

Honey, I shrunk the brokers!

By, Manish Jalan

Is Algo trading really killing the brokers in India? Every morning when I open by daily soup of News, I hear this ghastly story of more brokers shutting down the shops in India, because Algo's are killing them. Is that really the case? Read on...

When I was with Credit Suisse, a major portion of their brokerage revenue was being generated due to Algo trading. They would provide superior execution, helping clients by being offside VWAP (or, Volume Weighted Average Price) by a small margin on 2 to 5 BP and make a killing on the performance generated. When I was with Merrill Lynch it was the same story.

Why then in India, brokers are blaming partially the Algo for their business being less profitable. A part of the reason is that high frequency arbitrageurs and traders who made a killing in 2002-2007 equity Bull Run have just stopped making any money at all. The reason is 2 folds, the biggest one is the STT or the securities transaction tax which stands at a whopping 2.3 BP in Index/Equity futures in India. With such a cost any high frequency (HF) opportunity gets a washed, given that HF traders survive on wafer thin margins of couple of basis points. The second reason is that now because of more computer programs, any pure arbitrage / easy spread money is gone. The co-located servers and HFT programs makes sure that any small spread / pure arb opportunity is completely cannibalized with no room for screen traders at all.

The entire confusion in Algo, helping some brokers and killing some other brokers

comes because of difference between Prop and Agency side of Algo business. In Prop because the client is trying to make money using a Algo (or HFT) trading mechanism like market making, scalping etc. he has to make money in absolute terms. In Agency side of Algo trading because brokers have to only *execute* the orders on client's behalf using a VWAP, TWAP, In-line etc. strategy – he is more bothered about being less off-side w.r.t the VWAP of the day. He really is not interested in making money on these algo trades.

Most brokers in India, still focus on Algo trading from Prop side of the business. The agency side of the business requires good investment in infrastructure, IT team etc. but the pay-off is more certain and definitely more stable on the in the long run. Imagine doing a volume of 1000 Cr. using algo trading and client willing to pay 0.5 BP on it - you have revenue of Rs. 500,000 per day!

Internationally, most large brokers like GS, JPM, MS, DB, CS, UBS, HSBC focus on Agency as their core business in Algo trading. Prop – well GS is the leader but then it is a cannibalized game – best left to hedge funds and smart money managers. Not a game for brokers – whose expertise lays in execution rather the money making.

In the long run brokers in India have to evolve and give superior execution capabilities to their clients then try and make money on Algo trading platforms. Tomorrow's leaders in brokerage business will need to think about clients – NOT Prop – from Algo perspective.

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About Samssara Capital Technologies LLP

Samssara Capital Technologies LLP ("Samssara") is an investment solutions firm focused solely on developing automated algorithmic and quantitative trading and investment strategies. It was launched in 2010 by a team of IIM Ahmedabad and IIT Bombay graduates - Rajesh Baheti, Manish Jalan and Kashyap Bhargava. Samssara caters to its clients' needs of providing an alternative asset management vehicle, with the focus on 100% automated and quantitative trading strategies.

Samssara's products vary from pair trading (statistical arbitrage), factor models, Nifty Index beating products to very high frequency trading strategies. The team at Samssara works on mathematical models and statistics that identify repetitive patterns in equity, commodity and currency markets. The addressable market for Samssara is global - as the firm can develop and build models which can function in both developing markets with limited competition and developed markets with strong competition. Samssara's client base includes the leading international and domestic banks, international and domestic stock brokers, family offices, corporate treasuries and HNIs.

Profile of Manish Jalan

Manish Jalan is the Chief Strategist and Director of the Algo trading firm Samssara Capital Technologies LLP. Prior to his new found Indian venture, Manish was a Quantitative Prop Trader in Tokyo, with Merrill Lynch Prop Desk handling USD 100 Mn. portfolio. Manish has worked closely with many Indian brokers and numerous International banks in algorithmic trading, trend following strategies, statistical arbitrage, factor modeling and back testing. Manish is a B.Tech and M.Tech from IIT Bombay in Mechanical Engineering.

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