What's Next for Financial Professionals?

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Over the last three-year period, the S&P 500 Price Index has recorded a standard deviation of over 20%, and, figuratively speaking, the water is still boiling. In June, 2010, we witnessed the index fall 5.4%. Conversely, during July 2010, the price index advanced 6.9%. And as investors want to participate in the 6.9% appreciation and sidestep the 5.4% decline, we know that increasingly complicated decisions need to be made by those that drive this industry.

Roller Coasters typically consist of a track that rises in patterns, sometimes veering in a different direction before dropping down or doing a vertical loop that leaves the rider briefly upside down. Although they were not "thrill seeking", Financial Professionals feel like they have been on a roller coaster over this past

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decade due to the constant changes and challenges in the financial markets. This article will discuss:

- the monumental changes in the Financial Industry over the past decade
- the continued progression from Open Outcry to Electronic Trading
- the 2008 economic meltdown (a veritable "vertical loop") and

the next evolution in the industry and how it is likely to impact disability claims

At The Sierra Group, we follow employment trends and share labor market insights and analysis through our *Occupational Alert* newsletters to help keep those in the rehabilitation profession informed and aware of how to leverage information to control risk and assist with return to work efforts. The Sierra Group is a national consultancy that offers an array of vocational rehabilitation, recruiting, consulting, and training services designed to serve the needs of insurance companies, businesses, and workers with disabilities.

To understand the present, let's take a brief look at the past.

Summary of Major Events:

January 2001 NYSE/April 2001 Nasdaq - **Decimalization Adopted**, which reduced spreads making it difficult for the small Traders to compete against Trading Groups (think how Walmart wiped out the mom & pop stores, as it makes its money on volume not individual transactions)

September 2001 – **9/11 terrorist attacks bring down the Twin Towers**

April 2005 – **New Market Regulation ushers in electronic trading on every exchange**

July 2007 - **CME's takeover of the CBOT forming the CME Group**

March 2008 - **CME Group's takeover of the NYMEX, consolidating the 3 major Futures Exchanges into one entity**

The rest of 2008 resulted in significant changes in Wall Street's structure that had major repercussions not only for the U.S. economy, but the global financial system. As noted by Andrew Ross Sorkin (NY Times Reporter) in the epilogue of his book Too Big to Fail, **each of the Big Five investment banks failed, were sold or were converted into bank holding companies.** The two mortgage-lending giants (Fannie Mae & Freddie Mac) and the world's largest insurer (AIG) were placed under government control, and as a result of TARP (the Troubled Asset Relief Program) the US Treasury and, by extension, the American Taxpayer became part-owners in the nation's largest financial institutions.

As Sorkin notes, "To attempt to understand how the events of September 2008 occurred is, of course, an important exercise, but only if its lessons are used to help strengthen the system and protect it from future crises."

While Sierra can only sit back and observe what happens in the financial arena; it can actually strengthen risk management within the LTD insurance industry by keeping it informed of the changes and new trends that Financial Professionals will be facing in their careers. Indeed, over the past 15 years this consultant has kept the LTD industry informed regarding the opportunity for Traders to move to sedentary electronic trading both on and off of the "trading floor" (which allowed Traders to continue to perform the essential duties of their jobs despite back problems, knee problems, hearing loss, etc.). However, we now need to explore the issue of Low Touch Trading versus High Touch Trading and what it portends regarding the future occupation of Futures Trading.

Specifically Sierra wants to alert its customers to a recent article in Trader's Magazine (7/16/10) that predicted that by the end of 2011 trading technology will finally catch up with the telephone call. In other words, institutions will rely on the use of computer algorithms to make buy/sell decisions and submit the trades (this is referred to as *low touch*) as much as they will have Buyside Traders making these decisions and calling them into a sales desk (referred to as high touch due to human intervention). Remember this consultant's previous discussion regarding *robo trading*? According to Adam Sussman, Director of Research at Tabb Group (an industry consultancy), Buyside Traders were pleased with their algorithm performance during the 2008-2009 financial crisis and felt they could put greater reliance on electronic trading (of course this happened at the expense of Sales Traders) and using these formulas to allow them to handle more order flow than they could have handled manually.

Sierra has also noted over the past few months that there seems to be a lot of buzz about whether the standard point and click of the typical Electronic Trader can effectively compete against the HFT's (High Frequency Traders). HFT's utilize sophisticated algorithmic trading strategies, with computers directly interfacing with trading platforms, placing orders without immediate human intervention. Research indicates that while HFT's only represent about 2% of the market participants, they make up about 60% of the market trading volume.

Indeed, it seems everything this consultant has read lately talks about the impact of HFT's. When building out its electronic trading desk in 2009 Brad Katsuyama, Head of Electronic Sales and Trading at RBC Capital Markets was quoted as saying that there is a need to understand market microstructure, (electronic) order placement and ultimately how to incorporate models and analytics into execution decisions. "Knowledge is not publicly available on HFT, such as how to build strategies, what technology they are deploying, and what order types and liquidity signals they are using, so hiring from that industry seemed natural." Deutsche Bank's new head of equity electronic trading, Jose Marques, advised his firm to build tools that would take into account what algorithmic trading will look like tomorrow. He wanted algorithms that think like automated Traders (like machines), that resemble the tools used by HFT's. He was quoted as saying "They are looking at it cross-sectionally and in milliseconds. They're looking for statistical patterns in a very multidimensional, complex and dynamic data space."
This consultant's research noted that among the most recent developments in algorithmic trading, some now automatically read and interpret economic data releases, generating trading orders before economists have begun to read the first line of the release.

What does this mean to the Vocational Consultant?

It may be difficult for even those Traders and small firms who made the transition to electronic trading to keep up with these new trends. In short, with the increased use of algorithmic trading, we can expect to see a decrease in the number of Sales Traders and a likely increase in the number of claims. We will not be talking about Traders updating their skills to keep up with the new trends in their industry, rather we will be talking about Sales Traders being replaced by machines. Therefore, the coverage of "Own Occ" claims is going to be *riskier* as the technology continues to advance.

References:

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