

Global Debt Market

Hedge Funds' role in EGB markets

June 2024



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)

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

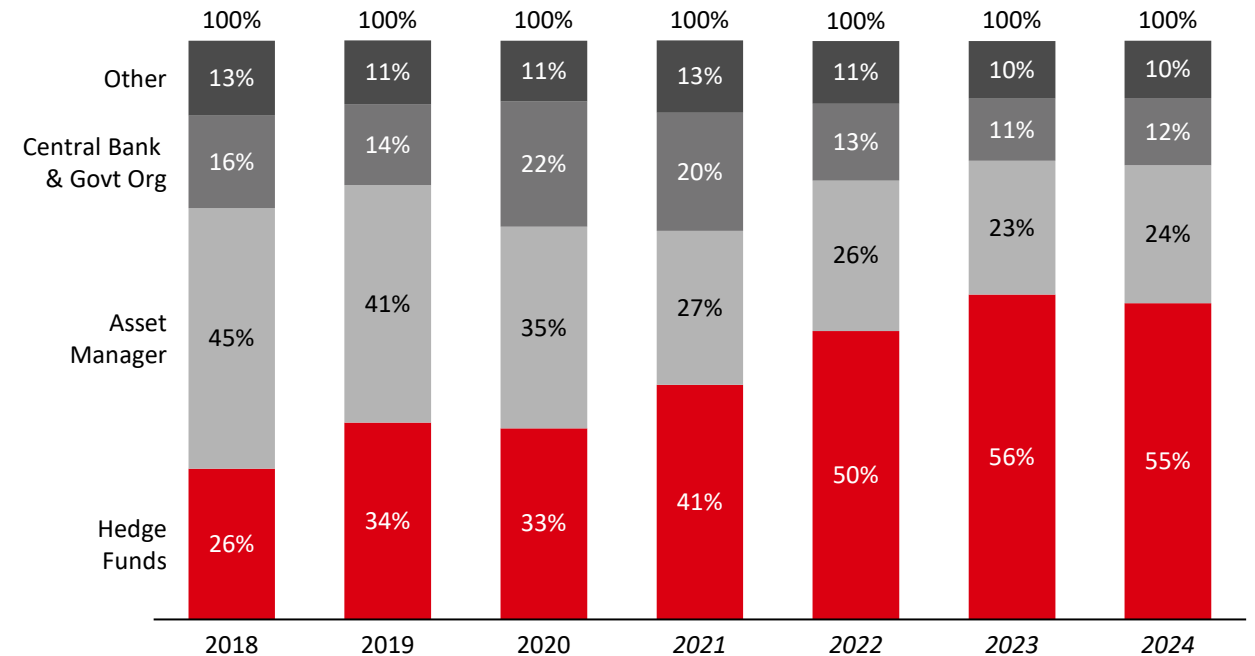
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As price swings become more common, Hedge funds footprint in growing are well-positioned to take advantage of volatile markets given their regulatory landscape is lightly regulated

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

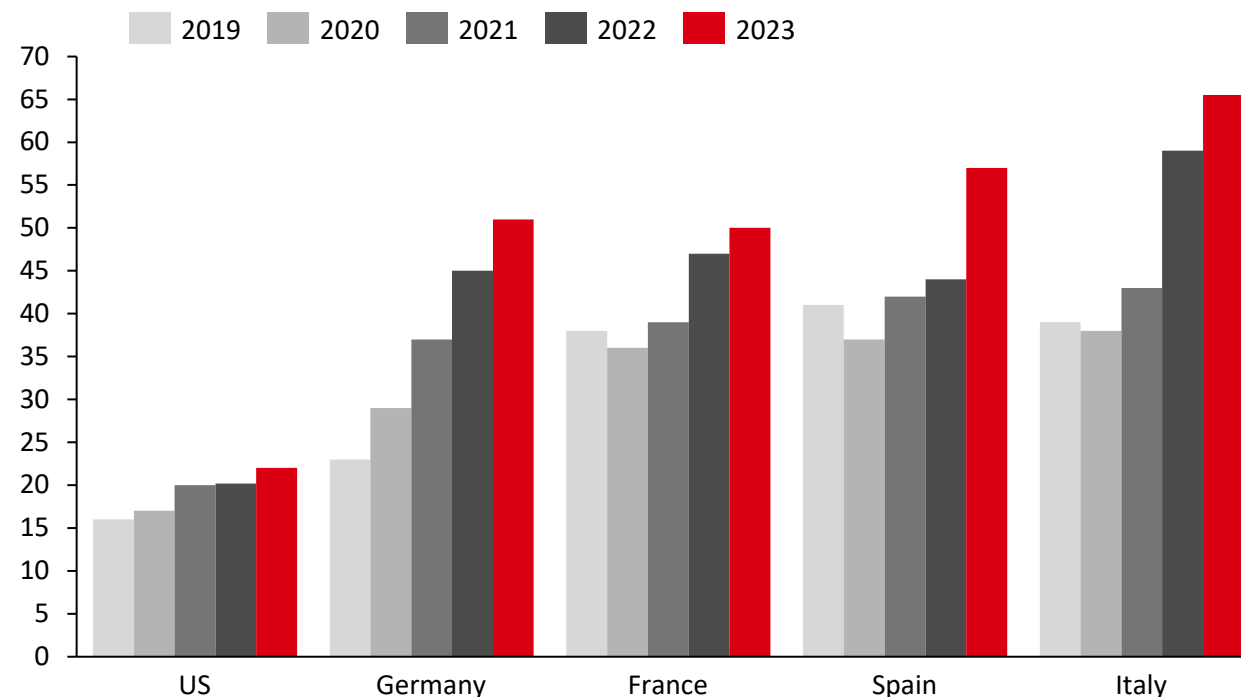
Secondary Trading

- ◆ 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

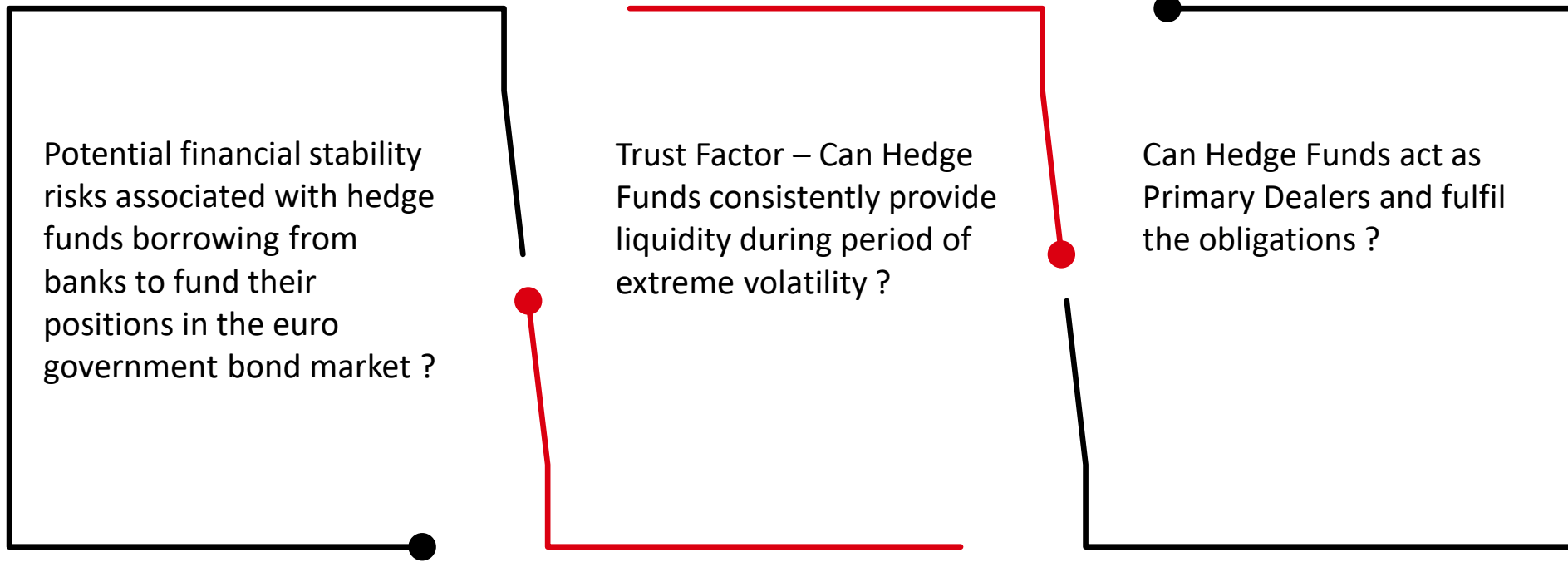
Exit Behavior

- ◆ 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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 Bahut shukriya
Merci
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Grazie
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 Na gode
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 O se