

# An insider's guide to the trading desk

IROs can leverage the trading desk to stay on top of today's fragmenting markets, explains *Elizabeth Judd*

Part of an IRO's job is explaining to executives and investors the daily ups and downs of a firm's stock. Doing this successfully has become a Herculean task given new investment vehicles and the lightning speed at which equities, bonds and derivatives change hands nowadays.

'If I'm an IRO and my CEO or CFO is asking, *What's happening with the stock?*, I've got to figure out how to get some color,' says Amy Ellis-Simon, global head of corporate access for Bank of America Merrill Lynch (BofAML). 'With electronic trading and exchange-traded funds (ETFs), it's hard to glean what end-investors are thinking, so access to the trading desk is more important than ever as there are fewer sources of this information out there.'

John Panichi, BofAML's managing director and head of US sector specialists, is equally convinced IROs need to engage in an open dialogue with someone who has up-to-the-minute market insights. Increasingly, he says, that place is the trading desk at a bulge-bracket broker, which typically knows whether a stock's performance reflects a reaction to an earnings announcement or change in strategy – or is a result of investors pre-positioning for macro-data due to be announced. Both Ellis-Simon and Panichi feel there are several ways of using these trading desks.

**Understand changes in market structure.** It's difficult to grasp the full panoply of changes in market structure that determine stock performance on a given day, says Panichi. As the point of sale is fragmented – shares no longer change hands exclusively on the NYSE or NASDAQ – there's exponentially more complexity in the daily trading of a stock. Panichi says trades that would have taken place on the NYSE floor have moved to other venues: upstairs trading desks at brokers, low-touch algorithmic venues, high-frequency trading (HFT) through ETFs and the derivatives market.

**Find sector specialists outside the exchanges.** Sweeping changes in the market mean public companies need a 'sounding board' so a new breed of specialists is springing up at bulge-bracket firms. BofAML, for instance, has an ETF trading desk, a derivatives desk, high-touch and low-touch execution trading desks and a delta-one trading desk, as well as an upstairs trading venue. It's one of the few large firms with global sector specialists sitting on the trading desks in the US, Europe and Asia, analyzing activity to create a big-picture view on any given trading day.

A sector specialist at a bulge-bracket firm can help an IRO identify whether the source of trading is an active manager, retail

interest or HFT. In other words, Panichi says, the function of a modern-day specialist is to distinguish a 'positioning correction from a fundamental pivot in the story investors are souring on or warming to.' He also says this new wave of specialists is used to fielding calls from IROs, engaging in a two-way dialogue. Once a relationship is established, a BofAML specialist might call an IRO whenever he or she notices activity the company should know about and monitor.

**Learn to decipher the signal from the noise, or get help detecting HFT.** Another valuable service a trading desk can provide is distinguishing between when a stock price is rising or falling because of 'real money and when it's due to machines or programs,' says Ellis-Simon. She says the trading desk can often detect patterns that indicate when high-frequency traders are afoot. Panichi agrees, noting that Warren Buffett calls Berkshire Hathaway shareholders 'partners', a term that accentuates their differences from algorithmic traders. 'You want to know when your partners are trading in your equity, and you want to know if there's a new partner coming on board,' he says.

Filtering out the noise created from programs is increasingly important for public companies. 'As a CEO or IRO, your job is to

maximize shareholder value, not maximize value within the millisecond of a trade,' says Panichi.

**Delve into derivative and convertible bond trades.** With derivative trades or the buying and selling of convertible bonds, it's nearly impossible to decipher the motivation behind a trade by looking at the tape action alone, says Ellis-Simon. To understand a derivative trade, she says, 'you may need help deciphering the motive. Is it a hedge? Is it a view?'

Convertible bond trades can be equally elusive. 'You can't always see how much they're hedging the convert positions,' Ellis-Simon adds. 'If you have an insight on that trading floor, someone can tell you, *Yes, it bought the bonds, but it put on a very light hedge so in reality it's very bullish on the stock.*'

Panichi adds that even when activity on the derivative or convertible desk is not responsible for a price move, buying or selling there is part of a larger, more nuanced picture of the overall markets. He believes it's the specialist's job to marry what's happening in the derivatives and bond markets with what's happening in the stock market.

**Try to time share buybacks more advantageously.** IROs engaging in a share buyback tend to take a methodical approach, choosing a start date and then buying shares regardless of market

fluctuations. Panichi urges IROs to consider the timing of their buyback programs to coincide with an attractive price in their own stocks – as any investor would. He recommends speaking with the trading desk before a buyback to learn whether there are upcoming announcements or events that might affect the timing of entry.

Ellis-Simon suggests companies take this one step further, working closely with the trading desk to begin buying at a propitious time. She's not advocating that IROs aggressively time the market during buybacks, but rather that they give the trading desk a call and get a quick read on favorable times to buy shares. 'If there are resources like this a phone call away, use them,' she says.

**Get the corporate access intelligence for planning a successful roadshow.** Panichi views the trading desk as a tremendous resource for 'setting up a really good, bespoke corporate access program.' To this end, IROs should ask the trading desk for a list of clients that might be interested in hearing their stories, as well as possible roadshow destinations. Ellis-Simon agrees, noting that IROs can improve their targeting programs simply by making use of the intelligence gathered by the trading desk. 'Because they're being inundated with requests, all companies have

to be more efficient about where they go,' she explains. 'Meeting with the same shareholders over and over again may not be the most efficient use of their time.'

Where the trading desk can provide true value is by suggesting prospective partners for an IRO to visit. 'Yes, there are clients that always want to see you and you certainly have to satisfy them,' Ellis-Simon concludes. 'But your job is also to figure out the incremental opportunities, and we can help by providing some color.' ■

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