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Deep Value: Don't Pay Unless We Perform

BY KATHERINE HEIRES

Creating automated trading strategies from scratch, optimizing them, and making savvy algorithm selections for each can be tricky and time-consuming. Some buy- and sell-side firms in need of external assistance have turned to three-year-old Deep Value, which touts an outside-the-box approach to thorny trading challenges.

Reflecting confidence that it can help customers achieve optimal use of their algorithms, Deep Value, a 12-person firm that includes three quants and three traders and has offices in Chicago, Toronto and Chennai, India, only charges its buy-side clients who have consistent order flow if its performance is up to snuff. For others, the firm uses a conventional payment model.

"If a buy-side desk has good data on current costs and those costs have held steady, we're able to offer up a pay-for-performance model, which is a challenging thing to do but ... is the right strategy to employ," said founder and managing director Harish Devarajan, a former trader and COO for Deutsche Bank's proprietary trading desk. After analyzing a client's historic trading data and expenses, Deep Value arranges to receive a percentage of what it saves the firm on its existing cost structure.

Among the firm's offerings is an "algo of algos" product—Rational Algorithmic



Harish Devarajan

Director (RAD)—that assists in the selection of brokerage strategies. "If a customer has eight brokers they can trade with," Devarajan says, "they have to choose between eight VWAP algo vehicles and eight implementation-shortfall vehicles and so on." RAD measures the performance of the brokers' algorithms every four to eight weeks. When it gets an order, RAD decides in real time which algorithm is best suited to the job—based on recent performance on comparable trades—and routes it accordingly.

"We see RAD as providing a service beyond what a trading-cost analysis ... firm would do," says Devarajan, who founded a DE Shaw & Co.-backed analytics firm whose technology was acquired in 2002 by Deutsche Bank. According to Devarajan, many of those firms simply provide tables of sampling data that is not statistically meaningful, in part because they compare brokers with varied flow and do not correct for market drift.

Using predictive analytics, "We collect data more carefully, allowing us to predict reliably that broker A does better than broker B," he says, adding that Deep Value bakes in that ability so that routing happens in real time.

In addition, Deep Value provides an Interactive Algorithms product that lets users trade in tandem with black boxes—"an effort to bring human judgment back into the trading equation, especially where algos are not very good at the task," says Devarajan. Deep Value's algos can learn and improve over time as a result of human interaction, he asserts. Also in the works is Alpha Experimentation, a platform that studies the interplay between a firm's execution logic and the inefficiencies that the order flow is trying to exploit.

New offerings are on the way to address the ongoing fragmentation of markets and the expansion of algorithmic trading into new asset classes. "We will be expanding into those areas of algorithmic trading where currently we do not have a footprint," Devarajan says.

"Deep Value is a small group of very intelligent guys doing some leading-edge work," says Matt Samuelson, senior analyst at Boston-based Aite Group. "Their pay-for-performance model says that they are confident about what they are putting out, and while it's very unusual on Wall Street to say, 'Don't pay us unless we perform,' evidently they are performing." ■

 DEEP VALUE