U.S. Securities Firms Midyear 2024 Outlook:

Ratings largely stable despite potential risks

Robert Hoban
Thierry Grunspan
Prateek Nanda
Devi Aurora

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S&P Global Ratings

This report does not constitute a rating action

Contents

S&P Global U.S. Economic Forecast Overview

Key indicator (annual average)	2020	2021	2022	2023	2024f	2025f	2026f	2027f
Real GDP	-2.2	5.8	1.9	2.5	2.5	1.7	1.8	1.9
Consumer spending	-2.5	8.4	2.5	2.2	2.5	2.0	2.1	2.4
Equipment investment	-10.1	6.4	5.2	-0.3	1.4	4.3	3.3	3.3
Nonresidential structures investment	-9.5	-3.2	-2.1	13.2	4.6	1.4	1.0	0.3
Residential Investment	7.2	10.7	-9.0	-10.6	-4.7	2.0	2.8	2.2
Core CPI	1.7	3.6	6.2	4.8	3.4	2.5	2.2	2.1
Unemployment rate (%)	8.1	5.4	3.6	3.6	3.9	4.2	4.4	4.1
Federal funds rate (%)	0.4	0.1	1.7	5.0	5.3	4.6	3.3	2.9
10-year Treasury (%)	0.9	1.4	3.0	4.1	4.2	3.6	3.5	3.5

Note: All percentages are annual averages, unless otherwise noted. Core CPI is consumer price index excluding energy and food components. f--forecast.
Sources: Bureau of Economic Analysis, Bureau of Labor Statistics, Federal Reserve, Oxford Economics, and S&P Global Economics' forecasts.

- Our economists expect the U.S. economy to expand 2.5% in 2024, and 1.7% in 2025.
- We now believe the Fed will start cutting in September; with 50 basis points of cuts in 2024 and another 100 basis points next year, with the balance of risk tilting toward sooner rather than later.
- Businesses continue to face higher costs of capital, which will limit capital expenditure and hiring, and the unemployment rate will likely rise in the next two years--to 4.4% from 4.0% currently.

Mostly Stable Ratings For Securities Firms Based On Solid Capital And Liquidity

Key expectations

- Despite potential challenges, we expect ratings to remain largely stable, with most firms maintaining solid capital and liquidity.
- Potential lower inflation and Federal Reserve rate cuts later this year spurred underwriting volumes and fostered lower market volatility in the first half of 2024. For retail firms, margins on client cash balances could move lower as interest rates decline, and cash sorting to higher-rate products could slow.
- We don't expect a persistent spike in market volatility (after the VIX recently rose to its highest level since the height of the COVID-19 pandemic). If volatility does persist, it could boost technology-driven trading firms' profits while dragging down markets, hindering underwriting volumes, weighing on retail firms' client asset growth, and dampening the profitability and RAC ratios of traditional institutional firms.

Key assumptions

- Our U.S. GDP growth forecast is 2.5% for 2024, and 1.4% for 2025 (compared with 1.3% and 1.4%, respectively, last December).
- Weaker growth will cause unemployment to rise to 4.2% in 2025--slightly above the longer-run steady state--from 3.9% currently.
- We expect bumpy disinflation as product and labor markets continue to normalize. We continue to forecast core inflation (excluding volatile energy and food prices) finally falling closer to levels consistent with the Fed's 2.0% target on a sustained basis by the middle of next year, ahead of which we expect modest Fed rate cuts.
- A turn in rates may soothe markets, but the spike in market volatility at the beginning of August may signal choppier waters. Political and economic uncertainty may spur further volatility, increasing the potential for losses and declines in the RAC ratios of trading firms.
- The effect of regulatory reforms, including around obligations to clients in cash-sweep programs, will likely depend on the outcome of the November elections.

The Impact Of Regulatory Changes Will Differ By Type Of Firm

Reforms	Expected impact
May implementation of T+1 settlement for U.S. equity trades.	Credit positive--should reduce systemic risk and the amount of margin firms must post to the NSCC.
SEC's new rules on trading and clearing of U.S. Treasuries.	Higher costs for all firms trading in this space, perhaps driving out some marginal players.
SEC's 2022 proposals on PFOF and U.S. equity market structure, particularly requiring auctions of retail orders.	If implemented as proposed, could materially reduce PFOF revenue for retail brokerage firms and reduce margins of technology-driven trading firms' wholesaling of retail orders. Market share leaders Citadel Securities and VFH Parent have the most to lose. However, the timing and final form of these rules remain uncertain and will likely be subject to the results of the November elections.

Key Risks

Economic growth slows more than expected

YTD rebound in underwriting volume stalls

Recent market volatility continues, or potential market correction

Firms stress their capitalization or liquidity, or increase risk in an effort to boost revenue

SEC's regulatory reforms dampen some brokers' profitability

Geopolitical uncertainty

Institutional Securities Firms | Key Expectations

Traditional institutional

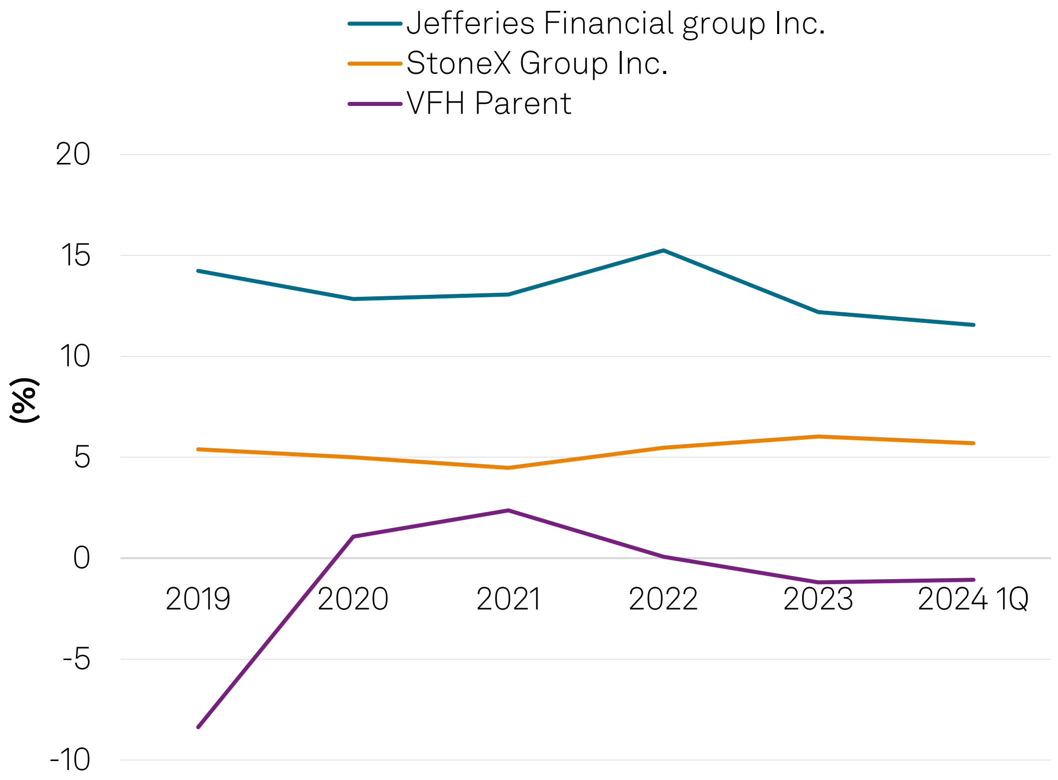
- If rates remain high, that should continue to bolster spreads on fixed-income securities, while rate or market volatility boost client trade volumes.
- Until August, modest volatility and stable rates had led to a rebound in investment banking revenue, particularly from M&A and debt issuance, if not IPOs. The recent spike in market volatility and potential political and economic uncertainty for the remainder of the year may weigh on investment banking, hurting profitability at Jefferies, Cantor, Stifel, Oppenheimer, and--to a lesser extent--Raymond James.
- Higher market volatility increases market risk and the potential for write-downs while lowering RAC ratios.

Tech-driven trading firms

- Higher market volatility typically boosts profit margins, but also market risk, which could lower RAC ratios.
- Higher volatility will likely also cause performance to diverge among rated firms, given different mixes of products and geographies traded.
- We expect continued expansion in products and geographies, as well as into longer-term strategies, but also some potential retrenchment in response to market conditions and regulatory developments.
- The rise of crypto ETFs is attracting interest. While regulatory uncertainty continues, a clearer regulatory framework may emerge following the elections.

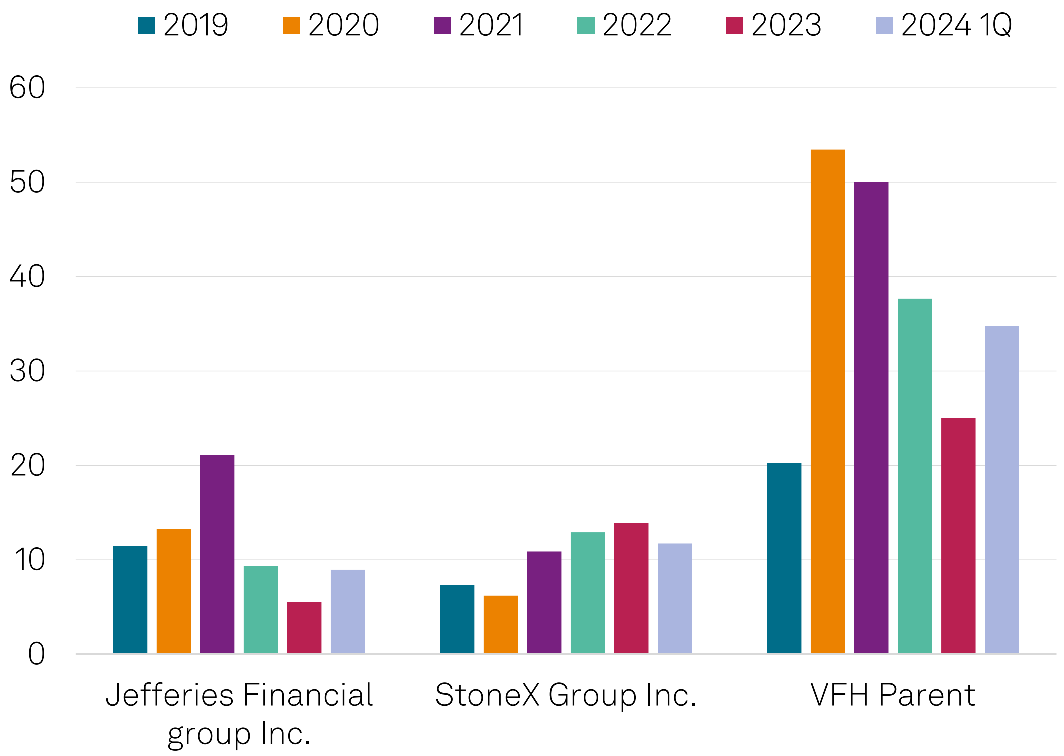
Institutional Broker Leverage And Earnings Trends

Total adjusted capital to adjusted assets



Source: S&P Global Ratings.

Core earnings/operating revenue



Source: S&P Global Ratings.

Retail Brokers | Key Expectations

All retail firms

- Lower but still high short-term rates will keep the cost of funding and yields on client cash balances elevated but continue to shrink sweepable balances. Market direction and volatility will influence retail investor participation and growth of client assets. DOL fiduciary rule implementation will increase costs for all firms, and recent actions on larger firms' cash sweep programs may signal wider pressures to come.

Full-commission brokers

- Higher rates likely to continue to boost sales of fixed-income securities.
- Long-term shift to asset-based fee accounts to increase recurring revenue but heighten revenue exposure to a decline in market values.
- For Stifel and Raymond James, which have banks, interest income and NIM down on increased funding costs and decline in client uninvested cash balances.
- Higher funding costs to decrease opportunities for economic acquisitions, which may slow debt growth.

Discount brokers

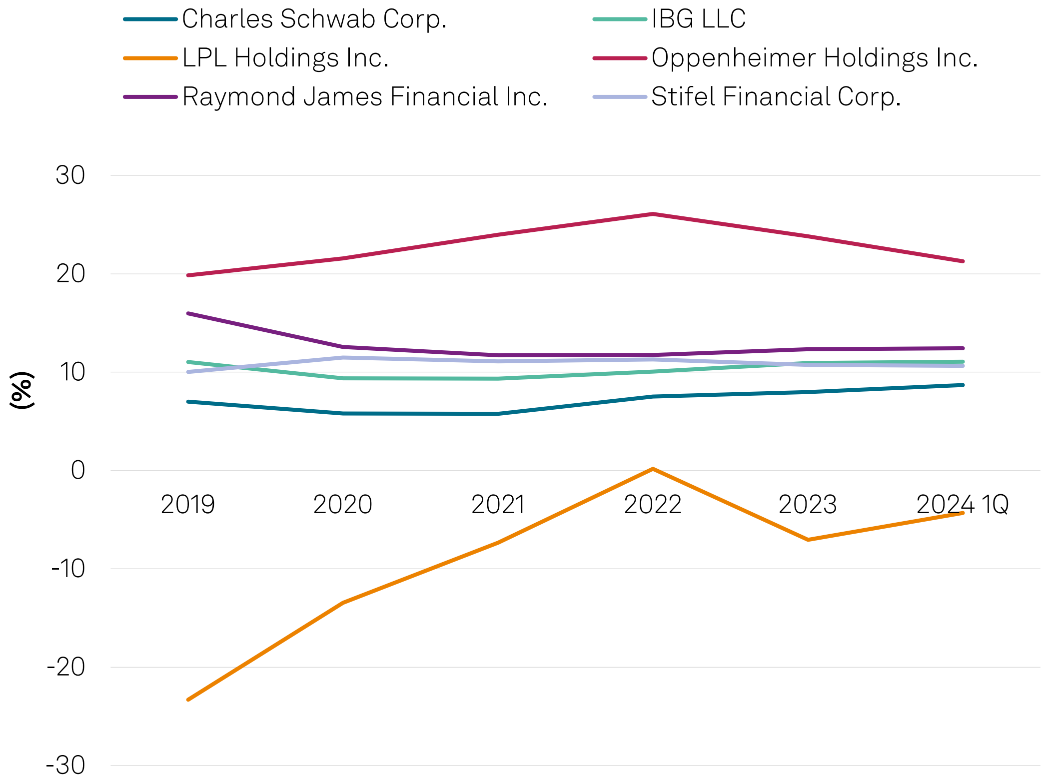
- Margin loan and options volume to be driven by market conditions.
- Schwab's client uninvested cash balances to stabilize, reducing growth of higher-cost funding as the firm continues to attract net assets to its platform.
- Schwab's migration of all former TD Ameritrade clients to reduce overhead costs. The firm will now focus on retaining clients after some service outages.
- Schwab's plan to sweep more to third-party banks could help reduce the volatility of its balance sheet and capital ratios.
- SEC proposals could substantially reduce PFOF revenue at all but IBG, hurting profitability.

Independent brokers

- Private-equity owned firms' (Osaic, Aretec, and Kestra) debt to EBITDA leverage and debt-service coverage may erode with declining cash sweep balances or revenue. Few near-term debt maturities to limit refinancing risk.
- LPL's rising debt (to fund 2023 stock buybacks and 2024 acquisition of Atria) boosted leverage, but we expect it to remain below management's upper limit of 2.5x.
- Sector consolidation to pressure firms to do debt-funded acquisitions that weigh on financial strength.
- Long-term trend of wirehouse advisers going independent to boost growth, while the shift to asset-based fee accounts will increase recurring revenue and revenue exposure to a decline in market values.

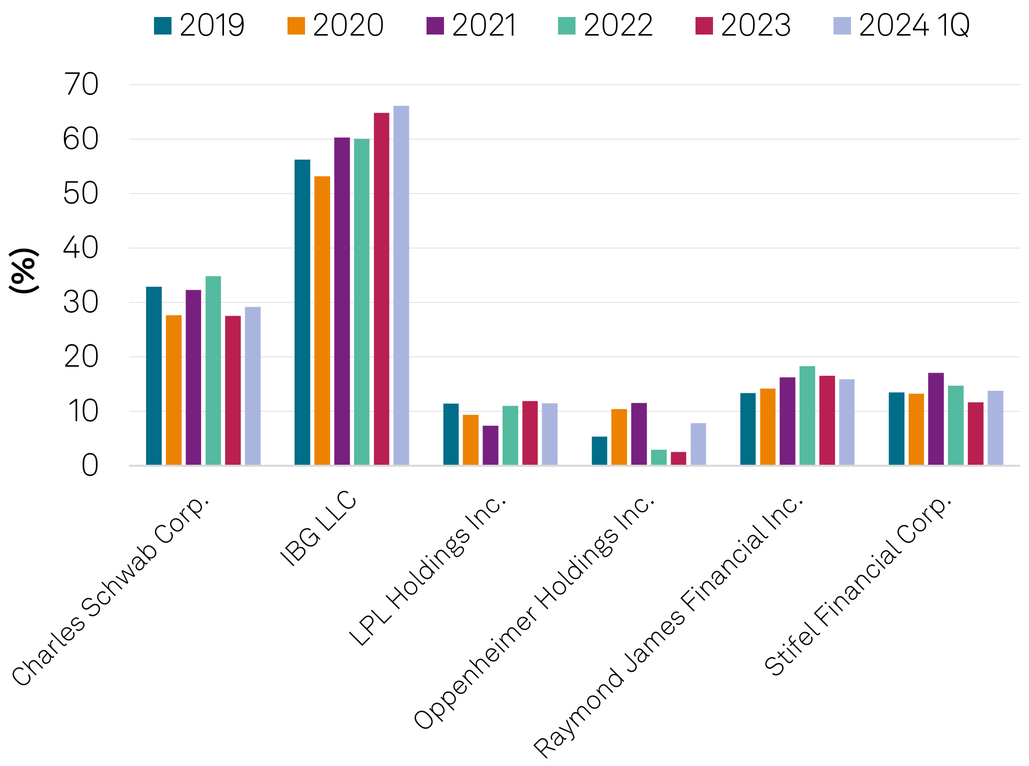
Retail Broker Leverage And Earnings Trends

Total adjusted capital to adjusted assets



Source: S&P Global Ratings.

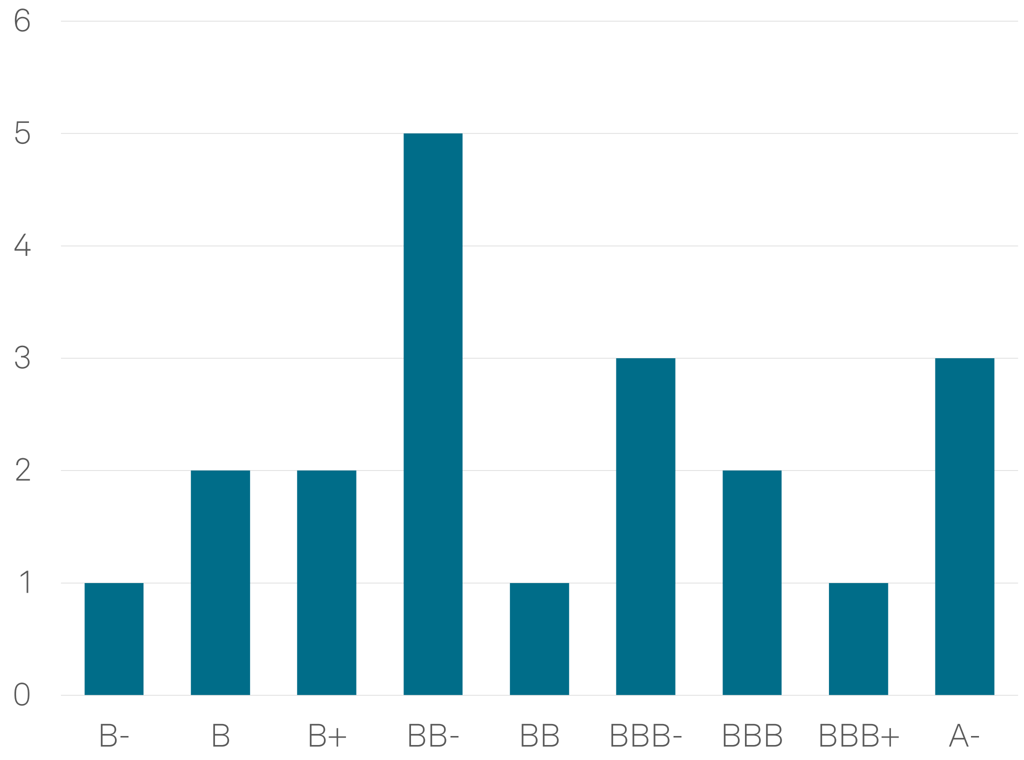
Core earnings/operating revenue



Source: S&P Global Ratings.

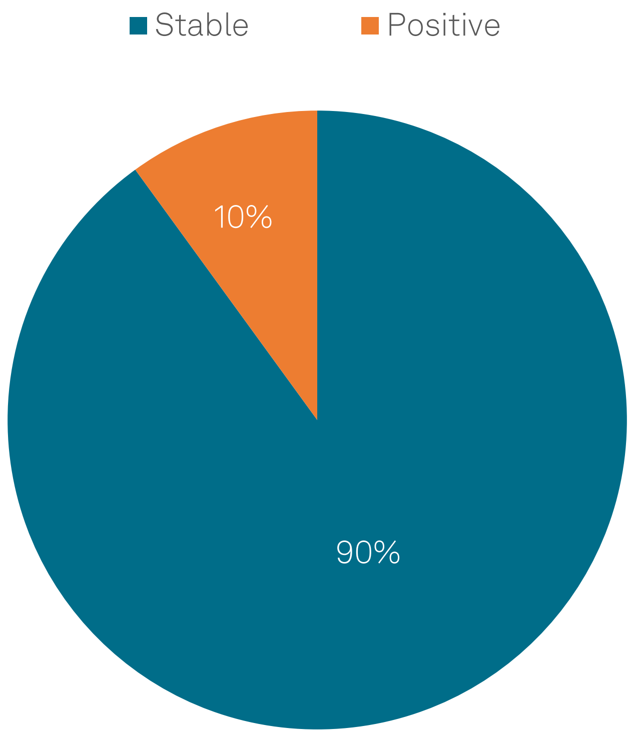
U.S. Securities Firms: Ratings And Outlook Distribution

Rating distribution



Note: Ratings are as of July 30, 2024. Source: S&P Global Ratings.

Outlook distribution



Note: Outlooks are as of July 30, 2024. Source: S&P Global Ratings.

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Rating Factor Assessments | U.S. Securities Firms

Company	Anchor	Business position	Capital and earnings	Risk position	Funding	Liquidity	Comparable ratings adj.	GCP	Additional factors	ICR (HoldCo)	Outlook
Ameriprise Financial, Inc.	--	--	--	--	--	--	--	a+	-2	A-	Stable
Aretec Group Inc.	bbb-	Adequate	Weak	Strong	Adequate	Adequate	0	bb-	-2	B	Stable
Cantor Fitzgerald L.P.	bbb-	Adequate	Adequate	Adequate	Adequate	Adequate	1	bbb	-1	BBB-	Stable
Charles Schwab Corp.	bbb-	Very strong	Strong	Adequate	Strong	Strong	-1	a	-1	A-	Stable
Citadel Securities LP	bbb-	Adequate	Strong	Adequate	Moderate	Adequate	1	bbb	-1	BBB-	Stable
CTC Holdings L.P.	bbb-	Moderate	Moderate	Adequate	Adequate	Adequate	0	bb	-2	B+	Stable
DRW Holdings LLC	bbb-	Moderate	Adequate	Moderate	Moderate	Adequate	1	bb	-1	BB-	Stable
Hudson River Trading LLC	bbb-	Moderate	Adequate	Adequate	Moderate	Adequate	1	bb+	-2	BB-	Positive
IBG LLC	bbb-	Adequate	Very strong	Adequate	Adequate	Adequate	1	a-	-1	BBB+	Stable
Jane Street Group LLC	bbb-	Moderate	Strong	Adequate	Moderate	Adequate	0	bb+	-1	BB	Stable
Jefferies Financial Group Inc.	bbb-	Adequate	Strong	Adequate	Adequate	Adequate	1	bbb+	-1	BBB	Stable
Jump Financial LLC	bbb-	Moderate	Strong	Moderate	Adequate	Moderate	0	bb	-1	BB-	Stable
Kestra Advisor Services	bbb-	Adequate	Weak	Strong	Adequate	Adequate	0	b+	-2	B-	Stable
LPL Holdings Inc.	bbb-	Strong	Constrained	Strong	Adequate	Adequate	+1	bbb	-1	BBB-	Stable
Oppenheimer Holdings Inc.	bbb-	Adequate	Strong	Adequate	Adequate	Moderate	-1	bb+	-2	BB-	Stable
Osaic Holdings Inc.	bbb-	Adequate	Weak	Strong	Adequate	Adequate	0	bb-	-2	B	Stable
Raymond James Financial Inc.	bbb-	Strong	Strong	Adequate	Strong	Strong	+1	a	-1	A-	Stable
Stifel Financial Corp.	bbb-	Adequate	Strong	Adequate	Strong	Strong	0	bbb+	-1	BBB	Stable
StoneX Group Inc.	bbb-	Adequate	Adequate	Moderate	Adequate	Adequate	0	bb+	-2	BB-	Positive
VFH Parent LLC	bbb-	Adequate	Constrained	Adequate	Moderate	Adequate	1	bb	-2	B+	Stable

Ratings as of July 30, 2024

U.S. Securities Firms | Subsectors List

Institutional brokers

Traditional

Cantor Fitzgerald L.P.

Jefferies Financial Group

StoneX Group Inc.

Technology-driven trading

Citadel Securities L.P.

CTC Holdings L.P.

DRW Holdings LLC

Hudson River Trading LLC

Jane Street Group LLC

Jump Financial LLC

VFH Parent LLC (Virtu Financial)

Retail brokers

Independent

Kestra Advisor Services Holdings A Inc.

LPL Holdings Inc

Ameriprise Financial Inc.

Aretec Group Inc.

Osaic Holdings, Inc.

Discount

Charles Schwab Corp.

IBG LLC

Full commission

Oppenheimer Holdings Inc.

Raymond James Financial Inc.

Stifel Financial Corp.

Related Research

- A Cooling U.S. Labor Market Sets Up A September Start For Rate Cuts, Aug. 6, 2024
- Global Banks Midyear Outlook 2024: Searching For Calmer Waters, July 16, 2024
- Global Banks Country-By-Country Midyear Outlook 2024: Searching For Calmer Waters, July 16, 2024
- Global Credit Conditions Q3 2024: Soft Landing, Fragmenting Trajectories, July 1, 2024
- Credit Conditions North America Q3 2024: A Brighter Outlook, Laden With Risks, June 25, 2024
- Economic Outlook U.S. Q3 2024: Milder Growth Ahead, June 24, 2024
- Credit FAQ: What Goes Into Ratings On Technology-Driven Securities Trading Firms, Oct. 24, 2022

Definitions

- RAC--Risk-adjusted capital
- NSCC--National Securities Clearing Corp.
- PFOF--Payment for order flows
- YTD--Year to date
- M&A--Mergers and acquisitions
- ETFs--Exchange-traded funds
- DOL--Department of Labor
- NIM--Net interest margin
- GCP--Group credit profile
- ICR--Issuer credit rating

Analytical Contacts

Devi Aurora

Managing Director & Analytical Manager

Financial Institutions

devi.aurora@spglobal.com

Robert Hoban

Director

Financial Institutions

robert.hoban@spglobal.com

Thierry Grunspan

Lead Analyst

Financial Institutions

thierry.grunspan@spglobal.com

Prateek Nanda

Associate Director

Financial Institutions

Prateek.nanda@spglobal.com

spglobal.com/ratings

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