Risk

AUGUST 2002
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Goldman and Deutsche to launch economic data options

Goldman Sachs and Deutsche Bank plan to jointly launch the first of a series of options on economic data in the first week of October. They are jointly marketing the products, which are based on the Parimutuel Digital Call Auction (PDCA) technology developed by US financial technology firm Longitude. The first auction will be on the September US non-farm payroll figure. If successful, the products would be the first tradable instruments for hedging exposures to, or taking positions against, economic indicators such as employment, inflation and GDP.

Longitude's PDCA process is based on a universal Dutch auction in which all in-the-money options are funded by the out-of-the-money options – the losers fund the winners. Longitude claims it requires no underlying, and is self-hedging and self-clearing. The dealers make money on the spread and pay a fee to Longitude for their franchise.

Longitude began signing up clients last October. Originally, JP Morgan Chase and Deutsche Bank acquired the franchises for options on economic statistics in the US, Europe and Japan. But JP Morgan decided to withdraw from that project and apply the Longitude engine to develop options on mortgage prepayments.

Goldman joined in JP Morgan Chase's place earlier this year. Goldman and Deutsche plan to collaborate on each auction, rather than focusing on economic statistics in a separate region, to bring the largest pool of clients to each auction. Oliver Frankel, managing director in fixed income, currency and commodities at Goldman in New York, says the firms launched a joint marketing effort last month to their hedge fund clients, banks and other potential end-users.

Based on feedback from their hedge fund clients, the firms decided to add vanilla options to the digital options the Longitude system originally offered, Frankel says. They will offer vanilla options, vanilla spreads and digitals, and digital ranges with multiple strike prices.

Supply and demand

The universal Dutch auction aligns option supply and demand. "It is much more powerful than traditional market-making," Frankel says. "Traditional market-making involves order mismatches, and you have to allocate risk capital for those mismatches. This universal auction format improves order matching by an order of magnitude," he says.

The firms will begin by holding option pricing auctions a few days before the economic data release dates. They will eventually hold auctions earlier to provide longer-dated options and build a forward curve. "For example," Frankel says, "with GDP we plan to hold one auction before the advance number is released, one before the preliminary number and one before the actual number – though all the options would be on the actual number."

The firms expect hedge funds and proprietary traders to be the first auction participants. Longer-dated options could appeal to a wider range of speculators and hedgers, including banks, corporates and asset managers.

Goldman and Deutsche plan to target all the major economic data releases. The September US non-farm payroll auction will be followed by retail sales and inflation. Bill Cassano, vice-president in Goldman's fixed income, currency and commodities group in New York, expects the firms will have conducted between 10 and 15 auctions in total, covering three to five statistics, by the end of the year.

Potential users have expressed two concerns. The first is liquidity, Frankel says. "Some of the larger hedge funds were initially concerned about liquidity, but we feel there will be more than enough interest, since hedge funds position themselves for economic releases every day." The other concern is the adequacy of data and analytics. Deutsche and Goldman plan to provide clients with implied standard deviations, and will discuss pricing and risk analytics with clients who request their help. ■

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