



FUTURES SPREADING CHALLENGES AND OPPORTUNITIES IN VOLATILE TIMES

The 2008 global financial shake-up will certainly be one for the record books. Market swings of 5-10 percent became almost a daily norm with traders and asset managers alike prompting a “flight to safety” as institutions failed or went into administration. Trading suddenly made news, as investors sought to make sense of what is now known as a “global financial crisis.” Traders found themselves facing surges in volatility many industry insiders never imagined. Spread across all asset classes, volatility in 2008 left financial instruments in positions that clearly required sophisticated trading tools to stay ahead.

Futures is an instrument in particular where volatility has resulted in both greater challenges as well as greater opportunities. Futures spreading is an arbitrage trading strategy where price differences between futures of different expiries or futures that are related, but not necessarily the same, can be exploited for trading profit. These arbitrage opportunities typically last just a few microseconds, so timing can make all the difference.

“Since the majority of trades in commodities are arbitrages, (long December, short January crude oil,) spread trading has increased,” Paul Zubulake, senior analyst at Boston-based research consultancy Aite Group notes. “In the financial futures markets, spread trading is mostly the rolling of positions. For example, if you are long December bonds and want to stay long, you will have to roll/sell December and buy March to stay in your position.”

Volatility has lent futures spreading a helping hand, so to speak, as the style of trading has gained traction, which Zubulake says may only increase as markets continue to push through the current crisis. “This (increase) is common,” Zubulake said. “For example, in Euro-Dollar futures, as traders may want to minimize risk by buying one contract which is more volatile and selling another against it which is less volatile, instead of just buying the contract.”

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Orc Software has added product enhancements that are particularly aimed at its high frequency trading clients and those engaged in arbitrage trading strategies. Through the firm’s software for proprietary traders, futures traders in particular have benefited from Orc’s powerful algo suite, particularly as commodity markets (metals, energy, grains, softs, etc.) have gone electronic and volumes have risen significantly.

In the following interview, Per Haglund, Product Manager at Orc Software, discuss Orc’s market position in volatile times and how the firm’s algorithmic trading suite offers the most modern of futures spreading tools.

What tools/products does Orc currently have in place for clients to engage in futures spreading?

Per Haglund: Orc Spreader is the centerpiece solution for futures spreaders. The Orc trading engine is capable of handling a large number of spreads with sub-millisecond latency. But just fast engine turn-around time isn’t enough. Orc has also developed a number of ultra-low latency market gateways allowing to deliver orders to the exchange as rapidly as possible. Together, Orc Spreader is able to deliver the response times needed to reduce hung trades (trades where one leg of the spread is not executed



fast enough causing a trading loss). In addition, Spreader offers the reliability needed in very active and/or turbulent markets to keep up and give the trader opportunities that may otherwise not be available.

Has Orc seen an increase in this type of trading?

Haglund: Yes, absolutely. Since ultra-low latency is so important, Orc has seen a dramatic rise in interest from the trading community for its algorithmic trading platform. More and more futures spreaders are moving from older technology to server-based and co-located solutions like Orc Trading for Arbitrage. We [as a firm] expect to see an increase in this trend as the spreading opportunities continue to narrow to those with the best technology solutions.

Is latency everything?


Haglund: Great question! While latency is extremely important, we are finding that for firms to be successful, they are looking at strategies that are also “smarter”. This means looking at the details of how a spreading strategy really works, especially in the case of fast moving markets that may move away from a trader. Things

like pay-up logic, stop-loss procedures, etc. are critically important. How a trading strategy responds to the market is just as important as getting to the market first. Traders can actually build and customize their own trading strategies in Orc Trading for Arbitrage. A fast trading engine is no longer enough.

Are any new products in development to aid traders interested in futures spreading?

Haglund: Orc is continuously working to strengthen its futures spreading solution. Today, we offer not only an ultra-low latency trading platform, but we have also worked with clients to develop a production-ready futures spreading solution that can be easily and quickly customized to the exacting requirements of our customer base. In addition, we have done more work on our GUI to make it even more responsive to the needs of futures spreaders. This complete futures spreading solution gives firms a serious advantage in being able to quickly deploy a futures spreading solution into the market and customize this solution rapidly as conditions change.

For more information about Orc and Orc Trading for Arbitrage, visit www.orcsoftware.com.



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