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Unlock the Opportunity to Equity Options Trading

SunGard MicroHedge

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INTRODUCTION

The U.S. equity options market has generated a great deal of interest in the investment community due to the tremendous growth in volume it has recently experienced. With the surge in employment of increasingly sophisticated models and investment strategies, new players have entered the equity options arena, driving competitors to either adapt to the new competitive landscape or lose their edge. In an industry where fractions of a second can mean the difference between putting on a trade and missing it all together, split second analysis and access to the lowest latency data available are keys to a strategy that keeps those competing in the equity options space “in-the-money.” Fierce competition has made accessibility, speed, reliability, and cost efficiency imperative to not just participating, but also winning.

THE EVOLUTION OF THE OPTIONS MARKET

Since the introduction of options 34 years ago, the U.S. equity options market has increased over 170,000% ¹, as illustrated in Figure 1 below.

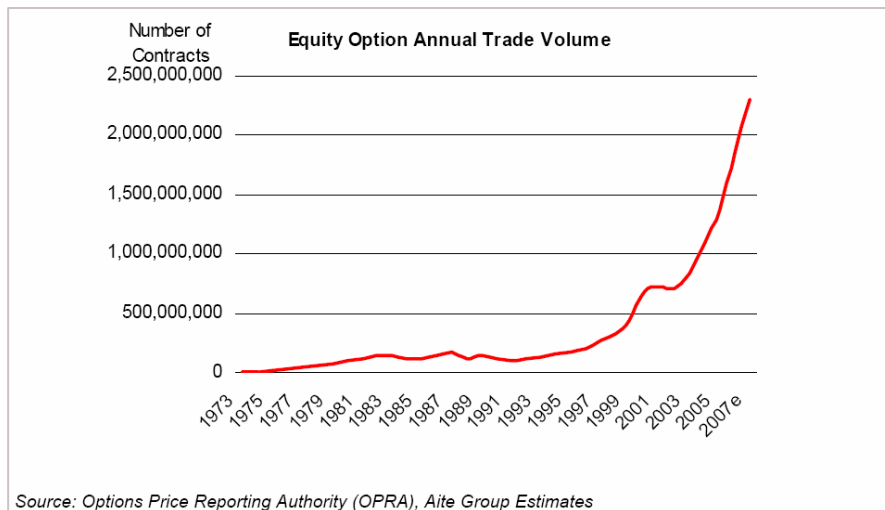


FIGURE 1

Furthermore, the Aite Group estimates that increased volatility in the U.S. markets, combined with volume growth driven by the penny pilot program, the growth in smart order routing and the proliferation of algorithmic trading, will increase options volume by nearly 40% in 2007 compared to 2006. The historical volatility index in Figure 2 shows the range in volatility between 2005 and 2007.²

The evolution of the capital markets over the past two decades has replaced mutual funds with hedge funds as the 800 pound gorilla. Traditional investment vehicles, such as mutual funds, pension funds, insurance companies, trusts, and those charged with investing these large pools of assets, no longer dictate the mood on the Street or the direction of the markets – hedge fund managers have taken

¹ Aite Group, LLC, The Equity Options Landscape: More Options Than Ever! (May 2007)

² www.stockcharts.com



FIGURE 2

their place. These seasoned Wall Street pros understand the importance of due diligence prior to investing capital in any asset class. Furthermore, they understand that speed in analyzing data, an execution platform with instant access to market and a robust risk management system allow them to nimbly deploy and repatriate large pools of capital. In addition to giving them an advantage over traditional investment managers, a smart options platform also allows them to deliver abnormal returns.

The trading landscape has dramatically changed with the rise to dominance of hedge funds. Managers who traditionally invested in cash equities have turned to options as a vehicle to increase leverage and generate superior returns. There is a strong correlation between hedge fund participation in the options market and the exponential increase in volume. Prior to last year, retail investors transacted the majority of trades in the options market. In 2006, institutional investors finally caught up to their retail counterparts, each accounting for 50% of volume with hedge funds transacting almost 30% of the total. Figure 3 demonstrates the changing balance between institutions and retail accounts.³



FIGURE 3

³ Aite Group, LLC, The Equity Options Landscape: More Options Than Ever! (May 2007)

SELL-SIDE FUNDAMENTALS

Nowhere in the financial services business is information more crucial than on sales trading desks on Wall Street. The typical sales trader is constantly on the phone with anxious clients who want up-to-date information on current market conditions. They need real-time access to quotes on stocks, bonds, currencies and commodities. With the added complexities of the derivatives markets and options, traders need the tools and platforms that provide instant access to the information their clients want.

Preemptively generating trade ideas is a critical factor in a sales traders' ability to not only maintain their book, but also to grow their business in the face of increasing competition. In order to survive in today's environment, competitors in the options space need to be able to analyze volatilities, incorporate their own assumptions and identify potential investment opportunities. Whether an existing client calls in search of new ideas or a sales trader calls potential clients, the answers and information they provide needs to be fresh and futuristic.

Running analytics on any of the over 300,000 options contracts can be extremely time-consuming; from identifying the underlying's symbol, to pulling up a particular strike and expiration, to inputting a model's assumptions, a sales trader needs a platform that minimizes the total time from initiation to execution. The less nimble a platform is in generating this information, the more likely it is that the client will miss the trade. A system that enables its users to examine all the moving parts in a single congregate screen with a synchronized holistic view reduces time by eliminating the need to switch between multiple pages. Firms are granted even greater flexibility when platforms can be hosted internally, as it further releases their local resources, thereby keeping infrastructure costs down.

Historically a client's implementation of equity derivatives was strongly correlated with a higher level of risk. As a result, capital requirements to assuage risk often severely restricted the non market-maker

<u>Strategy</u>	<u>Profit-and-loss Diagram</u>	<u>S&P 500 Index Options Position(s)</u>	<u>Strategy-based Margin Requirement*</u>	<u>New Portfolio Margin Requirement*</u>
Covered Call		Long 100,000 SPDRS @ 145.30 Short 100 SPX April 1460 Calls @ 21.66	\$7,048,400	\$948,342
Protective Put		Long 100,000 SPDRS @ 145.30 Long 100 SPX April 1450 Puts @ 18.72	\$7,452,200	\$272,402

FIGURE 4

* The stock index calculations assume that it is February 23, 2007 and the S&P 500 (SPX) is at 1451.19. Computation detail is available upon request. Please note that these are the minimum margin requirements required by the exchanges, and that the clearing firms may require their customers to deposit higher amounts of margin. Portfolio margining risk levels and related capital requirements can vary significantly from day to day depending on the portfolio volatility and the movement in the overall market.

clients' flexibility to take full advantage of options-based strategies. In recent years a new method to evaluate risk by sell-side firms has emerged and is being adopted by first-movers in the financial services industry. With the introduction of risk-based margining, which permits a variety of off setting financial instruments in a customer's account and applies risk-based models, new investors have entered the market because of the significantly reduced margin requirements. Sell-side firms stand to benefit greatly from this new development in portfolio margining. The margin requirement examples in Figure 4 show sample S&P 500 index options-based positions.⁴

THE SOLUTION: MICROHEDGE

As the equity options market evolves and participants' needs correlatively expand, there will be a greater need for firms to invest in solutions that can alleviate the complexities investors face. A comprehensive real-time platform, such as SunGard's MicroHedge & MicroHedge Risk Manager, covers all aspects of exchange-traded options on equities, indices and futures. MicroHedge & Risk Manager equip investors with one of the industry's most powerful trading and risk analytics software solutions to process market information, execute on all of the exchanges and analyze risk. This powerful combination enables sophisticated investors executing in the equity derivatives markets to maximize profitability and not get lost in their risk.

In addition to using industry standard models, MicroHedge & RiskManager offer investors the ability to stress-test their portfolios and slice and dice risk in a myriad of ways. Its flexibility and open source architecture allow customers to "hotwire" the platform and input their own models' volatility and interest rate assumptions. In addition to the breadth of existing solutions, SunGard's Margin Advisor offers a broader scale of processing using a rules-based approach to define strategy and risk-based credit policies, thereby helping give the firm greater comfort and control over credit risk. The system provides active monitoring of changes in positions and market prices, supports margin rules from all major global exchanges, and identifies accounts that are susceptible to intra-day volatility.

So when your clients rely on you, you can rely on the trusted services of MicroHedge. Although, professional floor traders aren't the only ones who turn to MicroHedge; this powerful tool has permeated its features and benefits to college institutions and large trading firms as well. Rather than using it as a tool to facilitate trading, these users utilize MicroHedge as a source to educate the masses about options. By allowing these non-traders to receive hands-on experience in options trading and risk management, they are enabled to assess real-time market conditions with stimulated real trading.

⁴ www.cboe.com/margin

CONCLUSION

In face of the evolving landscape, with the explosive growth in equity options volume and the introduction of risk-based margining, the key to future sustainability requires that firms recognize the need to invest in a comprehensive, yet flexible trading and risk analytics platform. By implementing the right technology solution, traders can execute their equity options strategy in a highly efficient manner, and focus on how to further deploy their partnership's capital by developing increasingly innovative strategies. MicroHedge is uniquely positioned to cater to various participants of the market – and those simply vying to enter it – with its breadth and depth of solutions to address each equity options touch point in the trading arena.

ABOUT SUNGARD MICROHEDGE

SunGard MicroHedge is a real-time options trading and risk platform. From risk management and volatility skew analysis to auto-quoting and order execution, MicroHedge delivers a complete platform for equity options trading and risk management. MicroHedge's open architecture helps provide the added flexibility to plug in custom valuation models, volatilities, and interest rates and automate many of the processes within the application.

MicroHedge, Auto-Quote, and Screen Based Trading SBT fully integrate to provide a complete options trading platform.

You can examine the risk of specific options in MicroHedge then make two-sided bid and offer markets on those options with MicroHedge Auto-Quote. Lastly, you can then execute option and stock trades with MicroHedge SBT. In total, the three products integrate to fulfill the primary activities that define electronic options trading.

For more information about MicroHedge solutions, email mh.sales@sungard.com or call (312) 577-6301.

Visit the MicroHedge website at www.sungard.com/microhedge

ABOUT SUNGARD

With annual revenues of \$4 billion, SunGard is a global leader in software and processing solutions for financial services, higher education and the public sector. SunGard also helps information-dependent enterprises of all types ensure the continuity of their businesses. SunGard serves more than 25,000 customers in more than 50 countries, including the world's largest financial services companies.

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