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High Frequency Needs High Touch

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There is a tremendous amount of irony in the path high-frequency trading - excuse me, principal trading firms have taken from their heyday in the late 2000's. We alluded to this a few months ago in our *Top Market Structure Trends to Watch in 2017*:

Prop trading moves beyond trading

Proprietary trading isn't only about trading anymore. While ultra-low latency infrastructures and rooms full of genius programmers can continue to make money trading, why should PTFs limit themselves to a single revenue stream?
With ultra-low latency all but commoditized and the most successful PTFs now well established, it only makes sense to further monetize the assets that they've developed over the past decade.

Selling technology, providing custom liquidity streams and acting as an outsourced trading desk are the low-hanging fruit. Expect even more creative extensions of the prop trading business to pop up in 2017.

When I first started meeting with these folks about 10 years ago, it was all pretty cloak and dagger. My most memorable experience was entering a very dimly lit office via a door that required biometric scanning for entry. We were escorted into a conference room, that was also pretty dark mind you, and in no uncertain terms instructed not to ask questions but only answer them. Which, of course, we were more than happy to do. as even the questions asked gave us a glimmer of insight into how they operated and what they planned to do moving forward.

While some mystery still exists, and some of the largest volume traders in the world remain unknown to most of the population, the principal trading community has by and large come out of the shadows and in some cases - gasp - now have customers! While this post isn't intended to be about Virtu's recently announced planned acquisition of KCG, it's impossible not to make note of the firm's continued move towards a customer business - a perfect case in point. While automation will still lead the charge, managing customer relationships will suddenly be more critical than ever.

But that's not really where the irony exists. What I find ironic is despite the amazingly technology centric nature of these businesses, both those with customers and those without, the importance of having the fastest technology has diminished over the past five years whereas the need for strong relationships has grown. High-frequency trading needs high-touch relationships.

For those sticking to their prop trading roots, establishing relationships with brokers, FCMs, regulators,

clearers, exchanges, analysts (obviously), and others all matter more than ever. For those with customer businesses, the need to establish relationships is even more obvious.

I asked a senior executive at one of those firms with a customer facing business why, with all of the top player's technology so good and spreads so tight, did they chose to trade with you. His response: because they like me and trust me. In other words, a prop trading firms is increasing its trading volume not through a new microwave link but via human relationships. Wow, times have changed.

We should never forget that no matter how high tech, how fast, how much data, and how much artificial intelligence is injected into capital markets, it's still a business run by people and relationships will always matter.

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