Retail FX Platforms:

Helping clients through volatile markets

Shaken confidence in global markets and various banks in particular has led to a lack of liquidity - at times even in the major currencies. For example, there were times in late September when spreads widened considerably in the interbank market even for the largest currency pairs such as EURUSD, reflecting a low appetite for risk and general nervousness in the market.

However, such episodes were brief and better spreads returned to major currencies, albeit perhaps not yet to standards enjoyed before the crisis. The same cannot be said for some of the smaller pairs, where the flight from liquidity appears to have become a more permanent feature. According to those we have interviewed, Retail FX appears to have stood up to the crisis well, demonstrating the continued resiliency of this very profitable sector, as well perhaps the effectiveness of new regulatory and capital risk to exposure ratio requirements in major jurisdictions. Recent volatility has clearly affected some clients very positively, whilst others like those depending on trading on very tight spreads are "are definitely through the looking glass right now," according to one commentator.

We spoke to Alain Broyon, CEO of Dukascopy – SWFX Swiss FX Marketplace, Ross Ditlove, CEO of MB Trading, James Pieron, CEO of JDFX, Vladimir Kisyov, Head of Marketing and Sales at Deltastock, Greg Michalowski, VP and Chief Currency Analyst at FXDD, Thomas O'Reilly, SVP of Sales, FXDD, and Lubomir Kaneti, COO at FXDD to find out how recent volatility has affected their clients and platforms:

Gentlemen what can be done to help clients trade effectively through current market conditions?

Broyon: The best tools an investor can have are reliable/fast execution and extensive liquidity (i.e. tighter spreads) The Dukascopy – SWFX business model was designed to constantly function in a manner that delivers leading edge technology with instant execution and liquidity cumulated from Marketplaces (i.e. EBS-ICAP, Currenex, Hotspot) and leading banks including UBS, Citi, JP Morgan and Goldman Sachs.

Michalowski: Experienced traders tend to know what they want to do, and how to do it. The clients we focus on in terms of education and quasi-advisory input are those who need some hand holding and more practical experience. These clients, especially during these tumultuous times, crave knowledge on what makes currencies trade the way they do. Our perspective is that a more informed trader is probably going to be a better trader. We believe in that philosophy, especially for the retail base we service. Once clients understand the basics of market analysis and the approach to trading with which they are comfortable with they can more readily manage their trading activities.

Ditlove: Being a direct access ECN broker, our goal has always been to make sure that our traders are not hindered by arbitrary "rules" on our platform. When things are volatile, customers need to have more control over their orders, and our system gives them that.

Pieron: I believe that JDFX has the best FX technology and connectivity on the planet and I use it to trade my own money. Pips are now more important than ever. Concerning spreads and execution – it's not what you see or what is advertised – it's what you get and what is booked to your account. The ITP product from JDFX will get you in and out of the market by the most efficient and cost effective means possible. Trades are fully transparent and routed to the top eight Tier-I banks. Tight spreads and 30ms fills continue up to 20 MIO and >= 100 MIO fills are available upon request.

Kisyov: One of the most important factors for the effective trading in the current market conditions is keeping spreads low and stable to the extent reasonable and possible. Deltastock maintains both guaranteed fixed dealing spreads and Level II variable spreads in the company's proprietary trading platform Delta Trading. Being flexible enough to offer traders these two options in one platform has proved to be one of our points of excellence. The advantage of being able to trade at fixed and variable FX spreads in one platform ensures the low transaction costs of your trading. For example, Level II spreads of

Ross Ditlove
"So the killer in forex is less liquidity, wider spreads, and big volatility. That puts a level of uncertainty on the table that only certain traders can handle"

Alain Broyon
"Market volatility has put pressure on feed and pricing models, and we have seen Banks/Liquidity providers taking less or more risks by adjusting their spreads and liquidity."

Lubomir Kaneti
"The forex market has not experienced a dramatic reduction of liquidity such as that experienced by the credit markets."

Forex majors tighten to as low as 0.1 pip (1/10th of a pip), depending on the market's liquidity in any given moment. Traders can open positions by placing an order through the Level II quotes module and close it with a trade, executed at the fixed spread. Always a key factor for trading effectiveness, instant execution is identified as a top priority.

How has the recent market volatility affected the automated trader and has it upset the profitability of automated models used by clients to trade FX?

O'Reilly: There is little doubt that the extreme volatility in the market of late has reduced both the numbers and scope of automated trading models. The recent wide intra-day ranges and wild swings in spot have affected trade execution and caused many computer trading models to effectively break down. Implied volatilities on both major and minor currencies increased drastically after the fall of Lehman.

Many of the black box models did not take into consideration the huge contraction in the credit markets and consequent dysfunctional forward markets, both of which had a major effect on their trade execution. Many models were also forced to shorten the term of their hedging strategies due to the increased costs of doing so.

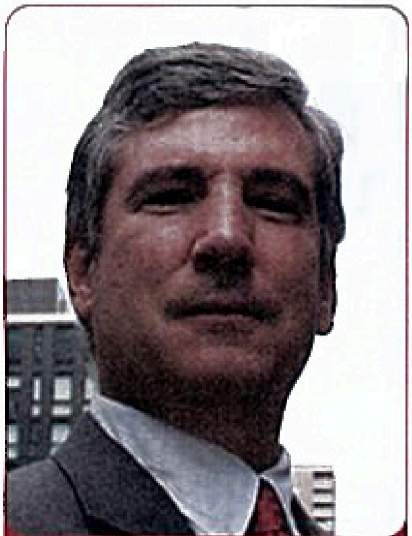
Ditlove: Some systems are designed to take advantage of broader moves, and with the volatility, it might be much longer now before a set of indicators reverses and closes out a position. Those traders are currently benefiting from the volatility and wider daily trading averages. On the other hand, some models use price averaging to add to trades that move against them. In calmer markets, that can work a lot. In the current environment, the models are adding and adding and adding, and suddenly the position is many times larger than it should be, deep in a loss, and the potential to get much worse is still there. So we see it both ways. The smart traders have adjusted their strategies to play for more movement rather than less. At some point, that will reverse as well.

Broyon: Automated strategies differ in the manner they are conceived and in their trade objectives. While some strategies need modifications on the Leverage value used, or simply adopt a less aggressive approach; others still offer respectable results.

Pieron: Clearly certain models have been become ineffective, while others that adapt to new conditions are profitable. The question is whether adaptive models can be created to deal with extreme market patterns. Buying volatility strategies may prove harmful as IV is at four times its normal range and persistently elevated levels of volatility means we may continue to expect strong price moves in the weeks ahead. Such trading market conditions are conducive to aggressive Breakout and Momentum strategies, while reversion strategies may underperform through

James Pieron

"Under the current market conditions, any type of risk adverse position management will get you knocked out of the market immediately and this process will repeat."



Greg Michalowski

"The majority of our clients are now following the pairs with greatest liquidity given the more volatile market conditions."

current price fluctuations. Carry trades, the few that remain, also under-perform in highly volatile environment.

Which currency pairs have lost out and which have gained from the current market conditions and why?

Ditlove: I think some of the less liquid cross pairs have been hurt the most by the environment that began in September 2008. If you are getting true bank quotes from a platform like ours, spreads on cross pairs are always wider. When you take out several key banks who are absorbed in the banking crisis, those spreads get wider. Therefore, traders are moving more toward the more liquid, more commonly traded pairs than ever before. That only means that there is a market within the market, if you will, and that isn't a bad thing. Economics work in a variety of ways.

Pieron: In the current environment of asset price deflation, all assets are hurt, including commodities. Commodity currencies like Canadian Dollar and Aussie Dollar have lost out due to their strong correlations with gold and oil. The Japanese Yen has gained against the dollar due to risk aversion in the market. The Yen has been the funding currency for hedge funds where fund managers short the Yen to buy risky assets or higher yielding currencies (carry trade). With risk aversion in the market, these trades are being reversed, strengthening the yen.

Michalowski: If there has been a currency pair that has lost out it would have to be the Yen carry trade pairs. The beneficiary of the trading flow has been in the majors where trends and information was more available and volatility was more bearable. The majority of our clients are now following the pairs with greatest liquidity given the more volatile market conditions.

Kisyov: Currency pairs such as USD/SEK, USD/ZAR, USD/NOK, USD/RUB, USD/RON have lost on their liquidity and their spreads have widened, thus making them unattractive to traders, although some of them rely on increased volatility to still trade these. Daily moves of several figures for pairs as EUR/JPY, GBP/ NZD, GBP/JPY along with other JPY crosses have made these pairs the current traders' favorites.

At the back end, has the market volatility put pressure on your feed and pricing models and how do you cope with the increased exposure?

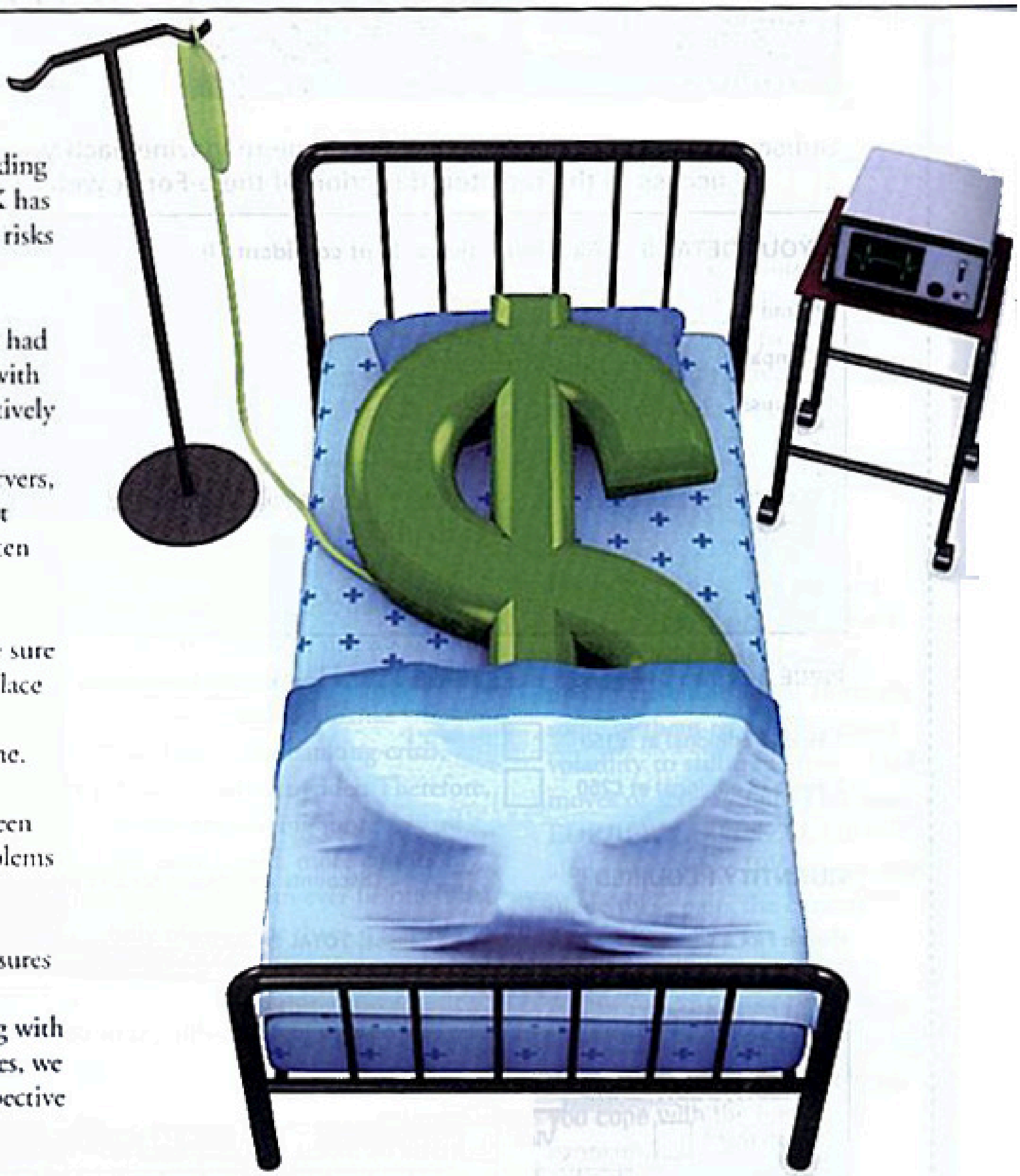
Ditlove: From our perspective, there's no extra pressure. Increased volume during the most volatile moments doesn't really change our feeds, and we don't have "exposure" in the sense that most forex brokers do. Our job is to connect our customers with a variety of liquidity sources, and we still do just that.

Broyon: Market volatility has put pressure on feed and pricing models, and we have seen Banks/Liquidity providers taking less or more risks by adjusting their spreads and liquidity. For Dukascopy – SWFX the effects on pricing were minor because the Marketplace cumulates the liquidity of numerous major players in the industry. Regarding exposure Dukascopy – SWFX has no exposure in the market or risks linked to market volatility.

Pieron: Our system itself has had no trouble at all keeping up with market conditions. With relatively few users on our platform compared with most retail servers, delivery and execution are not subject to latency that can often affects retail platforms.

Michalowski: We have made sure that the systems we have in place are able to handle both the increased volatility and volume.

Kisyov: Deltastock has not been experiencing any pricing problems for the 10-year-period of company's operation. Our expertise in managing risk ensures company's consistent and confident approach in dealing with the increased exposure. Besides, we do strictly observe all the respective exposure regulations.



Has the higher volatility attracted more attention from your regulatory authority?

Ditlove: Not that we've seen. As US capital requirements moves toward $20 million, it seems to keep everyone more at ease.

Broyon: The evolution of the situation has made the controlling authorities more involved in the economy and finance, bringing stricter control on internal risk management and exposure.

Kaneti: We have not had any specific discussion with regulators about the recent economic events and their reflection on the OTC FX market.

Kisyov: The increased volatility implications in terms of the precautions measures taken from the sector watchdogs – Bulgarian National Bank and the Financial Supervision Commission – are the new reporting requirements for financial companies. We currently submit company's financial accounts to the regulatory authorities more frequently then we did before the financial crunch.

With counterparty risk back in the spotlight, how much more concerned are clients about the security of funds than before the credit crisis of recent months and how do you reassure them?

Ditlove: In early 2007, when the net capital requirement was being reviewed and potentially moved to $5 million for FCMs, this was the entire discussion. Keep in mind, Refco was still on everyone's mind back then. Now that the net capital requirements moves toward $20 million in 2009, it's a whole different ballgame. The higher requirements have definitely calmed the average customer in terms of security of funds, and the recent credit crisis hasn't changed that.

Broyon: Clients are now more concerned than ever about the security and stability of the

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counter party. Dukascopy - SWFX offers the unique solution of the "Swiss Custodian Bank Program". A solution where an investor could request their Bank to allow them to trade with Dukascopy - SWFX Swiss FX Marketplace, directly from their personal account which allows them to preserve an already established relationship with their Banks.

Pieron: We do not actually hold client funds at this point, as our clients settle directly with our Prime Broker on a daily basis. Market conditions have made everyone more aware of credit limits and accountability. Clients are more concerned about the solvency of the banks today than ever. Smart investors are watching CDS spreads of these banks to assess the riskiness. Clients can be reassured of the safety of their accounts by using regulated banks with strong balance sheets, in safe jurisdictions.

Kaneti: Today when the likes of Lehman Brothers can disappear, Merrill Lynch is absorbed by Bank of America, and AIG needs billions of dollars of relief, some clients have expressed some concern. It is only natural. The forex market has not experienced a dramatic reduction of liquidity such as that experienced by the credit markets. Liquidity is still immense. FXDD works with some of the most stable and reputable banks. In addition, the risk we do assume is within controlled risk and capital tolerances, and can be covered with our interbank liquidity providers very quickly.

Kisyov: Safety of funds has always been crucial for clients. As the credit crisis has not affected the banking system in Bulgaria that far as compared to USA, the UK and the other developed European economies, there have been no unusual indications by our clients in that respect. A fully licensed brokerage regulated under the EU Directive 2004/39/EEC (MiFID), Deltastock AD implements all the relevant EU standards in the regulation and supervision of the financial