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What do Space-X and Virtu have in common?

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Over the last decade we've seen the talent pool for trading and space exploration become increasingly overlapped. Science-based PhDs can now either send a man to Mars or help make markets in US Government Bonds. But that's not actually the story here.

NASA's bread and butter is sending rockets into space. Bank trading desks similarly are the epicenter of bond trading. Greenwich Associates research shows that in 2016 58% of US Treasury trading by institutional investors was handled by the top five dealers. But the last few years have seen both NASA and the world's largest bond dealers start to outsource parts of those core functions. Whereas NASA has increasingly looked to SpaceX and other private sector companies to send rockets into space, JPMorgan, one of those top five bond dealers I just mentioned, tapped Virtu to supply its US Treasury trading infrastructure. If you had asked anyone in the know a decade ago if either of those events seemed realistic in the future, the answer would have been a resounding no.

But the more you think about it the more this and potential similar partnerships make sense. In this case, both realized that if they partnered with someone else that could do it better, they could focus on more critical parts of their missions. Now space exploration isn't my thing (unfortunately) so I'll leave NASA's decision alone, but the tie up between JPMorgan and Virtu is a bold one, and demonstrates the market's increasing willingness (and need) to start doing things differently.

When I first saw the headline about the tie up I was stunned. How could JPMorgan, one of the most successful banks in the post-crisis era, outsource anything to a firm that for years has worked to bolster its position as a new and improved source of liquidity? But after a few minutes it hit me - why should JPMorgan continue to build and maintain a trading infrastructure, when it can buy one for less that will perform better? Now to be fair, JPMorgan is only replacing technology for a slice of their bond business, but the gesture is notable none the less.

Interestingly Virtu isn't a particularly big volume player in the Treasury market. They don't show up on Brokertec's top 10 list, and fixed income doesn't even get its own line in the profit section of their annual report (it is lumped together with options and "other securities"). But their reputation in other asset classes and as a technology innovator, not to mention their willingness to partner, closed the deal. I'm sure the integration will cause pain and cost money for JPMorgan in the short term, but in the long run the now barely profitable business of trading US Treasuries will be able to operate with a lower cost base and as such a higher margin, but without hurting performance.

From Virtu's perspective, and ultimately the perspective of all principle trading firms, the deal is even sweeter. Firms like GTS, KCG, Sun Trading and Virtu have spent years perfecting their ability to trade liquid instruments in a low risk, high profit way. These firms and others like them could certainly continue on as is making money from their bread and butter business - trading. But the last few years, capped off by the JPMorgan/Virtu deal, have shown us that some PTFs are smartly looking for new ways to capitalize on the assets they've built up over the past decade - their people, their technology and increasingly their brands.

When I first explored the world of principle trading firms in the late 2000s, back when it was political correct to call them high frequency traders, it was all cloak and dagger. Getting into offices required fingerprint scanners and we were only allowed to answer their questions, not ask any. In 2016 the mood is dramatically different. Speaking to the press, presenting at conferences, hiring sales people to interact with clients and selling what was in the past the secret sauce all on the table.

Virtu and JPMorgan are unique in their own rights, so we won't see another deal with the exact same look and feel. And many PTFs after careful consideration will continue to stick to their knitting, not seeing the new opportunities as worth the investment or risk. Nevertheless, we will see more partnerships between PTFs and the Street, some very close and some at arm's length, as banks increasingly need the trading efficiencies that PTFs have spent years working to perfect.

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