

Chaos theorists

By Ann Saphir

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As collapsing markets clobber banks, hedge funds and private-equity firms, one corner of Chicago's financial industry is thriving.

Little-known firms such as Infinium Capital Management LLC, DRW Holdings LLC and Traditum Group LLC are racking up record profits on the same volatility that's pummeling more prominent firms such as Northern Trust Corp., Nuveen Investments and Citadel Investment Group.

Known in the industry as proprietary trading firms, they specialize in light-speed trading on short-term market movements, making money whether prices rise or fall on everything from soybean futures to interest rate options. Unlike traditional money management firms and banks, they play with their own money, make no long-term investments and hold few assets.

"For firms like us that are short term- and technology-focused, the big drivers are volume and volatility," says Nathan Laurell, director of market making and an owner of Infinium, which hired 60 of its 210 employees last year and is still adding staff.

Hiring at the trading firms, which employ thousands, has helped offset some of the layoffs sweeping the city's financial sector. And their surging profits show that a certain Chicago-style trading strategy dating to the earliest days of the futures exchanges is as viable as ever.

In fact, many of the traders populating the firms are veterans of the Chicago Board of Trade or Chicago Mercantile Exchange who left the exchange floor as computerized trading took over in the past decade. Now they spend their days riveted to banks of computer screens, using software and high-speed connections to trade on a far larger scale.

Many of the firms are clustered around the Chicago Board Options Exchange, which executes a significant number of their trades. CBOE volume climbed 25% to a record last year even as growth slowed at the Board of Trade and the Merc, both units of Chicago-based CME Group Inc.

"We have a dozen firms within a hundred yards of our building — Peak6, Blue Capital, Wolverine, Getco, to name a few — who are the bright lights because they are trading their money, not other people's money, so their risk controls are tremendous," Options Exchange CEO William Brodsky says. "Knock on wood, I haven't heard of a problem."

Options Clearing Corp., the Chicago-based clearinghouse for U.S. equity options, handled a record \$1.9 trillion in premiums last year. The surge in stock-options trading

also lifted Chicago options firms like online broker Thinkorswim Inc. Founded by a former CBOE floor trader, Thinkorswim agreed this month to be bought by TD Ameritrade for \$606 million, 50% more than its market value, because the Omaha, Neb.-based discount brokerage wanted a foothold in the fast-growing options business.

SINK OR SWIM

CME Group hasn't fared as well, as the credit crisis prompted its biggest customers — banks and hedge funds — to cut back on trading. Volume at its exchanges grew just 4% last year, the slowest rate since the company went public in 2002. This year may be worse: A Goldman Sachs & Co. analyst cut his price target for CME stock to \$210 from \$350, citing lower volumes, which so far this year are down more than 30%. Trading has slowed at CBOE as well, and Mr. Brodsky acknowledges this year is unlikely to top 2008.

"If volume continues to drop, it's going to hurt firms like us," says Ray Cahnman, chairman of Chicago-based Transmarket Group LLC, a 200-trader firm that clocked its best year ever last year. "Volatility makes up for lack of volume to some extent, but it also means you can blow up quickly."



Nathan Laurell, who co-owns Infinium Capital Management LLC

Photo: John R. Boehm

Executives at proprietary trading firms are depending on new growth as major Wall Street banks curtail their own trading and as financial instruments, such as credit-default swaps, move to exchanges from unregulated private markets dominated by banks.

"I think there's been a big power shift from New York to Chicago," says Michael Creadon, who heads the biggest of Traditum's three trading groups. Traditum added 45 of its 125 traders in the past 14 months and expects to hire a similar number this year.

The Chicago firms don't have the capital or the connections to participate in over-the-counter trading, but they can trade on exchanges, where clearinghouses back all trades. Mr. Creadon predicts investors burned by troubles at banks will seek to do more of their business on exchanges.

Indeed, CME is banking on such a shift, partnering with Citadel to offer a clearinghouse for credit-default swaps, which investors use to protect against corporate bankruptcies.

There isn't any public data on employment by proprietary trading firms in Chicago, but estimates range from 1,500 to 3,000. None of the firms would disclose financial results, but all say profits are up.

"People are losing jobs, getting laid off. How many businesses do you know where profits were up last year?" says Burt Gutterman, Traditum's managing partner.