ABSA CAPITAL

Absa Capital's equities franchise and equities trading in South Africa

Absa Capital is well known for its ability in the equity derivatives and prime services space, but is now starting to gain traction in cash equities, which includes equity research, sales and trading. Absa Capital has taken the opportunity to talk about its progression from a derivatives house to a full equities franchise, also outlining where it sees the market advancing over the next few years, including the impact of high-frequency trading

The Barclays purchase of a majority stake in Absa in 2005 and the subsequent acquisition of Lehman Brothers in 2008 are well documented. What is perhaps less well understood is how this has impacted Absa Capital's equities franchise in South Africa?

Absa Capital: The Barclays deal was obviously pivotal in enabling Absa to strengthen its fixed income, foreign exchange and equity derivative businesses.

The acquisition of Lehman's US business by Barclays Capital in 2008 has been as important to Absa Capital in developing its equities franchise. Barclays Capital has been extremely successful in integrating the respected Lehman equity business and this, in turn, has provided access to a global client base (and therefore liquidity), supported by world-class trading and execution platforms. Particularly pleasing has been how the roll-out of equities to Europe and Asia has not prevented the simultaneous roll-out to emerging markets, which includes us in South Africa.

Clinton Clarke

2010 has seen Absa Capital moving to a consistent top three position in the Johannesburg Stock Exchange's (JSE's) value traded tables, with a number of firsts being scored in recent months. What would you say are the main reasons for this success and do you expect this to be sustainable?

Absa Capital: Critical to achieving these volumes has been our access to world-class technology. This has enabled us to offer local and international clients access to JSE-listed instruments through any chosen delivery mechanism. For example, we provide clients with both physical and synthetic access to equity risk, either on exchange or via over-the-counter (OTC), in both funded and non-funded form. We are fortunate in that we have access to substantial balance sheet (locally and offshore) and can thus offer synthetic access product to large clients on a non-funded basis in meaningful size. Low latency and stability is obviously critical for the high-frequency players and is a substantial focus area for us. In the more traditional cash equity space, the introduction of technology that specifically focuses on order management routines is also an important component.

Finally, the provision of research content and access to global liquidity are significant contributors to our business model.

You mention that research content is important. How has the build-out of your equities research team evolved and is this aligned with Barclays Capital?

Absa Capital: We have provided top-down macro and fixed income research for some time now. However, Absa Capital cannot be the leading equities business without providing both industry and stock-specific fundamental research and analysis, supported by technical and quantitative intelligence, to assist in clients' bottom-up investment decision-making process.

Integration with Barclays Capital has been very smooth. They had existing strengths in commodities, along with large diversified mining, beverages, luxury goods and telecommunications. Our locally based team is focused on the banks, retail, diversified industrials, gold and platinum sectors. We also benefit from being able to distribute content via the unified Barclays Capital research portal, 'Barclays Capital Live'.

Is the demand for research and prime services similar across the various client segments?

Absa Capital: Virtually all of our clients have interest in research, but to varying degrees. For example, hedge funds, consisting primarily of multi-strategy, market neutral and/or long-short investment strategies use research as keenly as the traditional asset managers. High-frequency traders typically have less interest as their focus will be on finding firms who can provide technological support and systems offering self-execution capability with extremely high stability and extremely low latency. Absa Capital has been able to leverage a number of Barclays Capital in-house proprietary technologies to support these client requirements.

The provision of direct market access and other prime services offerings are critical in supporting both fundamental and quantitative funds. We are seeing strong demand for financing, stock borrowing and lending, clearing and settlement, risk management and reporting and access to investors for capital raising purposes.

High-frequency trading (HFT) is obviously a hot topic at the moment with concerns around the systematic risk that is perceived to be created from this and the relevance of this type of trading to overall market liquidity. Some commentators have even gone so far as to state that HFT contravenes the original purpose of an exchange. What is your view on this?

Absa Capital: On a global scale, HFT is absolutely going to remain a hot topic. Technology is now providing market access to clients at unbelievably fast speeds in highly stable environments. For example, the definition of low latency has moved from seconds to tenths of seconds to milliseconds in a matter of years.

Determining exactly how much of the JSE's volumes and trade count is due to HFT is difficult to ascertain as access is usually via OTC synthetics and thus not visible to the exchange and its reporting infrastructure. It is likely to be significant and increasing. Some international exchanges estimate that more than 50% of flow is due to HFT, which is obviously fuelling the debate.

I do believe, however, that there are a number of myths being presented. For example, that HFT causes market volatility, negatively impacts stock prices, provides an unfair advantage to traditional investors, and so on. High-frequency traders do not usually run overnight positions and their business strategy is to place large numbers of small orders, of which a fraction will be accepted. It is difficult to see how a trader who starts and ends each day with no positions can materially impact the market price. Stock price pressure normally occurs when accumulating or liquidating large positions. This does not fit the HFT profile.

Points taken, but where there is smoke… especially when the smoke is being created in some of the largest international exchanges.

Absa Capital: South Africa has a number of structural differences to some of the major international markets which reduces the likelihood of HFT imposed market risk events. For example, dark pools are currently not allowed, naked short selling is prohibited and stocks are taken to auction whenever there is a price movement that exceeds a pre-determined band. Finally, local regulations require an exchange to offer both trading, settlement and clearing functions. This creates significant regulatory barriers for the 'trading only location' models that are prevalent overseas. The JSE enjoys regulatory oversight, monitoring and managing all of the South African market in a manner which is not available to, say the London and New York stock exchanges.

Looking forward, what do you foresee as the being the major changes that we can expect?

Absa Capital: International interest in South Africa is likely to continue. South Africa has for a long time been considered one of the most liquid and structured emerging markets and continues to provide both outright investment opportunity and hedging possibilities for international investors. This trend is likely to continue, especially as South Africa's status as 'the gateway to Africa' gains recognition. Continued growth in Asia is obviously supportive for our economy and subsequently the stock exchange, as both have significant resource dependencies. We have also been working with the JSE to bring exchange-traded derivatives pricing on screen, which will add transparency and benefit our local financial markets.

Potential structural changes should open up opportunities for a variety of South African clients. Firstly, a continued move away from foreign exchange controls to prudential requirements may open up increased access for local clients to international equities, including African equities, especially in the form of inward-listed securities. Secondly, the proposed statutory solvency requirements for banks and insurers may lead to the need for such entities to introduce new financing vehicles, such as stock, preference, convertible and hybrid issuances. Both these changes should be beneficial for the market as they increase depth and access.

Adam Bunkell

Carlyle Whittaker

ABSA CAPITAL

Clinton Clarke
Co-Head: Sales and Research,
Head of Institutional Distribution
T. +27 11 895 5335
E. clinton.clarke@absacapital.com

Adam Bunkell
Head: Equities Distribution
T. +27 11 895 5518
E. adam.bunkell@absacapital.com

Carlyle Whittaker
Head: Equity Research Sales
T. +27 11 895 6694
E. carlyle.whittaker@absacapital.com

Absa Capital
15 Alice Lane
Johannesburg
South Africa

www.absacapital.com