

# Global Debt Market

## Hedge Funds' role in EGB markets

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# Hedge Funds Role in EGB markets

## Hedge Fund ever increasing presence

1

Rules introduced post the 2008 financial crisis have placed constraints on Bank's balance sheet

2

Hedge funds are increasingly active in the euro zone's \$10 trillion government bond market and now account for a **record 55%** of trading volumes (up from 26% in 2018)

3

Since 2021, Hedge funds have **hired** about **one third of bank's Euro rates traders**

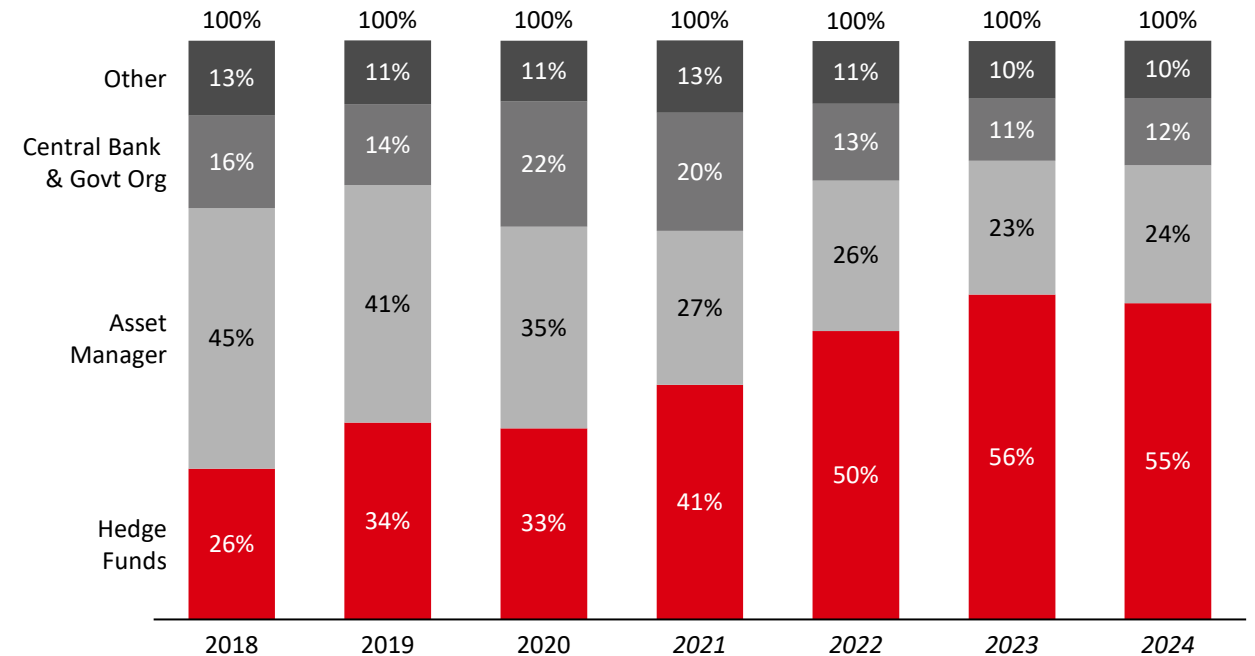
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As price swings become more common, Hedge funds footprint in growing are well-positioned to take advantage of volatile markets given their regulatory landscape is lightly regulated

5

Whilst Banks continue manage formal commitments of 'primary dealers' to buy government bonds and to trade them actively in good times and bad, but hedge funds have no such obligations

## Electronic Trading Volumes Split of Investor Sector



Hedge Funds' share of electronic trading volumes has **doubled** in five years

Source: Reuters & Tradeweb

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# Hedge Funds Strategy

## Trading Strategies

### Auction

- ◆ Selling the bonds before the auction (or going short) when bond prices tend to fall ahead of the supply
- ◆ Buying the new debt at the auction or after to sell it over the next few days or weeks
- ◆ May yield modest returns, but global participation in all auctions leads to substantial profits
- ◆ Relative value trades: Capturing relative dislocations between adjacent bonds or country spreads around debt sales

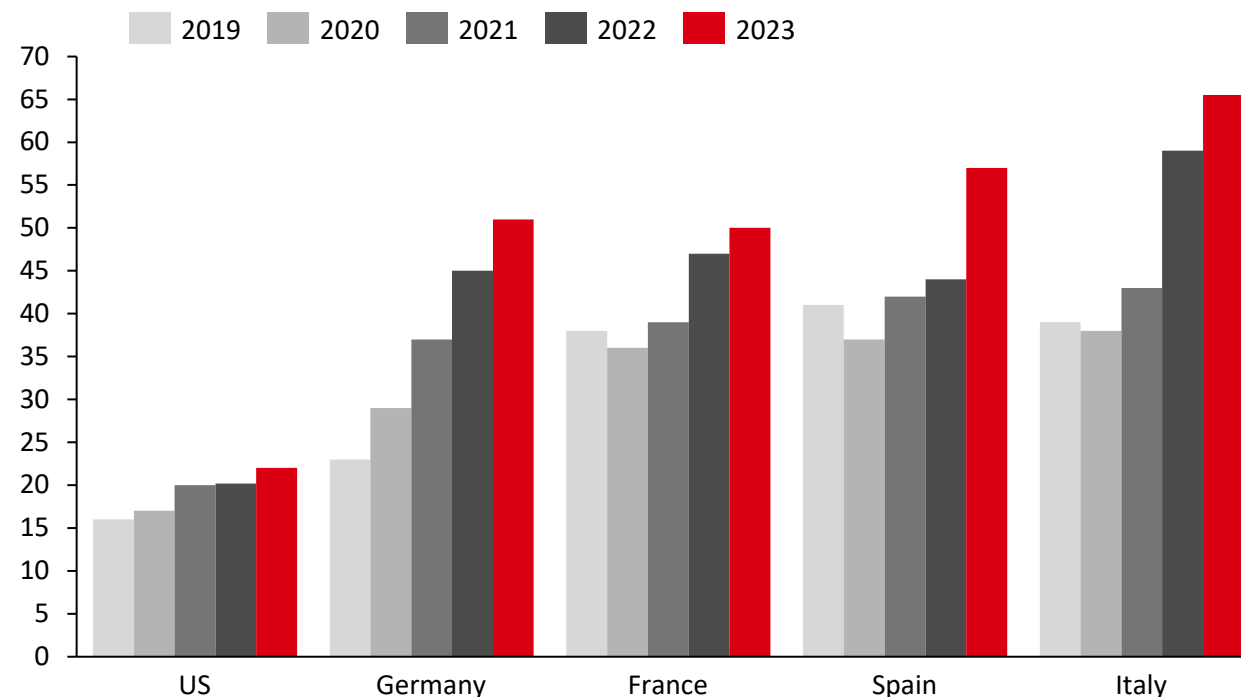
### Secondary Trading

- ◆ Arbitrage opportunities
- ◆ Basis trades
- ◆ Italian bonds are hedge funds' top pick in euro zone

### Market Marking

- ◆ Acting as Market Makers without being primary dealers
- ◆ Citadel being the first Market Maker in the US and planning entry into the European Market

Hedge Funds' % of Total Accepted Sovereign Bond Trading Volumes on Tradeweb



Two third of Italian bond trading on Tradeweb comes from hedge funds, interest up sharply across bloc

Source: Reuters & Tradeweb

# Primary Dealers vs. Hedge Funds in EGB markets:

## Formal commitments and Distribution

- ◆ Primary Dealers have formal commitments to provide secondary market liquidity and facilitate bond issuance via auctions or syndications. They also fulfil reporting obligations.
- ◆ Unlike primary dealers, hedge funds are not bound by formal commitments to trade government bonds. This flexibility allows them to operate more independently and on an opportunistic basis
- ◆ Banks have established and diversified distribution channels across regions allowing them to distribute debt to end users

## Risk Taking Capacity

- ◆ Banks face capital constraints due to post-2008 regulations which can limit their liquidity provisions and risk-taking capacity
- ◆ Hedge funds not only operate with greater risk-taking capacities, but also have more leverage. They are not subject to the same heavy banking regulations.
- ◆ Consequently, their trading and warehousing capacity is larger vis a vis banks

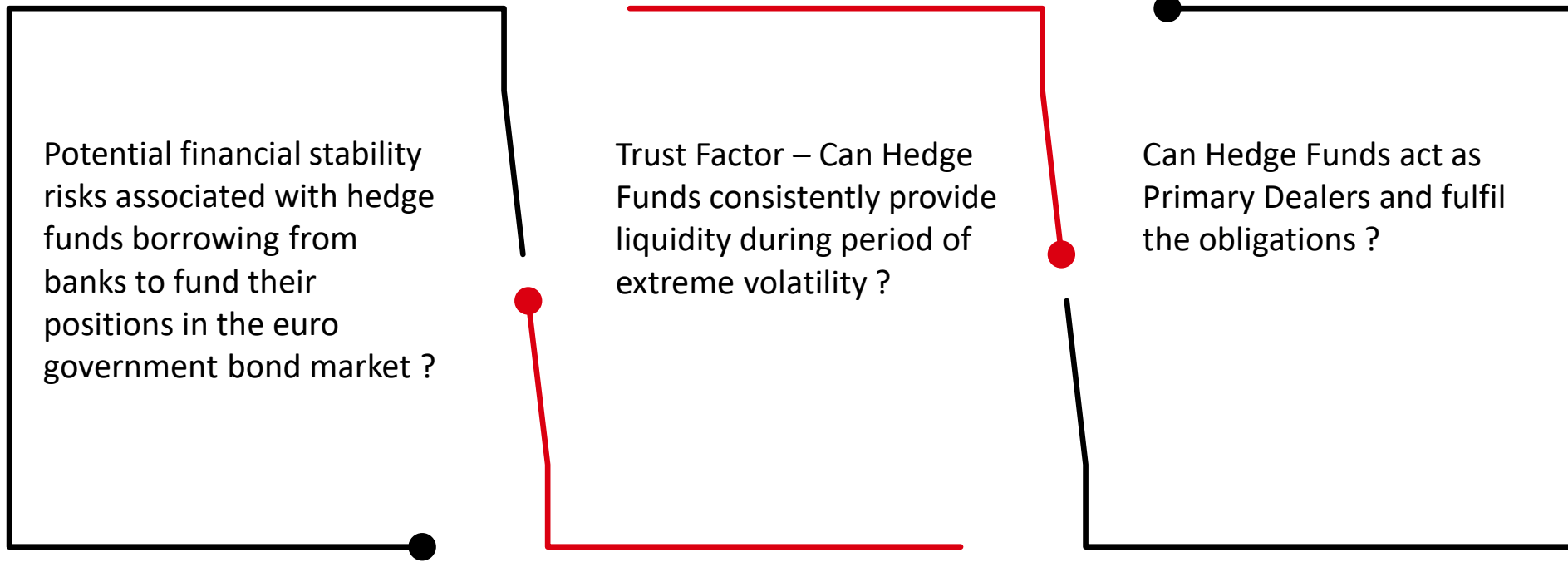
## Exit Behavior

- ◆ Banks are committed to staying in the market even during challenging times
- ◆ Hedge funds have the flexibility to reduce their commitment or even exit the market altogether when conditions become unfavourable, which could have an impact on market dynamics

## Inflation of Order Book

- ◆ Primary allocation from issuers is very limited for Fast money accounts (between 1% and 5%);
- ◆ One of the driving factors of large order books are driven by higher bids from Hedge Funds

# Discussion Points



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