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WallachBeth Capital LLC

is an 'inter-market-broker' specializing in exchange-listed equity options and index products, ETFs, listed and OTC equities, and non-U.S. equities. Markets Media sat down with Chief Executive Officer Michael Wallach and President/Chief Operating Officer David Beth to discuss the state of the company and the current financial-market landscape. The interview took place on Tuesday, August 24, at WallachBeth's lower Manhattan office.

Markets Media: Talk a little about the background of the company, from inception to present.

David Beth: We opened our doors in late 2008, but there's a lot of industry heritage in our firm. Both Mike and I, as well as most of the senior team that we've assembled, have at least 20+ years experience working in various roles throughout The Street. Our firm is really a collective of former major exchange specialists, floor brokers, market-makers, as well as upstairs facilitation desk and prop traders. Many of us have worked together in "prior lives," and we've always shared the same perspective about the business, and particularly what the brokers' role should be. We formed WallachBeth because we all knew there was a need and a demand for specialty firms that would provide unbiased agency execution with the same intellectual skill that's traditionally found at firms that provide capital execution.

Michael Wallach: We also saw a big need on The Street for people to take the best-of-breed technology and incorporate that with human capital and get executions at the right price. With most shops, whether it's a firm that's committing capital or a firm that's simply brokering orders, a lot of times it's implied that their primary goal is best price for the customer, but in practice, the primary goal is to either generate trading profits, or generate commission revenue, and a secondary goal is the price the customer receives. Our goal, and we live by it, is to find the right price for the client on every trade. Whether we do that electronically or whether we do that via voice brokering by going out to our liquidity network, it doesn't matter. Whether it's a 5 lot, 50 lot, 500 lot, or 50,000 lot, we do it the same way every time.

We opened our doors in November 2008. We started off with 10-12 people and we've grown to 36-38 in two years. While most firms in our space have downsized over the past two years, we've tripled in size over the past two years.

DB: Important to that is the fact that we felt it was necessary to keep a full staff on the floor of the New York Amex, to provide our clients with floor-based execution capability so that we maintain our hands on that order all the way through until the trade prints.

MW: We have three unique pods of business. We have cash ETF desk, we have a Delta One desk, and we have an institutional options desk. They all feed off each other.

We think we have a larger pool of liquidity than most firms, in fact we think we have the largest pool in terms of the network itself. Aside from our electronic connectivity to the various exchanges and ‘dark pools’, we connect to a wider and more diverse pool of natural counter-parties; sell-side and buy-side, any or all of which might necessarily have an “axe” in a particular trade.

We go beyond the traditional walls when it comes to sourcing liquidity. We reach out not only to the banks, prop traders, market makers and (authorized participants), but we go to the hedge fund traders, the index traders, commodity traders, currency traders, people who can make markets in illiquid products, and who specialize, whether it be biotech or in commodity-based products or materials or different sectors of what they trade. We go out and really look for those guys so when we have an order we know who to go to, who is going to make markets.

DB: We work as hard on our liquidity pool as we do finding customers. We like to think that they respect our trading capabilities and our market savvy enough to respond to us in potentially a different way than they would with any other broker. And we then think we present client orders better than any other broker as well. We’re confident in our ability to execute trades. We’ve been doing it since the 1980s. We traded through all different markets. The people here -- let’s talk on the options side -- most of those guys have traded for major firms and for themselves, and have been in the market 10+ years, 20 for some of them. Mike and I have both been in the business for 30 years. The ETF desk, those guys have been brokering since the inception of ETFs on the floor of the Amex. And the Delta One desk is driven by Steve Markowitz, an industry veteran, who’s traded as long as we have, since the 80s from the floor of the New York Futures Exchange. He’s been trading OTC markets and Delta One products for 17 years, he worked at Prebon prior to being here. So we are a bunch of industry veterans, which gets to the whole aura of what we do here.

MW: With all due respect to David’s counting birthdays, the firm is young in spirit. If you come in and look at the trading desk activity, you can tell we’re as vibrant as any desk on The Street.

DB: But we’re driven by very experienced, very savvy and relationship-heavy people.

MM: Trading volumes in the markets overall have disappointed this year. How has the weak backdrop affected WallachBeth?

MW: People want to trade through us, whether because we’re strong navigating volatile markets, or strong with complex orders. Our trading volumes are up year-to-year, and the reason why is that people want to trade at the right price. People are tired of having indiscriminately priced products. They want to come and they want to know they’re

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going to trade at the right price where they have the liquidity. I say it all the time, once somebody picks up the phone and sees the way we execute their order, price out their order, they come back to us with more orders. And I know—you talk about trading volumes are down —even at broker-dealers like us, trading volumes are down, because most people are sitting around waiting for orders to come to them. We don't. We have a constant unsolicited order flow on our desk from people who are looking to price things out, whether it be in the equity finance part of the business—reversals, conversions, things along those lines, or even on the institutional options side. Our ETF desk is hands down the best ETF desk on The Street. The cash ETF desk, the way we price ETFs, is the only way to price ETFs. I see the way we price out blocks of ETFs, whether it be a million, 2 million, 5 million or 10 million, and it's the way to do it.

DB: The teamwork concept we have here differs from other shops. In other shops, we believe, there's a lot of competition amongst sales traders and traders, as they want to get their guy in on a trade. We have more of the teamwork concept, where everybody is just happy to get the right price for the client, whether they're actually involved in the transaction or have assisted in getting someone else's "client" involved in the trade.

MM: Are you involved in high-frequency trading?

DB: Only when we're busy (laughs). No, we're not involved in brokering high-frequency orders.

MM: Some say that when volume slows, traders are more likely to send order flow to large bulge-bracket firms that offer more services. Are you seeing this trend?

MW: We're an execution shop. We're not a research shop, and we're not a "soft dollars" shop. That's not what we do. If people want to trade at the right price they come here. That is what we offer people.

DB: We offer execution. We are also very capable in helping our clients strategize, or "optionize" their order, optionize their thoughts. For example, if a client says "I think that XYZ is going to be up 10 percent in three months, I have X amount of dollars or this much exposure, how can I do this?, how can I make this play better?", we enhance clients' strategies by providing option strategy insight all the time. It is execution research and strategy enhancement.

MM: Why do you call yourselves "inter-market" rather than inter-dealer brokers?

MW: In the traditional IDB world, where you find the Cantors, the Prebons, the GFIs, etc., the interdealer broker's role is to preserve anonymity and help facilitate order flow between competing broker-dealers, and typically in OTC products. And the otherwise unwritten law is for IDBs to maintain their liquidity network between, or within, the circle of broker dealers only. As the world evolves, especially in listed products, "inter-market broker" is someone that connects to everyone involved in the market. You've got hedge funds that are trading no differently than prop traders from an upstairs broker dealer. It's not only traditional market-makers, or sell-side facilitation desks or prop trading firms that provide two-sided quotes, but hedge funds are making markets, institutional managers are making markets. They all have an axe on both sides of the trade, by virtue of the fact that WallachBeth is servicing both buyside and sellside and bringing them together, anytime that there's an opportunity or anytime that there is a transaction that needs to be executed. Our firm will discreetly broadcast that out manually and/or electronically to everybody and anybody that we know has an axe in that particular name. That's why we call ourselves an inter-market broker: we sit on top of the walls, not inside of them.

MW: And electronically, we protect the client electronically, by making sure the screen market is in fact the best available market.

DB: We interact with every order. Electronically, we protect the client.

DB: Here's the bottom line: we will interact with electronic markets at a cost to us to obtain the client a better price. We think that's the way to go. We are inter-market dealers: we'll trade some electronically, we'll trade some voice, or we'll trade it all electronically. We will get the best price possible for the client, through all markets.

MW: Writing the other side of a ticket for the sake of earning a commission isn't our goal. Our goal is to get the right price. If we happen to find the other side and that's the right price, great. if we can't, and if we lose the order, so be it.

MM: Exchanges have been reworking price structures, how have you managed through this?

DB: It's becoming increasingly difficult because of the fees. For example, the CBOE just put on that new router-way fee of 35 cents per contract electronically, for 1,000 lot or more. So what's happening institutionally is the exchanges are starting to tag these fees for customers and broker-dealers, they're passing their fees onto the broker and it makes our job harder. But we work with our clients, we teach them and educate them about fees and structure.

MM: What are your expectations for financial regulation -- is there anything in particular that you are looking forward to, or dreading?
MW: I'm not dreading any of it. I've been in the markets for 30 years, I've seen the '87 crash, I saw the '89 crash, I saw the '92 meltdown, I have seen all the meltdowns and all the financial regulations. Any regulatory changes that improve transparency and mitigate transactional risk, without introducing unnecessary burdens, is a good thing. We are always going to adapt to whatever regulatory changes are introduced to the markets.
DB: We've all been through regulatory changes, and we certainly live in the listed markets. Through our Delta One area, we operate within the constructs of the OTC market as well. We're more than prepared to have everything in the OTC world convert to listed, or not. If SwapsWire is a tool they make every OTC transaction go through, we're already a participant. If it's a membership at an exchange where they are going to pick a product we trade and put it on an exchange, we'll adapt. We're a technology-forward firm -- we have been ticketless, paperless from the beginning.

MM: How is technology driving your business, and what trends do you see in this area?
MW: We think we have the best technology in the industry on our desk. Most technology in the options world has become commoditized, at least most EMSs. The OMS side of the business still has a long way to go for options.
DB: Options OMS capability is not really out there, other than our own platform. We do have a platform we use, OMEX, and we think the technology is different than any other platform. It's a leading-edge technology that hopefully we'll be able to bring to market within the next three months. We think it's a turnkey solution for any broker-dealers. It runs options and equities, it takes cares of your OMS, EMS and back office all in one piece of software.
MW: As far as technology, I think with the screens being one-dimensional, and you talk about writing algos for options and having the machines trades for you and things along those lines, it's really not that simple. So they're still going to be brokered upstairs. This is no different from the way they are in Europe, where it is completely screen-based, yet they still broker the orders upstairs. Because that's where you're going to find the hidden liquidity and find where things are supposed to trade, at the right price.
DB: Because of the leverage of options you're never going to see the full picture on a screen, so it's up to the guys on the desk.
MW: We love technology. There are plenty of times where we go out

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technology-wise and we get much better pricing than we do from our own liquidity providers. And then there are times when there's no liquidity. That's why you have to meld the two together in order to look for best pricing.
DB: An unamed company who attempted to create an electronic auction market has now become a full-voice broker dealer. Their technology is very impressive, but because it wasn't embraced by the market, it just shows the complexity of the option negotiation process -- it's way too early for that to be fully electronic. They did a hell of a job but they're now full voice, they have five, six, eight people on the phones to try to salvage the broker-dealer.

MM: What are the main themes in the futures and options market going forward?
DB: Education is always a theme. The more you get out there and show people who run a chunk of money, the more you can educate them and show them how to use options so they are not afraid of them, to enhance their returns, it all revolves around education. It's education and strategy, and being able to back up your strategy with liquidity.
MW: Another theme is that a lot of the OTC products are going to become listed, we all know that.
DB: But the types of things that trade OTC will continue to trade. They're very important products, specific to needs of institutional customers.

MM: What is your macro view of the economy?
DB: As a firm we make it a practice to not go out and make recommendations to clients on any macro view.

MM: Any additional comments?
DB: Our goal, which we accomplish every day, is trading at a fair price, the right price. When you trade for people as you would for yourself, people know that and people walk away from the trade and say "hey that was a good execution, I'm happy". That's how we look at it.