

Q&A with Pulse Trading's Mark Enriquez.

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Mark Enriquez, managing partner and co-founder of Pulse Trading, spoke with Traders Magazine recently and discussed several issues affecting equity trading. He discussed prospective regulatory proposals, whether limits should be placed on high-frequency traders and profitability in a declining volume world.

Traders Magazine: Is it hard for agency brokers to make money in equities these days with such low volumes?

Mark Enriquez: It's very difficult. And I think it's obvious. If you look at a profile of a firm like Pulse, our size in the near future will be viewed as the minimum size for a brokerage firm. It used to be that a small shop, with a few good business relationships, could do very well. Now we've seen a number of firms with that profile that have folded up or merged into larger firms. It's probably true in any industry-when you see a decline in aggregate industry sales, smaller players pursue mergers with larger firms or are faced with falling by the wayside. The good thing for us is, since we're purely a commission shop, our expense lines of commission and execution costs are variable. This makes us unlike some other larger-type firms on Wall Street that have high fixed costs and have to lay some people off because their fixed costs are so high.



Mark Enriquez, Pulse Trading

TM: "Quote stuffing" and the Nanex report have become popular topics these days. Do you think it's happening today? If so, is the practice of quote stuffing giving high-frequency traders an unfair advantage?

Enriquez: We have no way of seeing it [quote stuffing]. There is the theory that the quote stuffing is done to slow down a particular venue. If they can detect a momentary price advantage – you send thousands of orders that have to hit a venue's database and you cancel them and do the math to figure out how many orders. I would say the venues themselves would be able to very quickly to see what you are doing and shut that person off. Certainly if anybody was coming to us with rapid fire orders that they were cancelling immediately, that would raise a red flag.

revelation of some size in the marketplace. So I think that the concern is actions that are meant to protect and have a level playing field for mom and pops trading 200 shares of Cisco versus the legitimate needs for anonymity and the ability to trade size for institutions, which are obviously representing the moms and pops.

TM: What is the latest trend in algorithmic trading? Is it unique algorithms designed for specific customers or staying with the 'one-size fits all' offerings?

Enriquez: We have a number of people who will do customization [of algorithms] for us. We don't build our own as there are so many people out there doing it and beating each other up on price. And so we can use algorithms supplied on a third party basis at a very cost effective rate versus developing our own. At this time there is more marketing hype than truly new innovations in algorithms. People are now saying that they're adding a level of decision support on top of the basic algorithm to help users modify their strategies - have software help them decide where to modify the strategy they employing.

TM: What are your customers asking for (what do they want these days) on the algo front? An additional layer of decision support? Or do they want something else?

Enriquez: We don't hear that. There are algorithms we're adding onto our BlockCross offering that will help people work orders while still exposing them to the BlockCross crossing network. The most common order type people hear is 'I would if I could, otherwise work.' So you have your order in BlockCross, which then accesses other buy-side liquidity, and if it's there and respecting both sides' limits, it will put up a big block. If it's not there, it will start to participate in other dark venues and the displayed markets and wait until such a time when a contra shows up in size. And again, if it's within your limit, you can put up a larger block. So the algorithm demand we're seeing is more for order management--type automation.

TM: Recently you made some changes to BlockCross, your block trading system, such as offering research on traders' desktops and becoming part of Instinet's execution management system. Has this increased your block-trading volumes?

Enriquez: We were on a strong growth curve in the beginning part of the year, but flattened as volume dropped Street-wide over the last three or four months. But what we have deduced from our analysis is that our market share has actually gone up. The top line absolute number is flat, but we're garnering more of the marketplace. I suppose that's encouraging, but at the same time market share doesn't keep the lights on. Volume does.

TM: What is your outlook for block trading in the coming months?

TM: So you are saying HFTs do indeed have an unfair advantage then?

Enriquez: I think there is always a potential for them. It's hard for us to speculate without having firsthand knowledge of it. I don't think it can necessarily translate into a huge advantage. There's just no strategy I can think of that makes someone earn an enormous amount of money on just one trade. But with these guys, they are replicating a trade or strategy thousand of times a day to earn a small amount on each one? Yes, there is that possibility.

TM: That said, should high-frequency trading be limited in some way, such as by mandating how long quotes should be posted? Or a fee charged for large-scale cancellations?

Enriquez: I'm very hesitant to call for limitations on how people can access the markets. That starts us down a path that who knows where it would end. I'm leery to advocate any kind of limitation. There are people out there, like Vanguard, who are saying publicly the high-frequency crowd shrunk the spread on so many names to a penny and that has actually benefited the investing public. We'll probably be able to debate that for years, overall, and I don't think anyone has a sufficiently complete view of how all markets operate and could really come to that determination. Again, I'm very leery on limits to how people can buy and sell stocks.

TM: Aside from the HFTs, what's going on in the electronic trading marketplace that concerns you the most?

Enriquez: The biggest concern outside the lack of institutional accounts putting money to work and where the regulators are going to fall [in terms of new proposals or rules.] Unfortunately, what we do is pretty arcane. The politicians that exert the pressure on the regulators, come with an imperfect understanding of how institutional trading works. I can certainly appreciate that they look out for the mom and pops of the world who trade with an E*Trade account, buying and selling a hundred shares at a time. That is well and good. It concerns us when regulations are put in place that affect how institutions, who are arguably very knowledgeable—our customers—who come to work every day with a very deep understanding of how markets and players work. So there's not much of a chance that these guys are going to get taken advantage of. They know how to avoid the pitfalls of certain actions of other participants in the market.

TM: What issues have regulators raised, such as rule proposals or concepts, like sub-penny trading or Trade-At, that you are looking at?

Enriquez: The "Trade At" proposal concerns us—anything that inhibits our ability to print customers within the spread in size in a non-displayed manner. Everybody says that back in the days of the specialist and some person or human being seeing all the order flow, well, that had its own problems. Ask any institutional trader what it was like trying to move large blocks on the floor in the late '80s or the '90s—that's what gave rise to the electronic trading tools and anonymity. So, you weren't exposing your order to people that were sitting there waiting to take advantage of the

Enriquez: I think everyone's been disappointed that September has started out so slow. There was a lot of anticipation there would be volume after the last barbeque and Labor Day. But it hasn't quite panned out that way. I think eventually, when you talk to the old timers, things ebb and flow. I think personally, with the rates of return being low in fixed income, people, when they do their retirement planning, will realize no amount of money saved that earns one percent will help me retire. So I think the risk appetite will inevitably return, and with that will be equity volumes.

It's going to be interesting to see. We're optimistic in BlockCross, as people realize as an institutional trader, your best bet is to be in block-oriented dark pools, and there are a number of them, and avoid the pitfalls of working in the displayed markets, where you have the high-frequency guys doing what they do.

TM: What about expanding business outside the U.S. markets? Are there any new business lines Pulse is exploring, such as branching into new asset classes?

Enriquez: We've done some international business, branched into fixed income, such as dipping our toes in corporates and agencies, and options, as well. Those are all viable paths for us. We're always talking to other firms to see how we can work together. We've done that since Day One. You always have to keep an eye open as to what other shapes your firm can take to continue to offer your clients and employees more opportunities.

TM: Any future alliances Pulse is looking at?

Enriquez: We're looking at people with liquidity who have expressed interest in participating with the BlockCross dark pool, but nothing is imminent. We've always had multiple conversations and everybody out there is having conversations about how to position their firm to survive, and then when markets do turn, ask how am I going to be well-positioned? Somebody with some pockets might be able to start picking up some property so that their firm is well-positioned when the markets turn. You could look like a genius. But if the markets don't turn, then you could be out of a job. But some people are willing to take that risk.

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