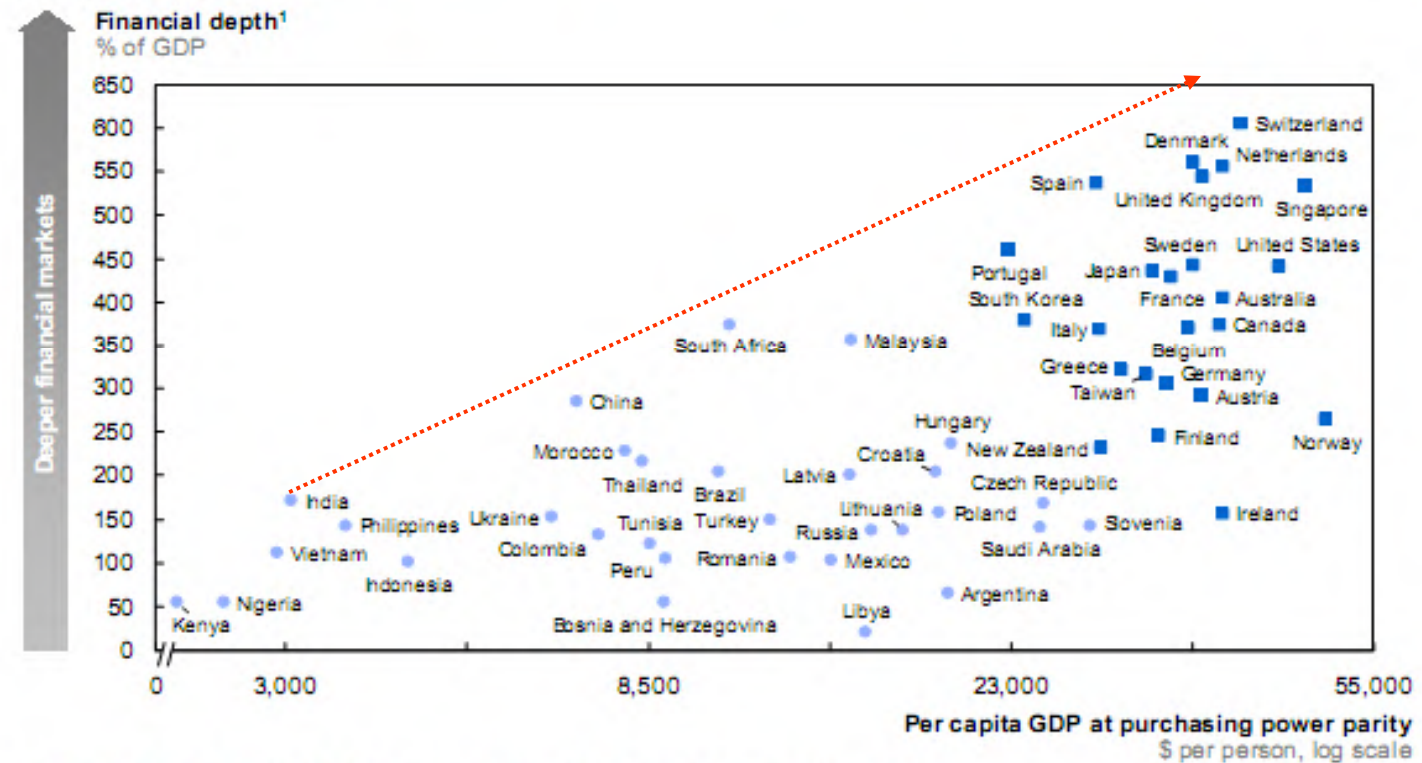
<sup>2</sup> Central and Eastern Europe and Commonwealth of Independent States.

SOURCE: Bank for International Settlements; Dealogic; SIFMA; Standard & Poor's; McKinsey Global Banking Pools; McKinsey Global Institute analysis

# Global Financial Opportunity

## Financial markets in developing countries still have significant room for growth

2010, end of period



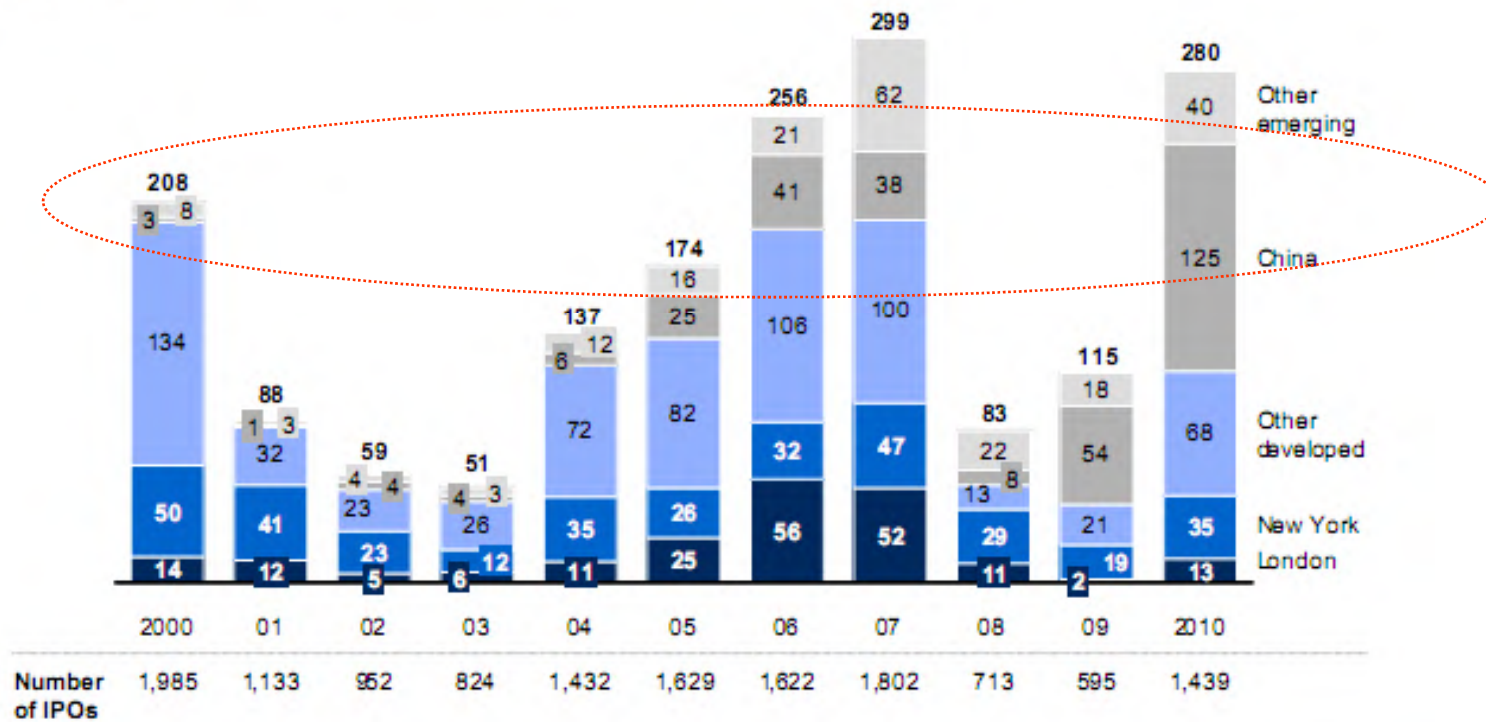
<sup>1</sup> Calculated as a country's debt and equity outstanding divided by country's GDP.

SOURCE: Bank for International Settlements; Dealogic; SIFMA; Standard & Poor's; McKinsey Global Banking Pools; McKinsey Global Institute analysis

# Global Financial Opportunity

More than half of global IPO volume occurred on emerging market exchanges in 2009 and 2010

Deal volume in different stock exchange locations  
\$ billion

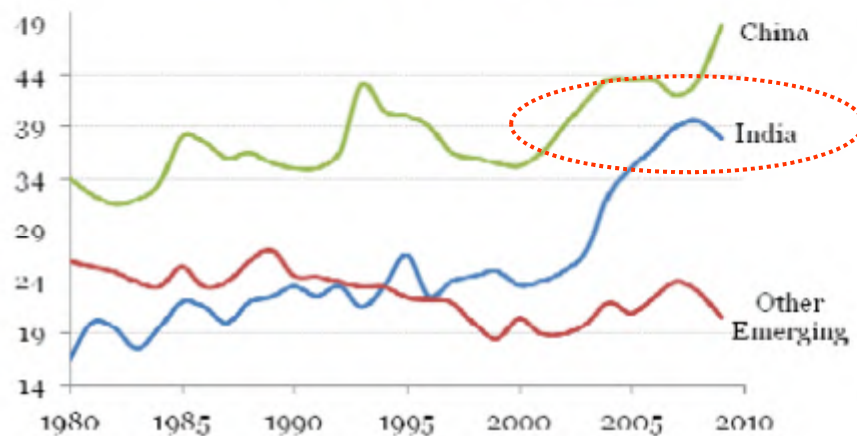


NOTE: Numbers may not sum due to rounding.

SOURCE: Dealogic; McKinsey Global Institute analysis

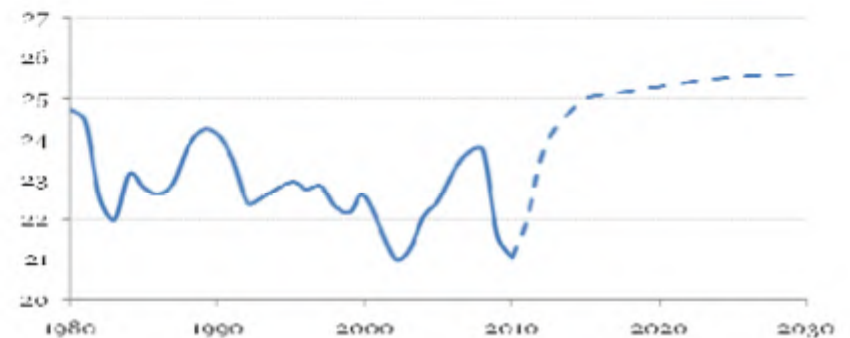
# Global Financial Opportunity

**Investment rate in emerging economies**  
In per cent of GDP



Source: CEIC; Haver Analytics; McKinsey Global Economic Growth Database; World Development Indicators of the World Bank; McKinsey Global Institute (2010).

**Worldwide investment rate forecasts**  
In per cent of GDP



Source: IMF (2011). Economic Intelligence Unit; - McKinsey Global Economic Growth database; Oxford Economics; MGI Capital Supply & Demand Model; World's Bank Development indicators; McKinsey Global Institute

# Global Broking Trends

US	European	Asian	India
Mature Market Structure	Mostly Mature Structure	Immature Market Structure	Evolving Market Structure
Markets highly fragmented with ATS at >20%	ATS / MTFs attract less than 20% of liquidity	Markets primarily concentrated on national exchanges	Markets concentrated on NSE & BSE
HFT significant % of volume (over 30%)	HFT in its infancy at less than 30% of volume	HFT limited by inferior matching systems and latency	Matching system still not as per world standards
Internalisation and broker-dark pools	Crossing systems offered by brokers	Crossing systems highly manual	Dabba trading Not Allowed
Algorithms necessary to 'sweep' dark pool venues	Basic benchmark algorithms	Algorithms in infancy and limited by more basic market structure	Basic Algos (Advanced algos used by MNC brokerage houses which have been developed by group cos.)

HFT – High Frequency trading; ATS – Alternative Trading Systems;

Source: Celent

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# High Frequency Trading

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- Frequent turnover of many small positions in one or more financial instruments (typically in liquid scrips) enabled by detection of minute changes in market intermediaries through use of sophisticated technology
- Egs. Statistical arbitrage strategies
- Need for HFT stems from creating liquidity in market
- HFT is a subset of electronic trading but not a synonymous with Program Trading (PT) or Algorithmic Trading (AT)
- HFT depends on reliable, ultra-low latency connections on regular basis
- HFT is a method to implement a strategy employed by a firm who are primarily trading using their own capital

# Alternate Trading System

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- An SEC-regulated trading venue which serves as an alternative to trading at a public exchange.
- In some ATSs (also referred to as “dark pools”) buyers and sellers are matched anonymously without pre-trade display of bids and offers, and the trade is publicly reported upon execution. It is important to note that the basic function of a broker-operated ATS is an electronic manifestation of a previously manual trading process, when trading desks would first try to execute trades internally before sending the order to a public exchange.

## Dark pools

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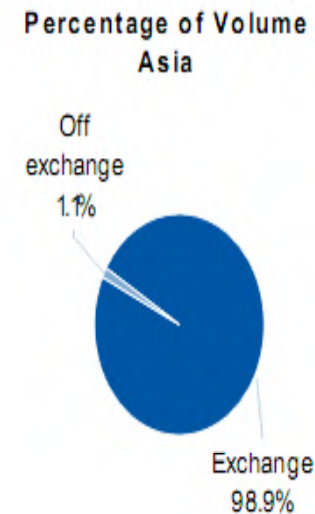
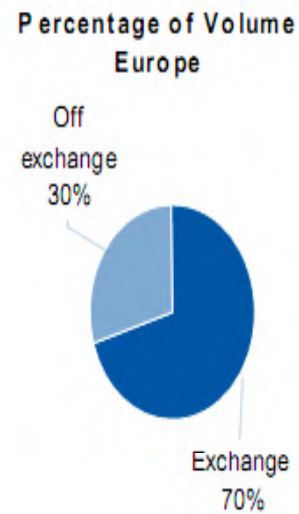
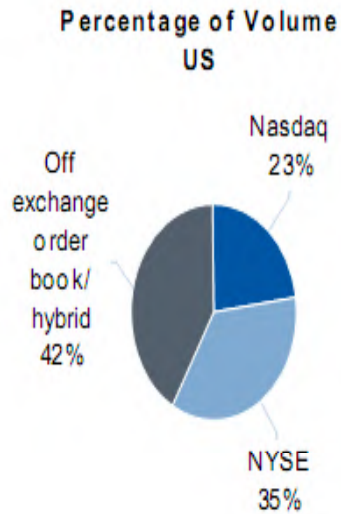
- Equity markets in the U.S. and increasingly around the world work on a participant model in which those wanting to trade will display shares to buy or sell and the asking or bidding prices. At exchanges, these displayed prices by brokers can be seen through what are called “Tier II quotes.”
- The opposite of displayed is “dark.” Thus, the term “dark pool” refers to a place where trading liquidity -- a supply of shares -- exists that is not displayed for all to see. Think of dark pools as members-only platforms for trading participants wishing to execute larger trades without advertising interest through an open-book, or displayed, position.

# Algorithms

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- Algorithmic trading is the process where ideas are turned into mathematical models and then coded into computer programs for systematic trading. It is a science where investment, trading, mathematics and computer sciences meet.
- The computer algorithms are designed based on the historical performance of the strategy back tested against historical data.

# Global Off Exchange Trends



Source: Securities & Exchange Commission (SEC) Rule 605 data, Celent analysis, Oliver Wyman; Note-data may underrepresent some market centers, such as dark pools or crossing systems, which specialize in large orders (such as orders >10,000 shares)

# Global Market Structure Drivers

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- **USA**

- Around 42% of US volume executed off exchange due to homogeneous and non-concentrated market structure
- Securities Law has become structured and regulator Securities Exchange Commission matured based on historical learning.

- **Europe**

- Around 30% of Europe volume is executed on Multilateral Trading Facility (MTF's) like Turquoise and Chi-X
- A Multilateral Trading Facility (or MTF) is a specific type of European financial trading system. The concept was introduced within the Markets in Financial Instruments Directive (MiFID), a European financial law, and describes a trading venue that brings together buyers and sellers in a non-discretionary way according to a defined set of rules resulting in trades.
- Europe is expected to become more fragmented under MiFID with rise of new MTF's

# Global Market Structure Drivers

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- **Australia**
  - In 2010 Australian Securities Exchange (ASX) adopted new measures like bringing down latency, reducing trading costs and facilitating co-location in order to increase volumes.
- **Japan**
  - Tokyo Stock Exchange (TSE) introduced low-latency platform in 2010
  - TSE's revised regulations on Remote Trading Participant System allows overseas financial firms without domestic branches to directly trade in Japan

# Global Market Structure Drivers

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- **Hong Kong**
  - Hong Kong Securities & Futures Commission (HKSF) still in evolving stage.
  - No significant plans to relax off-exchange crossing and reporting rules
- **Singapore**
  - The Singapore Exchange has allowed banks in Singapore licensed by Monetary Authority of Singapore (MAS) to participate as clearing Members of its securities market.
  - MAS has relaxed position towards crossing networks
  - Recent dark pool partnership between SGX and Chi-X to form Chi-East

# Global Market Structure Drivers

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- India
  - General perception of regulation of Indian Capital Market is that it is over regulated and regulations are retail-oriented
  - Indian Capital market has a concentrated market structure with majority of trading taking place two stock Exchanges
  - Technological innovations introduced in India viz. DMA, Algorithm trading & Smart Order Routing (SOR)
  - Contribution of automated trading tools restricted to foreign brokerage houses due to easy availability of advanced trading tools by group companies and a global client base
  - Regional players without significant relationships, market know-how or access, research and improved technology.
  - Western market innovations like High frequency trading, Alternate Trading System & dark pools still a long way to make entry to India

## How do we do better?

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- Understanding trends and challenges of:
  - Indian Financial Markets
  - Big Financial/Broking houses
  - Foreign Financial/Broking Houses

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# THANK YOU

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