THE DAILY CHECK-IN WITH GOLDMAN SACHS

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HOST: LIZ BOWYER, GLOBAL HEAD OF BRAND AND CONTENT STRATEGY
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Liz Bowyer: Hi William.

William Wolcott: Hi, Liz. How are you?

Liz Bowyer: Good, thanks. You run our credit portfolio trading business in the Global Markets division. There have been a lot of changes in the credit markets in recent years. Give us a sense of what's happening.

William Wolcott: I would say that broadly what we've noticed in the credit markets is a theme around the equitization of credit markets. And we've seen a number of exciting transformations over the last few years. ETFs have been a large driver and a large driving force of that transformation. We've seen an uptick in bond portfolio trading, algorithmic trading, and more list trading as more and more investors have become comfortable with transacting in ETFs and trading in broader lists in the credit markets. And that's driven a number of exciting innovations that have added liquidity and transparency to the market and lowered the barrier to entry for a lot of new investors.

Liz Bowyer: And what are some of the liquidity benefits?

William Wolcott: Credit ETFs, I think, have been one of the biggest driving forces in liquidity in credit markets, especially recently over the last few years. We've seen the volumes in credit ETFs really start to grow and become a greater percentage of the total volume traded in the bond market everyday.

To give you a sense of the scale, in investment grade, that's around 15 percent, of the daily market value traded is now traded through the ETF market. And in high yield it's even in greater percentage, it's around 30 percent. And so, what that does is that adds liquidity to the credit markets and to that ecosystem. And then you have an efficient mechanism for market participants to observe where the clearing real level for risk is in the credit markets.

Liz Bowyer: And what about transaction costs, which have long been an issue in the bond market?

William Wolcott: So, I think generally when you see an incurred in liquidity, an increase in transparency, that also leads to lower costs. And so, that's one thing that we've observed as these new market structure developments have come along, is the cost of transacting in the bond markets has gone down. And so, when I think around ETFs, around algorithmic trading and credit, around portfolio trading, a lot of these things are reducing costs for our clients and bringing more market participants in. And making it easier to transact in and express views in the credit markets.

Liz Bowyer: So, William, one of the big concerns about credit ETFs is how they would fare during times of market stress. So, how do they hold up in 2020?

William Wolcott: I think when you replay the tape on 2020 and you look at credit ETFs objectively, the tape looks pretty good. Credit ETF volumes rose two- or three-fold during March and April. And the products broadly performed as advertised. It created a lot of opportunities for our business to manage our risks and better provide liquidity for clients. And I think also created opportunities for our clients to add risk and add scale at a time when some of the underlying bond market liquidity was more challenged. So, credit ETFs were additive to, I think, the liquidity paradigm in March and April. I think the volumes reflect that.

And then also you had the Fed coming in to add ETFs when they came in to purchase securities in the credit markets. And I think that was another positive catalyst for credit ETFs. And we've seen that, the performance of the products, how the create/redeem mechanism performed during March and April, in addition with new participants coming into the markets carry over into 2021. And more and more clients continue to adopt these products and using these tools as part of their investment process.

Liz Bowyer: And so, what does what you're seeing in credit ETFs reveal about broader trends in market structure?

William Wolcott: I think it's scale. I think that's the number one word that I would say has been associated with it from a market structure standpoint, is clients are asking for more scale. And we and others are investing to be able to provide more scale in the credit markets. Whether that's providing liquidity in ETFs, providing liquidity in portfolio trading, or other channels. It's investing in scale and investing in ways to provide liquidity with less human interaction and involvement to be able to do thousands of trades in a given day. Historically, a lot of corporate bond trades were negotiated over the counter in a chatroom or over the phone. And that's changed as the market has transformed, enabling market participants to transact in hundreds or thousands of bonds daily. And that, essentially, evolution has catalyzed a lot of these, you know, market structure development.

Liz Bowyer: You mentioned that credit ETFs are bringing new market participants into this space. What kind of participants?

William Wolcott: When I think about new market participants, a number of the new entrants have been traditional players in the equity markets. And they've been very successful running quantitative or other more systemic strategies in equities that have been enabled because equities market structure allows for continuous liquidity, transparency, and price discovery.

And so, as we're seeing those things come online in credit, that's enabling a new breed of investors to come into the credit markets. And it's creating another market participant for our more fundamental and traditional investors to interact with. And I think that evolution, in terms of the client base and some of the new participants coming into the market, will continue to fuel a lot of these innovations that we're currently seeing in the credit markets.

Liz Bowyer: So finally, William, what are some of the other big themes in the credit markets that you'll be focused on this year?

William Wolcott: I think sustainability is the thing that comes to mind as top of mind from a focus standpoint. ESG is increasingly a consideration a lot of the flows that we see across our platform and our clients are focused on constructing more sustainable portfolios. And we're very, you know, committed to providing solutions and also providing liquidity around that trend towards sustainability. And I think that will be increasingly a larger driver of flows across our platform in the months and years ahead.

Just to tie it back to ETFs as well. That's another way for individual investors to also invest along that theme. There are a number of ESG focused ETFs in the credit markets. And we've seen an uptick in flows recently into those products as clients look for different ways to express a view around a more sustainable portfolio.

Liz Bowyer: Thanks William.

William Wolcott: Thanks Liz. Appreciate you having me.