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Fixed Income Trading

Greenwich Associates Report Shows Hedge Funds "Reasserting Themselves" in Trading in U.S. Fixed Income Markets

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By Vincent Pitaro, *Hedge Fund Law Report*

Greenwich Associates, LLC (Greenwich), has issued a report on trading volumes in the U.S. fixed income markets and the growing role that hedge funds play in those markets. The report indicates that, compared with 2011, in 2012 hedge funds increased their share of fixed income trading volume by about a third.

Greenwich provides consulting and market research services to the financial services industry. In the course of three months this spring, Greenwich interviewed 307 U.S. hedge funds and 778 other U.S. institutional investors about the fixed income market. Its survey covered the period from the second quarter of 2011 to the second quarter of 2012 (study period). Its interviews covered a broad range of topics, including trading and research activities and preferences. This report focuses on year-to-year changes in trading volumes in the fixed income markets and the relative proportions of trading accounted for by hedge funds and other market participants. This article summarizes the key findings in the report.

Greenwich found a 20% overall increase in fixed-income trading volume during the study period. It surmises that a general move towards U.S. Treasuries lowered Treasury yields and caused investors to chase returns in other market segments. That, in turn, accounted for higher trading volumes in those other segments. The two segments with the highest increases in volume were distressed debt and emerging markets, which increased by 57% and 54%, respectively. The only segment with lower trading volume was investment-grade credit. Greenwich attributes the 6% drop in trading volume in that segment to "unattractive returns."

Hedge funds and other funds/investment advisers both increased their share of fixed-income trading during the study period, with hedge funds' share of trading volume rising by a third, from 18% to 24%. Greenwich links the rise in hedge fund participation to a decline in banks' trading activities. It found that banks' share of trading volume dropped dramatically during the study period (from 24% of volume to 17%). It attributes this to banks' elimination of proprietary trading desks, which has had the effect of moving those traders into the "more lightly regulated hedge fund industry." See "Key Legal Considerations in Connection with the Movement of Talent from Proprietary Trading Desks to Start-Up or Existing Hedge Fund Managers: The Talent Perspective (Part One of Three)," Hedge Fund Law Report, Vol. 3, No. 49 (Dec. 17, 2010).

It also appears that fixed-income trading by hedge funds is a significant contributor to overall trading volumes. While fixed-income trading by all investors was up 20% across the board, hedge fund trading grew by 30%. Similarly, while investment-grade credit trading volumes

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dropped 6% overall, hedge funds reported a 60% drop in their trading in that segment. One Greenwich table shows that over the past six years, on average, hedge funds have accounted for half or more of overall trading volume in distressed debt, high-yield derivatives, structured credit and leveraged loans. In fact, hedge funds account for two-thirds or more of the trading volume in distressed debt and high-yield credit derivatives. Hedge funds have been least active in trading in high-grade bonds, mortgage backed securities, government bonds and interest rate derivatives.

For a copy of the Greenwich Associates report, click here.

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