Risk publications

AsiaRisk Awards 2021

Risk.net October 2021

Derivatives house of the year, Japan

Barclays

Derivatives house of the year, Japan

Barclays

Japanese market sentiment was subdued for much of last year, with investors uncertain about how the Covid-19 pandemic would play out or who would be the next US president. Two weeks after the election, there was a resurgence of investment activity in the country. Barclays was there to meet this sudden change in direction with creative structures that delivered decent returns and kept risk low.

One class of product that has proved particularly popular over the past 12 months is based on intraday momentum strategies, which use certain indicators to buy stocks as the market is going up and short stocks as the market is falling.

This kind of strategy is not new to the Japanese market, and, indeed, Barclays has been offering such products in the country since early 2019.

These investments generally did quite well during the Covid-19 crisis last year, when their tail-hedging properties were most needed, but they suffered from one crucial shortfall: the underlying equity baskets were all made up of US stocks. This left many Japanese investors with an imperfect hedge against their equity portfolio.

Barclays thought it would turn things around, and, in April 2020, launched the first ever intraday momentum strategy on Japanese equities.

"We spent more than six months thinking about how this could be made to work, and then we finally realised what we needed to change in our models," says Julien Calas, a member of the cross-asset structuring team at Barclays. "Once we had that piece of the puzzle in place, we were able to deliver a strategy that effectively gave the same risk profile as the US intraday strategy, but on Japanese stocks."

He says there are some peculiarities within Asian equity markets that mean they don't behave in quite the same way as the ones in the US.

"Right from the start, we saw a lot of interest from Japanese clients when we showed US intraday momentum strategies, and this only increased further after the market turmoil last year," says Ryo Ishiyama, head of solutions distribution sales. "But even those clients who had invested in the US strategies asked us for a Japanese version to better fit their portfolios, so when we found something that worked, that was really something. One of our best moments."

Barclays' ability to successfully launch such products in Japan ahead of its competitors is testament to the bank's solid research capabilities, both within Japan and globally. Hybrid FX/equity autocall products have also been proving popular this year. These are products that combine a benchmark index – typically, the Nikkei 225 or Euro Stoxx 50 – with an emerging-market currency crossed with the Japanese yen.

"The emerging FX asset class is something very close to equities in terms of risk profile, and those FX/equity hybrid autocall products were closely aligned with the 'animal spirit' style of investing that we saw making a comeback at the end of last year," says Calas.

Barclays started offering such products to retail investors in 2019. Its first such product was linked to the Brazilian real, which, at the time, was proving a hugely popular choice for Japanese investors seeking extra yield. Last year, investor interest switched to the Turkish lira, so Barclays quickly added that particular currency to the mix. It has also just finished setting up a hybrid autocall product linked to the Mexican peso, although it admits that uptake in this particular structure has so far been fairly lacklustre.

"We might have to wait a little bit longer to get interest from clients. I think we view this as something that has potential for the future," says Takayuki Watanabe, head of structured distribution sales.

Other currencies that could have potential, says Watanabe, are the Indonesian rupiah and the Russian ruble: "This goes in cycles, and is mostly driven by carry-trade interests. At the moment, the focus is on lira and real, but, as market conditions evolve, we can expect the usual suspects for emerging-market FX to re-emerge."

From Barclays' perspective, the challenge in offering these hybrid products is to have sufficient insight into the currency markets in order to be able to adequately hedge the risk, especially since the liquidity in many of these emerging markets quickly dries up once the tenor of the product goes much beyond three years.

"When you start looking at longer-term maturities for some of these markets, volatility quickly becomes illiquid, and you have to be very careful how you model the FX correlation with your equity component," says Calas. "We wouldn't be comfortable doing these products if we didn't have experienced traders in the respective currencies."

Calas says that launching the first such product, linked to the Brazilian real, was the most challenging because the product was so new and the appropriate trading structure needed to be developed from scratch.

"After that first launch, then, for each new FX pair, it was just a matter of looking at the relationship and asking: 'Can we model it?'" says Calas.

Client feedback about Barclays has been highly positive, too, with many clients holding the bank up as a beacon of creativity.

"The products that Barclays offer are fairly unique, and they have some great ideas, especially in the derivatives and options space," says Ryozo Ishikawa, a director of the investment division of Japan-based Simplex Asset Management. "We are always looking for new transaction ideas to make money – and on this, Barclays delivers, so I am happy to work with them."

For example, the asset management firm has been selling S&P 500 options with a weekly expiry date – and Barclays was able to make a market for these trades. "This kind of derivative is relatively difficult to make a market for, but [Barclays] were the first dealers that could provide a high level of liquidity for us on an over-the-counter transaction basis," says the portfolio manager. "They have very good insight into market information, and their execution capabilities are good, as well." ■