

Sales Trader of the Future



Author Kevin McPartland

Editor Alison Zomb

Analyst Kevin Kozlowski

Designer Eileen Sierra

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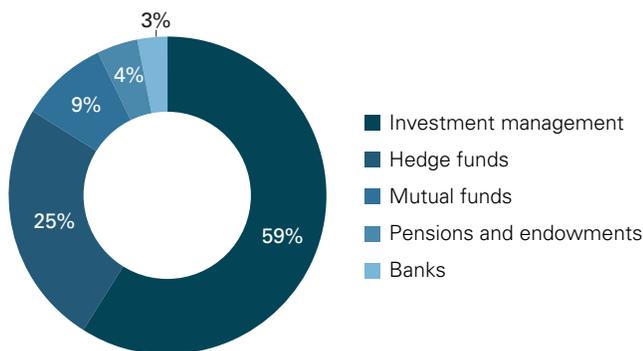
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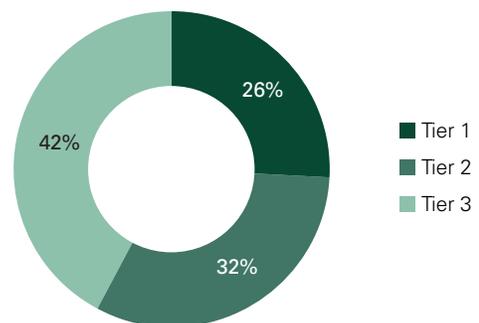
METHODOLOGY

During the month of April 2014, Greenwich Associates conducted telephone interviews with 19 professionals at sell-side firms to understand how the sell-side equity sales trader and sales desk are evolving in today's market. Respondents were asked about the size and composition of the desk, the impacts of regulations, and how the role of the sales trader has changed. This paper also includes data based on interviews with 316 buy-side U.S. equity traders and 225 U.S. equity portfolio managers regarding U.S. equities. Respondents answered a series of qualitative and quantitative questions about the brokers they use in the U.S. cash equity space.

Buy-Side Institution Data



Sell-Side Participants



Tiers are based on the Greenwich Associates 2014 Commission-Weighted U.S. Equity Trading Share which measures each broker-dealer's share of total commission including commissions for high-touch, electronic, portfolio, and commission management trading and is based on trader's allocation of spend. Tiers are determined by institutional commission volume with each broker-dealer. Tier 1 firms represent 35% of the total estimated commission pool, Tier 2 represents 8% and Tier 3 represents 5%. The total estimated commission pool for 2014 is \$10.34 billion for the 12 months ended Q1 2014.

Executive Summary

Sales trader relevance has been debated for more than a decade as buy-side driven execution algorithms and trading tools have made self-service trading ubiquitous. Despite the ability of institutional investors to trade via cheaper self-directed channels, more than half of U.S. equity trading done by clients passes through broker sales traders. Why? A smarter, more client-focused sales trading force, coupled with uncertain markets and a complex market structure, keep clients picking up the phone.

The sales trader of the future looks dramatically different than in the past. While the major method of differentiation—relationships—has not changed, the definition has evolved. Twenty years ago relationships meant sending order flow to old friends and college roommates. Today relationships mean providing the right kind of

information and services that make the buy-side trader look smart in front of the portfolio manager and ultimately lead to a better ranking in the broker-vote process. Establishing these newly defined relationships is how the future sales trader can cement his importance.

Enter sales trader technology. The next generation of sales trader tools—many of which already exist and are available for the taking—go beyond the CRM systems common today. Communication methods have exploded, including social media, group chats, various IM platforms, (occasionally) email, and phone calls that can now be recorded and transcribed in real-time. Based on these communication records, market data, news, and a client's portfolio history, technology will enable sales traders to send custom suggestions via the client's preferred method of communication, and do that on a scale that wasn't possible before.

The sales trader is not dead, nor has he been replaced by a robot.

The reality: Buy side use of self-directed electronic-trading channels has changed little since 2009. The story is not that electronic-trading tools are failing to attract more flow, but instead that a new breed of sales traders is continuously proving their worth. A smarter, more client-focused sales-trading force, coupled with uncertain markets and a complex market structure, keeps clients picking up the phone. As a result, not only do sales traders continue to handle more than half of the institutional investor trading volume in the United States, but in 2014 they commanded a higher commission-per-share year-over-year for the first time since before the financial crisis (see chart on following page).

Brokers are pricing high-touch trading as a premium service and investors are willing to pay up.

The story of the sales trader is not all positive, however. Of the nearly 20 brokers Greenwich Associates spoke with for this study, 43% said they have reduced the size of their sales trading desk over the past 2–3

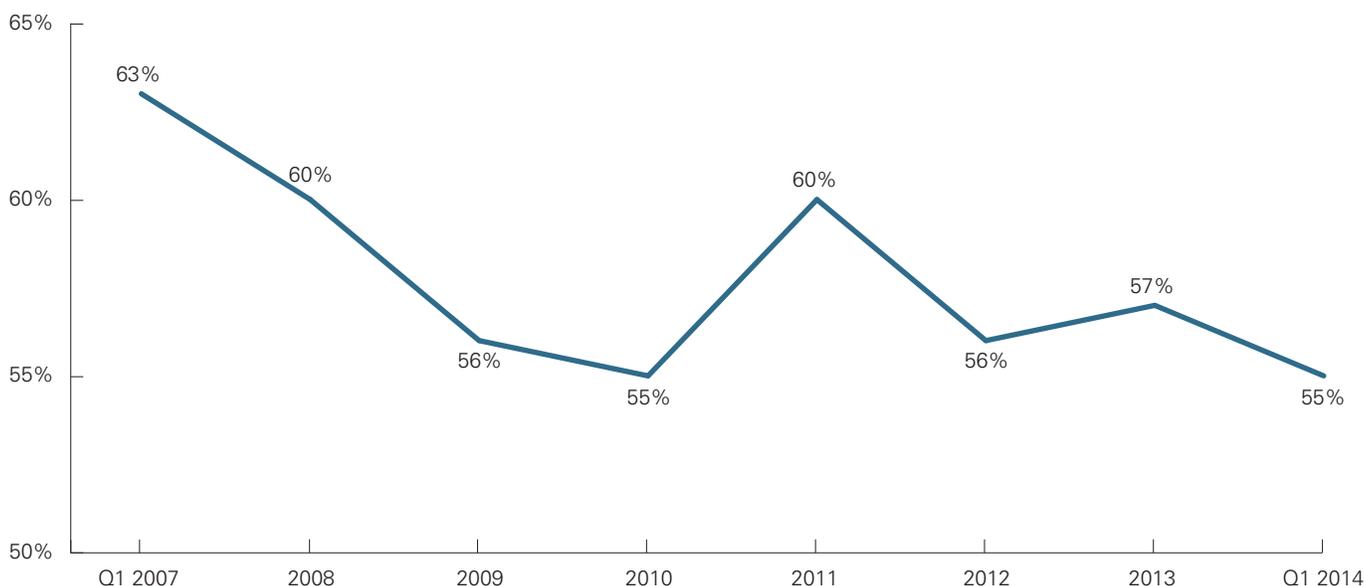
Defining High-Touch Trading

While high-touch and low-touch are common industry terms, how they are defined can vary considerably. Greenwich Associates uses the following definitions in our research and analysis:

- **High-Touch:** Single-stock trades sent to broker sales traders, communicated either by phone, messaging, email, or FIX protocol.
- **Low-Touch:** Electronic single-stock trades using algorithms including dark pool sourcing algos or DMA/smart-order routing trades and/or electronic single-stock trades that are sent to crossing networks.

years while 29% have kept staffing levels constant (see chart on following page). Part of this drop can be attributed to changing terminology within the industry. Execution consultants, for example, may not be considered sales traders despite their high-touch interaction with clients. Nevertheless, today's trading desk is often handling the same amount of order flow with fewer people.

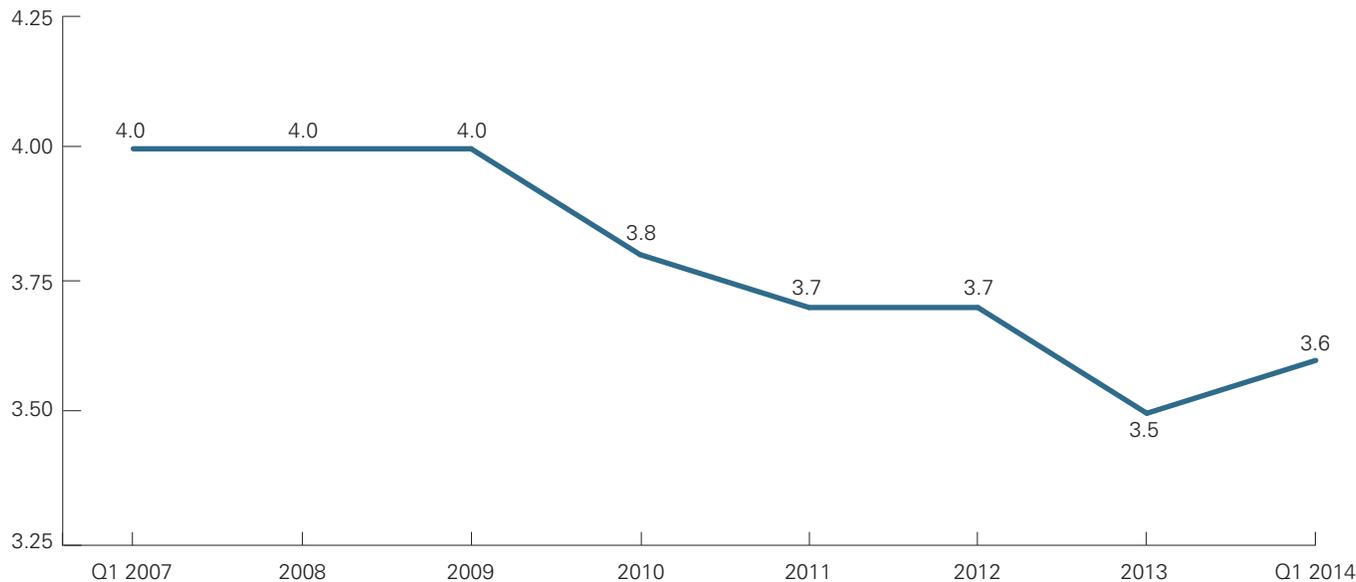
Single-Stock Trades with Broker Sales Traders



Note: Based on responses from 257 traders in 2007, 241 in 2008, 267 in 2009, 250 in 2010, 256 in 2011, 291 in 2012, 284 in 2013, and 303 in 2014.
Source: Greenwich Associates 2014 U.S. Equity Investors Study

Average Cost of High-Touch Agency Trades

(Cents-per-share)



Note: Based on responses from 258 traders in 2007, 230 in 2008, 272 in 2009, 269 in 2010, 285 in 2011, 273 in 2012, 275 in 2013, and 291 in 2014.
Source: Greenwich Associates 2014 U.S. Equity Investors Study

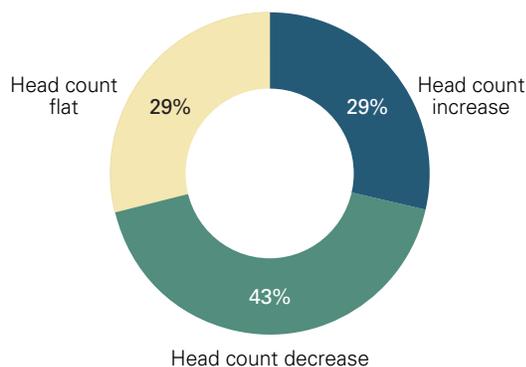
It should be noted that all of the nearly one-third of brokers who have experienced growth on their sales trading desk in the past few years were boutique/specialist firms that saw the opportunity to step in where the larger firms have been backing away. They are not simply throwing bodies at the problem however, but are instead making strategic hires who understand the dynamics of today's

markets and are arming them with technology that helps them react to client needs more quickly, efficiently, and in a more cost-effective manner.

This all begs the question—are brokers sacrificing quality of service to eke out profits from a business whose margins continue to get smaller and smaller? The answer is not simple—nor is it the same for every firm. Large brokers have scale but a much more complex operating model. Mid- and small-sized firms are more nimble and often more reactive; however, they lack scale and budget to hire armies of experts and build cutting-edge trading technology. Offering high-touch service for clients to execute via low-touch methods is particularly challenging, as it brings low-touch profits at high-touch prices.

Clients are finding the benefits of each model, executing low-touch flow through the brokers with the best tools and high-touch flow through brokers with the right sector specialists. Choice is good for clients, but makes a more competitive market for the sell side. In a business still largely directed by relationships, putting in place sales traders who are both cost-effective and can prove their value to clients on a daily basis is critical—but the formula today is not what it was in 1999.

Sales Trading Desk Size Changes Over the Past Two Years



Note: Based on 14 sell-side respondents.
Source: Greenwich Associates 2014 Future of the Sales Trader Research Study

Market Structure Impact

Greenwich Associates data shows the total commission wallet for U.S. equities grew in 2014 for the first time since 2009. While certainly a good sign for the sell side, making money in cash equities remains challenging. In a market where profits are tied to share volume, high stock prices, low volatility and lower than expected equity inflows have all kept volumes and profits low.

Every broker we spoke with tiers their clients, with over 90% doing so based on the profitability of the underlying accounts. Tiering clients isn't new, and top clients receive more attention in almost every business. But for equity brokers, a new level of rigor has become a necessity, and the top-tier buckets have continued to shrink. This is especially true amongst the bulge-bracket brokers, who reserve research, corporate access and high-touch coverage to only their best clients. Clients in the second and third tier certainly are not ignored, but in recent years they are more likely to be covered by more junior resources and directed to low-touch channels whenever possible.

Sell-Side Client Tiering Strategies



Note: Based on 12 sell-side respondents.
Source: Greenwich Associates 2014 Future of the Sales Trader Research Study

This has created a huge opportunity for boutique brokerages and sector specialists to step in where the bulge bracket has stepped back—and step in they have. Between 2007 and 2014, the bulge bracket's commission-weighted research share has dropped 25% while the share taken in by mid-tier/specialist brokerage firms has jumped 80%. The commission-weighted trading share numbers are even more dramatic, declining 18% for the top tier and increasing over 100% for the mid-tier brokers over the same period.

The growth of commission-sharing arrangements (CSAs) has played a big part in this shift as well. Now used by 76% of buy-side firms, CSAs have allowed the buy side to make trading and research decisions separately from one another. This freedom has driven up volume sent

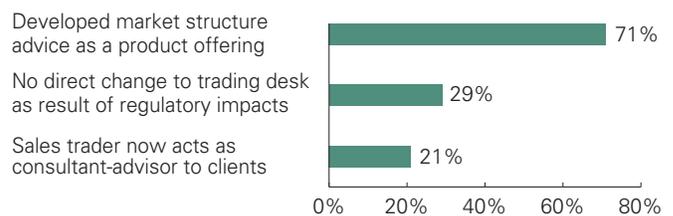
through mid-tier, high-touch desks as the access to information and research they provide, especially for mid- and small-cap names, has been differentiating.

It is important to keep in mind that the top nine brokers still handle nearly 64% of commission-weighted, buy-side flow, and as such their importance in the market can't be ignored. Their ability to commit capital and provide corporate access, among other things, can be hard to match based on their scale and relationships. That said, the buy side is thirsty for content, and with the ability to now seek out the best available research regardless of where they trade, it's a whole new ballgame.

Content is more than just written research. Keeping buy-side traders informed of market events that help them help the portfolio manager is critical. For hedge fund clients, short-term trading ideas that are actually unique can prove a huge differentiator. Insights into liquidity—where it is and how to get it—are also sought after. Finding liquidity today is considerably more complex than knowing the right broker on the floor of the NYSE, and clients look for sales traders who can present an aggregated view of liquidity and market information in a customized way.

Market structure advice is also highly sought after. Seventy-one percent of the brokers we spoke with have client-accessible market structure experts as part of their total offering. Understanding the dozens of execution venues, how they work, the regulations that allow them to exist and how changes in Washington might impact their ability to invest is more important than ever.

Demand for Market Structure Advice



Note: Based on 14 sell-side respondents.
Source: Greenwich Associates 2014 Future of the Sales Trader Research Study

But very few on the sell side can quantify the value of market structure advice. Correlating a strong market structure team with increased commission share cannot yet be done scientifically. One sales trader we

spoke with did provide good anecdotal evidence that market structure expertise pays. His firm hosted an event complimentary for clients that included several industry experts as well as SEC Commissioners. While the event itself was an expense, he said they were “most certainly paid back” in the morning via additional trade flow from the attendees.

What Clients Want

Market structure factors, including CSAs, regulatory scrutiny and sub-penny spreads, are making profitability more elusive—but the sell side is adapting accordingly. The buy side is doing the same, taking a best-of-breed approach to both high-touch and low-touch service. Determining the “best” low-touch offering is getting easier. For example, Greenwich Associates research shows that 73% of the time, buy-side equity trading desks are using transaction cost analysis (TCA), which can highlight the top-performing algorithms.

Defining the traits of a good sales trader is much more subjective. Ten years ago sales traders needed to be good at “blocking and tackling”—basically knowing how to work an order the right way to limit information leakage and get the right price. Today the buy side expects a sales trader who can not only get an order done, but also understands how the market works and the external factors that might influence a client’s decision-making progress. While being an expert in macroeconomics,

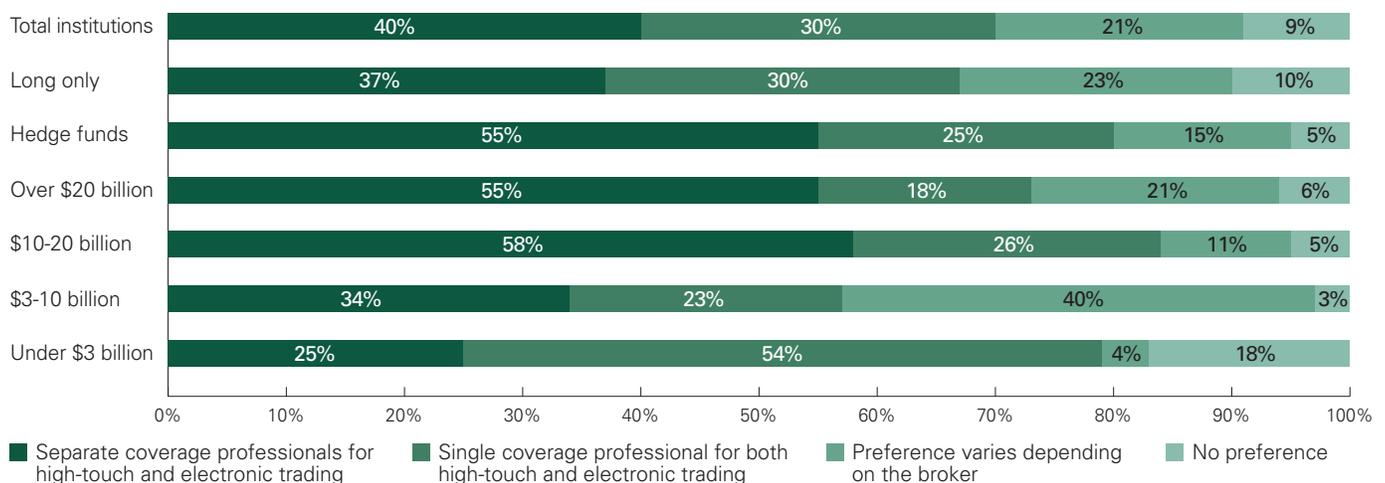
market structure and individual sectors is not a requirement, being able to carry on an intelligent conversation on these topics is a must. Just knowing your client’s kids’ names and having Yankees tickets isn’t enough anymore.

High-touch sales traders must be able to talk low touch. According to the sell side, the top buy-side request today is transparency into how their orders are handled and where they are executed—and sales traders need to have those answers. The recent market structure debate has only increased requests such as these.

That said, the buy side isn’t particularly keen on their sales trader having a complete view into their low-touch trading. The single point of contact (SPOC) model has gained traction on the sell side over the past few years, the idea being that a single sales trader can address all concerns of a client—high-touch, low-touch, multi-product, and multi-sector. Based on conversations with 122 buy-side traders, that model isn’t terribly popular, with only 30% specifying SPOC as their preferred method of coverage.

This lack of enthusiasm is not because the buy side wants a complex web of touch points at each broker. Some asset managers and hedge funds feel uncomfortable with any one person at the broker having access to their trading activities. Whether this is a legitimate concern or paranoia is to be debated, but the concern impacts their choice of coverage model nevertheless.

Client Coverage Preferences



Note: Based on responses from 122 traders in 2014. Source: Greenwich Associates 2014 U.S. Equity Investors Study

Equally as important, most investors want to talk to the expert. Sector specialists, for example, have become particularly sought after and have boosted the market share of mid-tier brokers. Keep in mind, however, that a primary point of contact is different from a single point of contact. The primary contact must be able to speak intelligently about a broad range of topics, but should also be willing and able to get the client in front of the expert when appropriate.

The time has come for the buy side to re-evaluate the SPOC approach. The barriers between high-touch and low-touch flow were created fifteen years ago as algorithmic trading began to take hold and brokers needed experts to explain to clients how electronic trading worked. The sales trader's job was to help navigate the market, not explain how to customize an algorithm. While that separation of duties made sense then, the divide is somewhat artificial today.

Sales traders are tasked with understanding the needs and wants of their clients. If the sales trader only has a view into the high-touch flow of their clients, they will never be able to fully understand how that investor is interacting with the market as a whole. While certain clients will also prefer to talk to specialists—an expert in arrival price algorithms, for example—hiding low-touch flow from the view of the sales trader is making less and less sense.

Even so, coverage is not a one-size-fits-all problem. As the list of brokers used by the buy side expands, more and more buy-side traders will expect different coverage models from different brokers. If a particular broker is used only for mining stocks, for example, then a single point of contact at that broker for high-touch trading, low-touch trading and research might be a much more efficient approach. The same principle holds true for a top-tier firm used primarily for their electronic offering and little else.

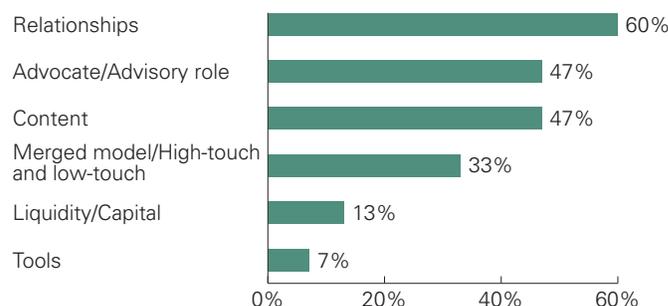
Lastly, talk of multi-asset coverage has also become common in the past few years as a part of the SPOC discussion. In our conversations for this research, there were no mentions of plans for multi-asset coverage. And of the several thousand buy-side firms that participate in our research across all asset classes (equities, FX and fixed income), there are very few cases when the same individual talks to us for more

than one asset class. However, there does appear to be a trend towards multi-product. For instance, an equities sales trader should be able to speak fluently about strategies involving equity options or total-return swaps. With liquidity as a premium, knowing the full product suite available to gain the needed exposure is increasingly critical to the buy side.

Standing Out From the Crowd

The sales trader of the future looks dramatically different than in the past. While the major method of differentiation—relationships—has not changed, the definition has evolved. Sixty percent of the brokers we talked to, both large and small, cited relationships as their key differentiator. But the definition of relationships has evolved. Twenty years ago relationships meant sending order flow to old friends and college roommates. Today relationships mean providing the right kind of information and services that make the buy-side trader look smart in front of the portfolio manager and ultimately lead to a better ranking in the broker-vote process. Establishing these newly defined relationships is how the future sales trader can cement his importance.

How Sell-Side Sales Trading Desks Differentiate Themselves



Note: Based on 15 sell-side respondents.
Source: Greenwich Associates 2014 Future of the Sales Trader Research Study

The actions of the 43% of brokers reducing sales-trading head count seem to go against the idea that relationships are the biggest differentiator. Even for many of those hiring or keeping total head count flat, the juniorization of the sales trading desk is a pandemic trend. Investors often trade with a given firm based solely on the relationship they have with a specific sales trader. When that individual is replaced with a college graduate, as has frequently been the case in the past few years, the client often

takes his business elsewhere. How can brokers keep that flow and maintain the deep relationships they've developed over time with fewer and/or less experienced sales traders?

First, service customers based on their needs and preferences rather than a standard tiering model that dictates how a client must be covered. Client profitability must not be ignored, as the cost of time and effort provided can't be larger than the expected revenue. This is especially true in today's environment that is no longer focused on top-line revenue but instead on bottom-line profits. However, providing the right type of service—allowing access to a particular analyst, for example, instead of just sending a written report—might encourage a small client to do more business with the given sales trader. Making these decisions effectively requires sophisticated analytics that examine customer behaviors and long-term trends, which brings us to the second answer: technology.

When we think of sales traders we think about phones and doing things the old-fashioned way. Phones still facilitate voice communication, but now high-touch service requires much more. Every sales trader we spoke with for this study had tools specifically built for them. The majority use vendor-provided software, with just over 40% using tools that were built in-house. Those using homegrown solutions were either in the top tier or from technology-focused brokerages.

The majority of technology tools used by sales traders today fall under the umbrella of market intelligence, a capability cited by 43% of our sell-side study participants. This can be defined as a

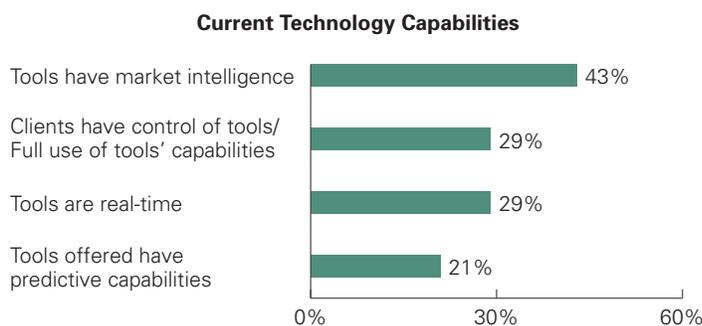
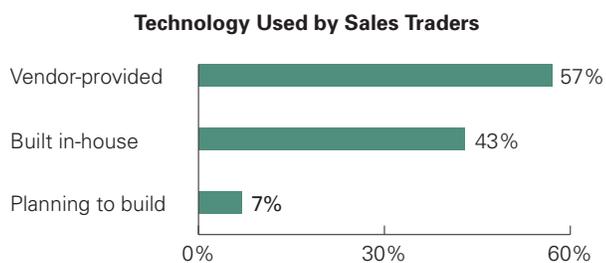
combination of market data—prices, volumes, news, etc.—and customer-specific data. The result is a client relationship management (CRM) system designed specifically for traders. Not only does the system track the last time a particular client was engaged, but also the contents of their portfolio and the stocks they trade most frequently.

These tools were created for a time that is now in the rearview mirror. Communication was mostly one-to-one and almost completely over the phone and IM. Inputs used to make trading decisions and recommendations were limited to market data, news, traditional research, and a client's trading history. It all seems so quaint in hindsight.

The next generation of sales trader tools—many of which already exist and are available for the taking—must dig much deeper. Communication methods have exploded, including social media, group chats, various IM platforms, (occasionally) email, and phone calls that can now be recorded and transcribed in real-time. In addition to streamlining broker/client interactions, the content of these communications is now a major input into the predictive analytics available to today's sales trader, along with computer-readable news feeds, the transcripts of TV broadcasts, sentiment analyses, crowd-sourced earnings estimates and digitized equity research.

While the data set doesn't meet the Silicon Valley definition of "Big Data," it is getting awfully close. This big data set and the tools wrapped around it are at the heart of how the future sales trader—whether one with 10 years of experience or one—can better service their clients.

Sales Trader Technology Usage



Note: Based on 15 sell-side respondents. Respondents indicated using both in-house and vendor-provided technology.
Source: Greenwich Associates 2014 Future of the Sales Trader Research Study

Technology can ensure that clients receive only the information they want via the channel they want it. Understanding each client's preferred methods for interacting with their sales traders can be key. For instance, a hedge fund customer might prefer to receive research via email, trading ideas via instant messenger and execution notifications via FIX directly into their EMS, whereas another long-only asset manager client might prefer all communications to be made via phone. Both the former and the latter appreciate the high-touch service provided via a sales-trader relationship, but the former prefers that service via electronic channels. This approach to customer service is not rocket science, but for a sales trader covering 50 accounts, the only way to get it right is to automate the process.

With a sales trader armed to communicate with clients in the most efficient way possible, the next step is ensuring the sales trader has something good to say. While with today's technology a sales trader can be alerted to call a client about a particular opportunity given their trade history, next generation tools will enable the sales trader to suggest a broader set of opportunities using sophisticated analytics. This is where that big data set comes into play. Based on transcriptions of previous phone calls and information inquiries, market data, news and a client's portfolio history, technology will enable sales traders to send custom suggestions via the client's preferred method of communication, and do that on a scale that wasn't possible before. Think about how Amazon.com suggests what you might want to buy, but for institutional investors.

This form of "artificial intelligence" is exactly what will allow sales traders to provide an improved level of service to a longer list of customers despite industry-wide cutbacks of sales-trading desks. The return on the investment required to acquire this level of sophisticated technology makes the decision easy.

The capacity of each sales trader, the number of quality interactions with clients, the broker's ranking with clients and ultimately the total order flow from a given client will all increase without any additional hiring. Clients will see benefits as well: Execution costs will drop as venue-cost analysis is worked into the initial idea, communication from the broker will be more streamlined using the method of choice, and the amount of data available to the client will increase dramatically but remain manageable, as only the useful ideas will flow through.

Clearly this is all easier said than done. Technologists have come pretty close to synthesizing the thought process of the sales trader, but integrating that with the enormous data set available today, while ensuring that the technology enhances rather than diminishes the broker/client relationship, requires a new level of artificial intelligence. While it may seem somewhat ironic that the conclusion of a research piece on the future of the sales trader ends with talk of technology, technology leverage continues to provide the leg up many businesses need to pull away from the pack.

In an ideal world, each sales trader would cover only one client and in doing so provide them the best customer experience possible. Unfortunately that one-to-one model is not economically feasible. Technology will never replace human intuition and personal relationships—but it can certainly enhance them—which is exactly how a sales trader will be able to service 50 clients in such a way that each feels as if they're getting one-on-one coverage. And that is the sales trader of the future: someone that is less order taker and much more a guide and advocate. And guiding an investor through the complexity that is today's equity market isn't possible without the enhancements that technology can provide. ■

Kevin McPartland is head of Greenwich Associates market structure and technology research.

