



FX Transparency

Measure. Manage. Monitor.

Explaining Trading Benefits in the FXT Peer Universe

Trading benefits happen when a manager is able to beat the mid-rate at a point in time, or an average of mid-rates over a window of time. Obviously, this can happen easily on a single trade with no timestamp measured vs. a benchmark like full-day ITAP (Interval Time Average Price), but how does it happen still when sample sizes in FXT's Peer Universe are set to > 150 trades per currency per product?

There are four likely scenarios why this may occur:

- 1) Active buy-side traders attempting to beat the full-day ITAP benchmark through market timing, some of which are consistently successful over the long run.
- 2) Buy-side traders that use prime brokerage (bank credit) to make markets and beat the mid-rate by dealing on the market making side of the bid/offer spread like a bank does.
- 3) On the custodian / standing instruction (SI) universe side, trading benefits seen are often netted trades. Some custodians offer their clients the ability to participate in netting. For example, Manager 1 and Manager 2 are both clients of the same custodian, and Manager 1 needs to sell \$500k SGD, and Manager 2 needs to buy \$250k SGD. The custodian will fill both tickets at the same SGD rate, and both Manager 1 and 2 receive the benefits of netting, especially Manager 2 since they have the smaller trade amount and their buy order will be filled at the sell price since the sell amount was larger, and the buy SGD ticket will have a trading benefit.
- 4) Inaccurate client source data / timestamps or off-market legs of cross trades (disaggregation).

What steps does FXT take to mitigate the effects of these trading benefits in the peer universe?

- The law of large numbers can be a powerful ally in the battle against inaccurate client source data. By restricting the peer universe to include only a manager that has at least 150 trades over the one-year lookback window in a currency and product (spot vs. swap), the effects of poor trade data are minimized. For example, a manager must have 150 or more BRL *spot* trades to get a rung on the peer universe ladder. To get a rung on the ladder in BRL *swaps*, the same must be true, at least 150 BRL *swaps* over the past year.
- Trades outside +/- 500 bps from the mid-rate are excluded unless they happen to be within the day's trading range (high/low). This process helps to keep errant client source data out of the universe.