Securities Industry News

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OCTOBER 22, 2007

VIEWPOINTS

JonesTrading: A Human 'Light Pool'

Founded in 1975, agency brokerage JonesTrading Institutional Services refers to itself as the "oldest and largest execution-only firm." Experience claims aside, JonesTrading prides itself on a business model that it says can locate liquidity in the most volatile market conditions.

The firm says it "proactively" seeks out, through its Active Crossing Network, internal order matches between its institutional clients, thus keeping market impact to a minimum—though it also taps a long list of market centers. According to Will Geyer, who joined in April as COO and president, 40 percent of the firm's trades are crossed internally.

Niche brokerages such as JonesTrading "tend to have a better chance at locating liquidity that has yet to be made available through electronic trading," said Adam Sussman, senior analyst at Westborough, Mass.-based Tabb Group. "It is through traditional networking and relationships that these brokers are able to provide value to their buy-side clients." While specialized brokers continue to feel pressure from declining commission rates and the concentration of business in larger, full-service shops, "they will survive as long as they hold the keys to hard-to-find liquidity," noted Sussman.

Geyer described JonesTrading as "a group of people dedicated to doing one thing well." He added: "We never take positions and our approach is conflict-free. These relationships are built through years of experience with our service; this creates a dialogue that unlocks a very unique pool of liquidity for our clients. We are the human 'light pool.'"

Packy Jones

We are the answer to the question, what do you do when you have swept the dark pools and you got nothing done?

The month that Geyer joined, JonesTrading received a $50 million equity investment from San Francisco-based Friedman Fleischer & Lowe, which is "enabling Jones to expand its niche into new markets and asset classes," said Geyer. At the time of the deal, Friedman Fleischer & Lowe vice chairman Spencer Fleischer stated that JonesTrading has "a service model [that] is unique and differentiated and provides exceptional liquidity to its customers."

JonesTrading, which has 11 offices and 162 employees in the U.S., is based in Westlake Village, Calif. and was built by George Jones Jr., a securities industry veteran and son of George Jones Sr., who broke into trading in the 1930s and was a principal in Mitchum Jones & Templeton. In 1982, George Jr.'s son, Packy, joined the firm from Newhard Cook & Co., where he'd been since leaving Jefferies & Co. in 1980. In January 2004, Packy Jones became CEO and chairman of JonesTrading.

Packy Jones recently sat down with *Securities Industry News* markets reporter Dawn Kissi in Los Angeles to discuss finding liquidity in fragmented markets, the added value of market color and how his firm has kept pace with the technology-driven changes in the industry.

How has the brokerage business changed over the last five years? If you were to go out and start an agency-only trading desk today, most people in the business would look at you like you were crazy. The business model itself seems to fly in the face of the secular changes we have witnessed through the advances in trading technologies that disintermediate the traditional high-touch broker-dealer. What is lost is that these changes are actually working to highlight the specialization that exists here in the people that make this firm successful.

The biggest change we have seen is that other brokers are moving away from what we do. The trading expertise that was previously distributed across many firms is now flocking to JonesTrading. Today, we have 18 former heads of trading desks on our team. The relationships and experience they have in the markets is what makes us special.

Our focus is on the dynamic hard-to-trade situations where the needs of the investment essentially transcend what is available in the visible and electronic marketplace. We are the answer to the question, what do you do when you have swept the dark pools and you got nothing done?

There are many instances where customers sit on pent-up liquidity and are not willing to blindly cross without the context for the situation. In many instances the proactive component of the liquidity search is what draws naturals out to trade and gets both the buyer and seller into a block that meets their needs.

What do you consider a hard-to-trade situation? An investment that would be greater than 20 percent of the average daily volume [ADV]. The size of an average institutional order is close to 300,000 shares. There are many mid-cap and small-cap securities where this average demand would tip it into the hard-to-trade category. There are also many situations where larger blocks of million-plus shares come into play, where investors need a solution to the dynamics of the market. This is where the buy-side trader and an experienced sell-side broker work together to develop a non-automated execution strategy.

It is important to look at what is happening to the larger brokers to understand why clients end up picking JonesTrading. Larger brokers are racing to offer all services to all people—in essence, to create a Costco-type strategy where you can go to one place and get all your shopping done. Because of the thin margins that exist in these wholesale-type models, they have to have less people offering coverage in more services. The sales function becomes spread out a mile wide and an inch deep. They are no longer able to dig deep into a trade and babysit it all day.

Our model is the complete opposite: We do one thing and we try to do it better. The purity of the JonesTrading model is self-rewarding or -punishing. If we do a bad job we don't get any more trades; the client doesn't come back because they have to pay for research or an investment banking deal. The good news is that we continue to break through to higher levels of trade volumes every year, so it's working.

How large a role does automated trading play? We believe in electronic trading. There is no doubt that these tools improve the quality of execution and the efficiency of the trading process. In fact, our technology strategy is to replicate the best of what a buy-side desk would have on their desktop. This allows us to use the most advanced and efficient of what is out there without being strapped to substandard in-house products. It also puts us into a deeper dialogue with our clients that use the same tools. We then can act as an extension of their trading desks.

What is your general approach to technology? We are flexible; we look at the arbitrage that exists in the provision of these execution technologies. Technology scales, so firms that have built these applications want to get as many users on them as possible. We look at each and evaluate their potential from a total cost and performance standpoint. If what we are looking for is not there or is too expensive, we build it ourselves. We are present wherever liquidity is available because we don't want our customers to miss prints while we are working through our network. In practice, that means using all the major algorithms, DMA [direct-market access], smart routers and dark pools that are out there.

Liquidity has become a hot-button issue. What is JonesTrading's view? Liquidity is the "golden fleece" for Jones-Trading and for every venue, electronic or human, because if you have liquidity to offer it begets more liquidity. At Jones-Trading the liquidity we offer is the ability to participate in our client network. The relationships we have developed over the past 30 years have been built on a foundation of trust and results.

The un-conflicted, agency-only model uses a rigorous protocol for protecting the order we have in hand rather than the one we don't. Our customers respect that, they know if we are dealing with others, ethically we will broker for them the same way. This implementation technique allows them to introduce indications of interest [IOIs] that they would never show to firms that commit capital or are too large to manage the execution process in a controlled way. Every client at Jones has a direct line to a dedicated trading broker who brings expertise and access to our upstairs network.

How has market fragmentation affected you? Fragmentation has actually increased JonesTrading's competitive edge. As a firm, we were designed to put together big blocks, and over our 30-plus-year history we have nurtured rich connections in our un-conflicted network. These trusted relationships make it possible to boil down the oversupply of information into one agnostic view, essentially distilling market blur into a nuanced snapshot. We then use our experience and protocol to tease out information and complete the trade. By maintaining a singular focus on our upstairs role, we've become the perfect antidote to fragmentation.

How many of your firm's trades are handled with a human touch? We cross close to 40 percent of the shares we trade per day between our natural buyers and sellers. The average print size that hits the tape for all of our orders is 54,000 shares. I think you would be hard pressed to find any venue that comes close to these numbers.

In a recent Tabb Group survey, 33 percent of buy-side respondents cited market color and trading expertise as top criteria in choosing a broker. How do you bring color to the markets? I think the top-criteria number cited in the Tabb survey would be much higher if you stripped out the liquid trades and looked at the decision contributors for high-impact executions. This is where the evolution of our fragmented market centers and dark pools plays against the needs of a trader. In addition, the dissolution of the NYSE floor has created a vacuum of insight into the supply-demand dynamics of listed trades. Now what you see on the screen is your total picture, essentially a blur. You can check the IOIs and [trade advertisements] and sweep the dark pools, but that isn't going to give you trading color.

That first step you take to proactively search for liquidity has to be a trusted one because exposure is introduced. Jones-Trading, by nature of being the hub for our client network, provides a unique perspective to each trade. Our protocol protects our clients through iterative dialogue that brings the right amount of color to consummate an execution at an agreed price point. In many instances, the large-percentage-of-ADV blocks we execute bring out more participants who had been on the sidelines waiting for liquidity.

What does JonesTrading need to do to remain competitive in the block trading space? Continue to listen to the needs of our customers. What we hear today is that our specialized service should be leveraged into other asset classes and regions to complement what we do. For example, many of the names that we traffic regularly are distressed situations where our investors are executing both the debt and equity transactions for capital structure arbitrage. In these names, we tend to know the story and who is involved, but today we only offer a liquidity opportunity in equities. In the near future we will launch a debt-trading capability to give our traders the ability to cover both asset classes. This will improve their knowledge and make them a more efficient conduit for our clients.

Another example is helping private equity firms and corporations with capital market transactions. We have a great distribution channel that can operate with economics that are compellingly cost-effective to our clients. We don't have to carry the investment banking and research overhead, so we can pass on those price benefits to our clients.

The last component of our growth strategy is to extend the size of our network by moving into foreign markets and offering a technology platform to tap into our indications of interest. There is a lot of opportunity in front of us, and it truly is an exciting time to be at JonesTrading. ■