

BONDWAVE DATA DIGEST – VOLUME 3

Cost of Trading

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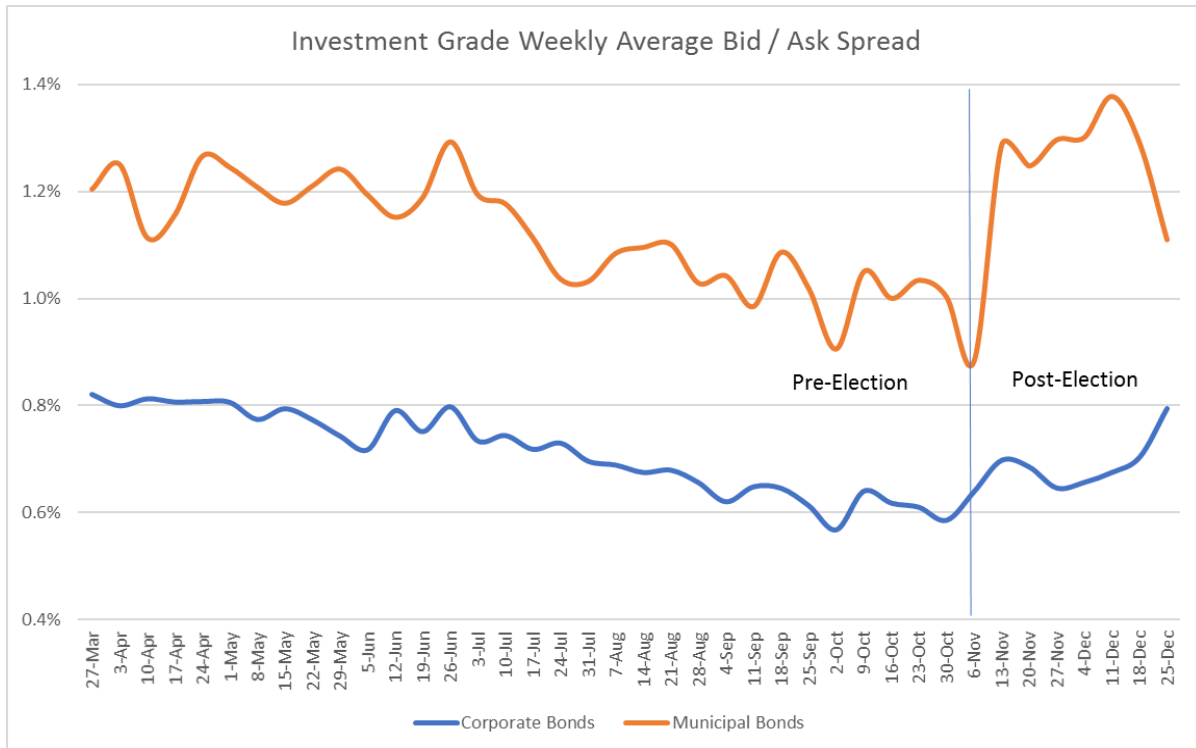
What happened to the cost of trading in the last three quarters of 2016?

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¹ BondWave's customer-to-customer bid/ask spreads are defined as the full round-trip cost of customer trades. As such, they incorporate both mark-up and mark-down in addition to the dealer-to-dealer bid/ask spread.

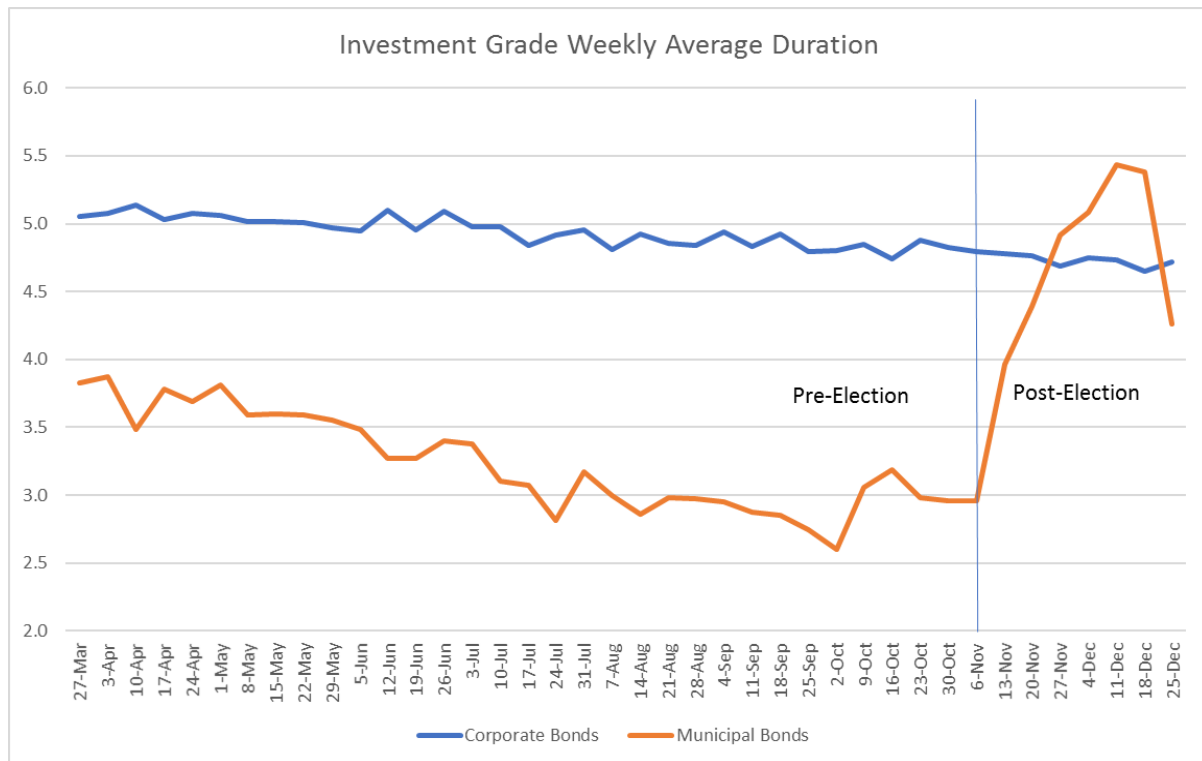
Corporates vs Municipals: Similar Patterns, Different Magnitudes



Sources: TRACE, EMMA and BondWave

After a general tightening of bid/ask spreads from April to November, both investment grade municipal and investment grade corporate bonds saw a widening of bid/ask spreads after the election. Municipal bonds seemingly reacted more strongly than corporate bonds. This could be attributable to a couple of factors, including decreased liquidity or a shift in the nature of bonds traded. Typically, longer dated bonds have wider spreads than shorter dated bonds, so it could be that investors have chosen to trade at the longer end of the curve in response to the Republican sweep of the Executive and Legislative branches and how that is likely to affect the Judicial branch.

Duration: Tells a Different Story



Sources: TRACE, EMMA and BondWave

Municipal bonds saw a significant increase in the average duration traded while corporate bonds continued to decrease in the average duration traded. Because the term structure of bid/ask spreads for corporate and municipal bonds is upward sloping, an increase in bid/ask spreads for municipal bonds can be explained by their shift in duration. However, for corporate bonds the opposite is true. Corporate bonds saw an increase in spreads despite the decrease in their traded duration.

Putting it All Together

The data supports the conclusion that corporate bonds became more expensive to trade between the elections in early November and the end of the year. From a pre-election low of 0.59% for the week of October 30, corporate bid/ask spreads increased almost 34% to 0.79% by year end.

Municipal bonds saw an even more dramatic rise in bid/ask spreads, from 0.89% for the week of November 6 to 1.38% for the week of December 11 (a 55% increase). However, the increase can be attributed to a move along the curve (increasing duration) as opposed to a shift in the curve.

A Note on Method

To control for a variety of drift sources BondWave used a constant set of securities throughout the above time series. Only bonds that traded in at least 6 of the 9 months were included in the study. Zero coupon bonds were excluded. In total 2,147 investment-grade corporate bonds and 781 investment grade municipal bonds met these criteria. All observations are averaged at the CUSIP level before being averaged across CUSIPs.

The data contains both dealer-to-dealer and customer-to-customer spreads. The average difference between dealer-to-dealer and customer-to-customer spreads in corporate bonds was 28 basis points over the entire period analyzed. The average difference between dealer-to-dealer and customer-to-customer spreads in municipal bonds was 52 basis points over the entire period analyzed.

About BondWave

BondWave LLC (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.

We believe in the value of investing in individual bonds and the importance of this asset class in any investor's overall strategy. In the past, because of the size and complexity of the bond market, simple tools did not exist to make investing easy for traders and advisors to more effectively service their clients. As a result, the vast majority of retail investors access bonds via funds where they are unable to achieve the same benefits that individual bonds offer.

BondWave has developed the tools to meet this challenge.



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