BondWave Trade Insights – Volume 1

A Land Where Typos Still Exist

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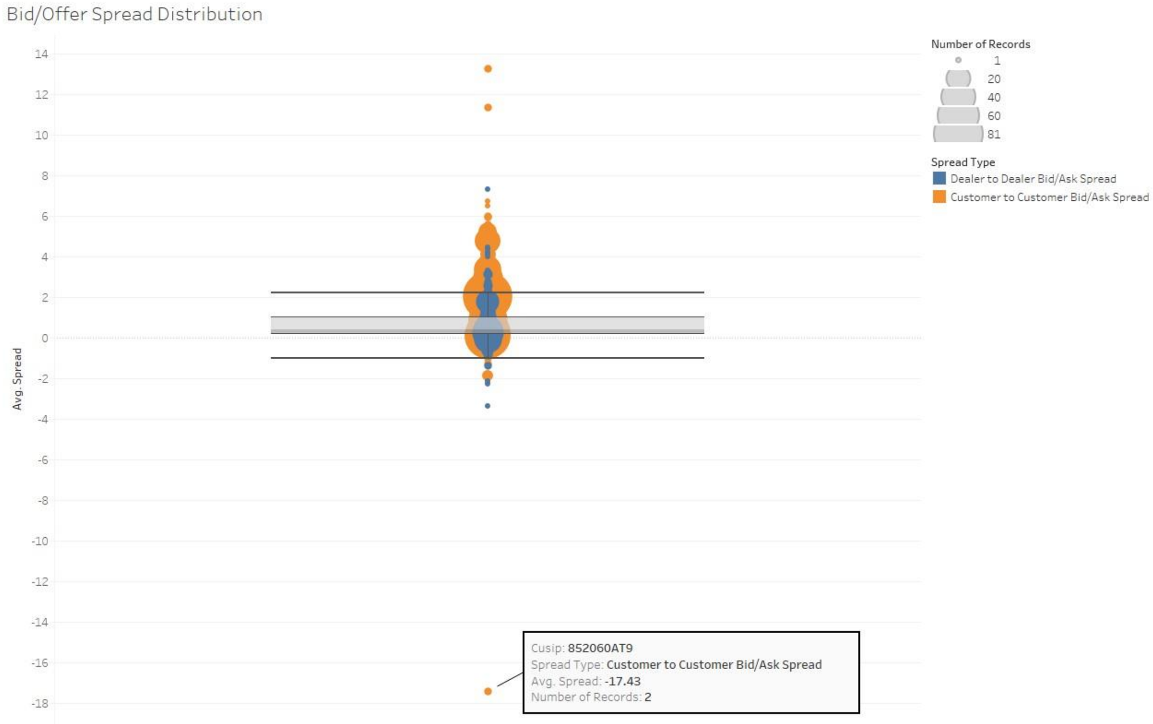
When it comes to trade reporting in equities the current debate centers on whether certain high speed trading firms have microsecond advantages over other market participants because they purchase trade report feeds directly from exchanges rather than waiting for the slower, consolidated feed from the SIP (Securities Information Processor). No one debates the accuracy of the reported trades (though they may debate the order), just the speed. The accuracy is taken for granted because there are a number of processes in place to ensure the accuracy. Exchanges have "clearly erroneous" trade review procedures that remove obvious outliers within minutes of their occurrence. There is also a connection between reported trades and trade settlement such that if a trade is reported wrong, one of the two sides will have a strong economic incentive to ensure the trade report is corrected.

By comparison, trade reporting for fixed income securities seems almost quaint. Without the full automation possible with exchange trading, participants have up to fifteen minutes to report their trades. And with one exception (dealer to dealer trades in corporate bonds) there is no connection between trade reports and trade settlement. This leads to some fun outcomes when reviewing the trade tape for bonds. At BondWave, we have developed a series of products that rely on accurate and timely trade reports. Therefore, we have developed a number of techniques for analyzing the tape and filtering out what we believe to be clearly erroneous trade reports.

The errors appear to fall into a number of broad categories. The easiest to find are price transpositions (typing in 102 rather than 120) and incorrect side of trade (buys that are clearly sells and vice versa). The less obvious situations are those that appear to be trade throughs. A trade through occurs when a buy occurs at a higher price than the existing best offer and a sell occurs at a price less than the existing best bid. This is a complex and detailed topic that I will save for a later note.

Today and in coming notes we will look at some of the more obvious errors.

Price Transposition:



The above box and whisper blot shows a daily distribution of bid/ask spreads calculated by BondWave for every municipal and corporate bond trade reported through RTRS and TRACE for April 4, 2017.

The obvious outlier is highlighted. If the data is accurate the market maker/liquidity seeker dynamic is turned completely on its head. Market makers paid liquidity seekers 17 points per round trip trade. If that is true it is time to start a hedge fund. Unfortunately, the hedge fund will only exist as long as the market makers have capital to burn, which at 17 points a round trip, isn't long.

However, an alternative explanation exists.

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Bond Trade Activity Search Results

From 04/04/2017 to 04/04/2017 GO | Glossary of Terms

Issue: **SFTBF3703056** Description: **SPRINT CAP CORP** Coupon Rate: **8.750** Maturity Date: **03/15/2032**

Execution															
Date	Time	Settlement	Status	Quantity	Price	Yield	Remuneration	ATS	Modifier	2nd Modifier	Special	As-Of	Side	Reporting Party Type	Contra Party Type
4/4/2017	16:17:41	4/7/2017	T	1MM+	120.500	6.574	M		_	_	-	-	B	D	C
4/4/2017	16:15:00	4/7/2017	T	5000	120.000	6.621	M		Z	_	-	-	B	D	C
4/4/2017	14:00:38	4/7/2017	T	100000	102.700	8.428	M		_	_	-	-	S	D	C
4/4/2017	13:28:59	4/7/2017	T	2000	119.750	6.644	M		_	_	-	-	B	D	C
4/4/2017	13:28:59	4/7/2017	T	2000	119.750	6.644			_	_	-	-	S	D	D
4/4/2017	11:30:19	4/7/2017	T	500000	120.469	6.577		Y	_	_	-	-	S	D	T
4/4/2017	11:29:07	4/7/2017	T	500000	120.531	6.571		Y	_	_	-	-	S	T	D

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The above is a snapshot of all the trades that occurred in this bond on that day as reported to TRACE. This snapshot was taken two days after the trade date. The trade occurring at 14:00:38 (customer buy of 100,000 at 102.70) is the trade driving the negative bid/ask spread. The obvious answer here is that the actual trade price was 120.70 rather than the reported (and as yet uncorrected) 102.70. A simple typo, but one that can easily pollute analysis if not caught and corrected.

Why It Matters

Flash forward to May, 2018 when new FINRA and MSRB rules will go into effect to require dealers to report mark ups on retail client confirmations using the waterfall process outlined in their new regulations. If I sell that same bond to a retail client out of my inventory at 14:01 at a price of 121 will I have to report a mark-up of 18.30 even though the actual mark-up is 0.30?

BondWave LLC (BondWave®)

BondWave is a financial technology company specializing in fixed income solutions. We serve a wide range of customers, from small independent RIAs to some of the largest broker-dealers and custody providers in the financial services industry. Traders and advisors use our tools to provide a superior fixed income experience to their clients. By creating sophisticated, yet simple solutions for all stakeholders in the investment process, we help traders and advisors better leverage individual bonds as they work to achieve the investment objectives of their clients. Our tools enable strategy-based investing - including portfolio creation, monitoring and rebalancing - while greatly enhancing the communications between the trading desk, advisors and their clients. BondWave is liquidity and trade agnostic and our sole focus is to provide a simple, sophisticated user experience around individual bond investing. Additional information is available at www.bondwave.com.

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