Deep-Pocketed Funds Give Up on Speed Game

ByGeoffrey Rogow (Courtesy Howard Getson, Capitalogix)

For some large investors, the trading game has shifted from speed to size.

A focus on size, specifically using "big data" to get a trading advantage, has become a major component of research budgets at hedge funds, asset managers and even some large banks over the last year. The spending push is a shift from just a few years ago, when firms' research and development budgets were focused on making sure they were first in line on every trade.

As the spending shifts, a new industry is emerging to serve these deep-pocketed investors and their high-tech trading systems. Established technology giants like SAP and Oracle as well as emerging niche players are pitching new products and services that promise the latest trading keys on everything from regional home prices to social media.

"There are limits to raw speed and they have reached that limit," said Sinan Baskan, vice president for capital markets at SAP AG. "But the diversity and volume of data enables you to discover something new."

In one example of the unique way firms are looking to take advantage of big data – impossibly large pieces of information that can now be analyzed by increasingly sophisticated computers — Connecticut hedge fund has its eyes set on FedEx Corp. In an effort to gauge FedEx employees' confidence in the growth of their company, the fund has compiled a decade's worth of information on a slew of eclectic items from the delivery company. These include the rates of charitable and political giving by FedEx employees, the percentage of its employees with private-schooled children, home prices in the company's hometown of Memphis, and the social media usage of FedEx truck drivers. In charting that information against the company's stock and options price, along with its quarterly earnings, the fund is seeking to get an unique, potentially forward-looking read on the company's performance.

"Making meaningful decisions out of big data in real time is where [sophisticated investment firms] are focused today," said Mr. Baskan.

Hedge funds have largely driven the latest push, but asset managers and large banks have also become steady clients, said Alfred Eskandar, chief executive of technology firm Portware LLC. The focus for these firms is on company and country evaluations, as well as the cost of trading.

He notes that a focus on just speed creates challenges for trading firms if they can't make enough money to offset the costs of maintaining systems needed to outpace rivals. In one example of the hit that high-frequency firms have taken recently, industry giant Getco LLC posted a 90% decline in profits last year on lower market volatility and an industry-wide slump in volume.

Also pushing firms away from the speed game, trading groups were spending millions to get an advantage that at best provided an edge that lasted just a few milliseconds.

"We saw a lot of guessing in algo trading early on where people said I need to be as fast as possible. I need to co-locate. But being first didn't automatically win," said Mr. Eskandar.

One challenge in this shift lies in preventing trading strategies from getting into the hands of competing investors. Some investment firms fear that their outside partners will take the knowledge they develop in their collaborations and then use it in subsequent projects with other clients.

"Pretty much every day this question comes up with prospective clients," said Oli Freeling-Wilkinson, chief executive of social media trading firm Knowsis. "So, we have a conversation about how much that proprietariness would cost and go from there."

Smaller firms like Knowsis and DataArt, a software development company that counts several large hedge funds as its clients, can have an edge when dealing with niche financial firms, who may prefer to work with a smaller technology company that's less likely to share knowledge gained on a project with other clients.

"We do a lot of work for credit and mortgage-backed funds. Just looking at a lot of strategies that involve deeper data to analyze different levels of a credit deal," said Alexei Miller, DataArt's founder.