U.S. Securities Firms Outlook 2022: Higher Rates And Uncertain Markets

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S&P Global Ratings

This report does not constitute a rating action

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Key Takeaways

Key expectations

- Profitability will suffer for all but the technology-driven trading firms, and institutional firms' market risk will increase from elevated market volatility.
- Higher interest rates will help retail firms' profitability but may hurt traditional institutional firms' funding costs.
- Regulatory reforms on payment for order flow (PFOF) and market structure are likely to be introduced, but nothing big will be implemented in 2022.
- Despite these potential headwinds, ratings will remain largely stable, with most firms maintaining solid capital and liquidity.

Key assumptions

- Real GDP will rise 3.9% in 2022, and the recent surge in COVID-19 cases will not derail the economy.
- The Fed will finish tapering asset purchases and start raising rates in March 2022, with at least three rate increases expected in 2022, and announce quantitative tightening in early 2023.
- Regulatory scrutiny will increase--particularly of payment for order flow (PFOF), market structure, and meme stocks.
- Market conditions are likely to be more volatile in the face of higher rates, the end of quantitative easing, geopolitical instability, and COVID-19.

Credit Conditions | North America

S&P Global U.S. Economic Forecast Overview

November 2021

Key indicator	**2020**	**2021f**	**2022f**	**2023f**	**2024f**
Real GDP (year % change)	-3.4	5.5	3.9	2.7	2.3
(September forecast)	--	5.7	4.1	2.5	2.2
Real consumer spending (year % change)	-3.8	8.0	3.8	2.5	2.5
Real equipment investment (year % change)	-8.3	13.1	2.1	4.4	5.3
Real nonresidential structures investment (year % change)	-12.5	-7.9	0.6	6.3	5.4
Real residential investment (year % change)	6.8	8.6	-2.8	0.6	2.6
Core CPI (year % change)	1.7	3.4	3.5	2.6	2.3
(September forecast)	--	3.3	2.7	2.5	2.4
Unemployment rate (%)	8.1	5.4	4.0	3.7	3.4
Housing starts (annual total in mil.)	1.4	1.6	1.5	1.5	1.5
Light vehicle sales (annual total in mil.)	14.6	15.1	15.2	17	17.1

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.

- We expect the **U.S. economy to have expanded 5.5% in 2021**, a 37-year high.
- However, **due to supply chain disruptions, we have lowered our growth forecasts** in recent months.
- We now expect **real GDP growth of 3.9%** in 2022 (down from 4.1% in our prior forecast).
- Because inflation has remained elevated, we expect the Fed to **finish tapering asset purchases and start raising rates in March, and announce quantitative tightening in early 2023**.
- We believe the Fed will ultimately quantitatively tighten through the maturation and runoff of securities rather than sales.

Key Risks

- Persistently elevated inflation, triggering aggressive monetary tightening and market volatility or decline
- Falloff in issuance volumes dries up underwriting revenue
- A market or economic slowdown caused by a resurgence in the virus
- Market volatility or correction crashes retail investor engagement
- Firms may stress their capitalization or liquidity in an effort to grow revenue
- Regulatory reforms or heightened scrutiny increases costs or limits revenue opportunities in PFOF, crypto, and SPACs
- Emerging risk: wider adoption of crypto currencies and investments increases potential economic and regulatory fallout of a crypto crash

Institutional Securities Firms: Key Developments

Traditional institutional

Higher market volatility increases the potential for market-to-market losses and market risk, which could lower risk-adjusted capital (RAC) ratios.

A reduction in debt issuance volumes would hurt profitability at Jefferies, Cowen, and Cantor and, to a lesser extent, at Raymond James, Stifel, and Oppenheimer.

Higher volatility and rising rates may lead to an increase in trading revenue.

Advisory fees, including on earlier issued SPACs (single premium annuity contracts), may be more sustainable, even if special purpose acquisition company issuance dries up.

If markets get worse, we expect firms to contract their balance sheets to maintain supportive capitalization.

Tech-driven trading firms

Profitability typically benefits from higher market volatility, but increases market risk, which could lower RAC ratios.

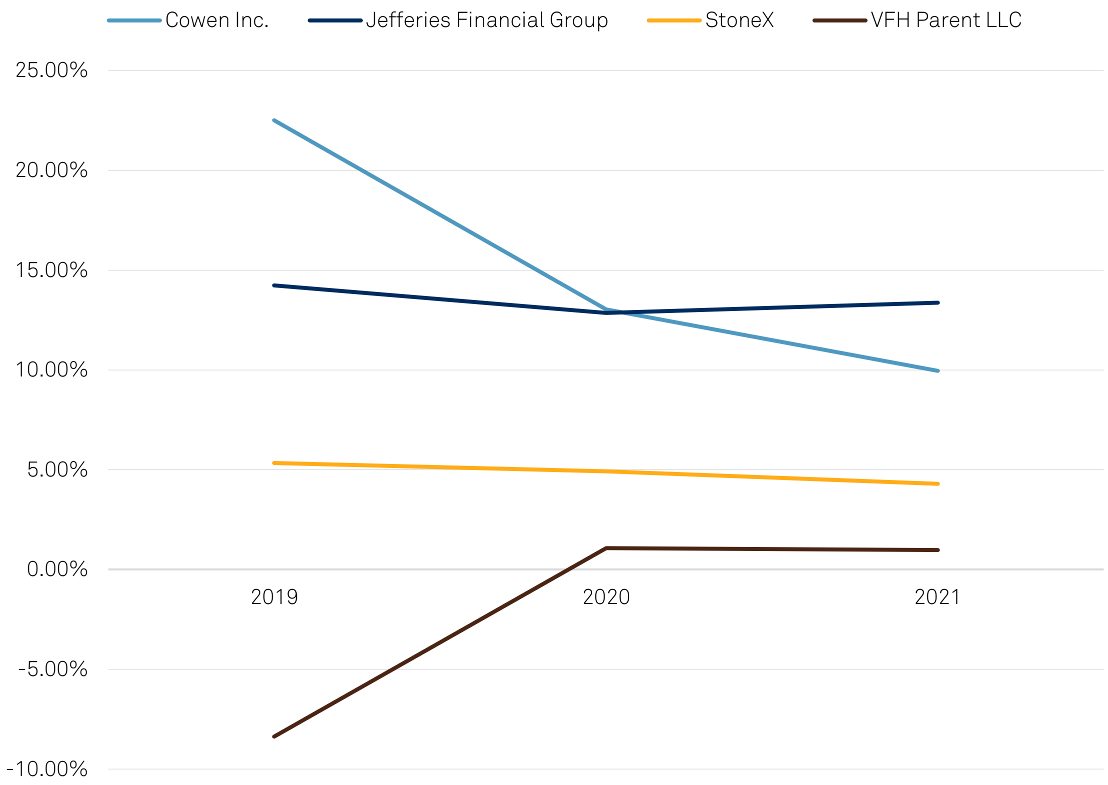
We expect regulatory focus on PFOF to increase costs and reporting requirements, but we do not expect a full ban on PFOF.

Growth of crypto trading is a profitable opportunity, but with substantial market risk and credit risk to crypto counterparties.

We expect continued expansion in products and geographies, including some firms entering the wholesaling U.S. retail equities and options orders in competition with VFH Parent and Citadel Securities.

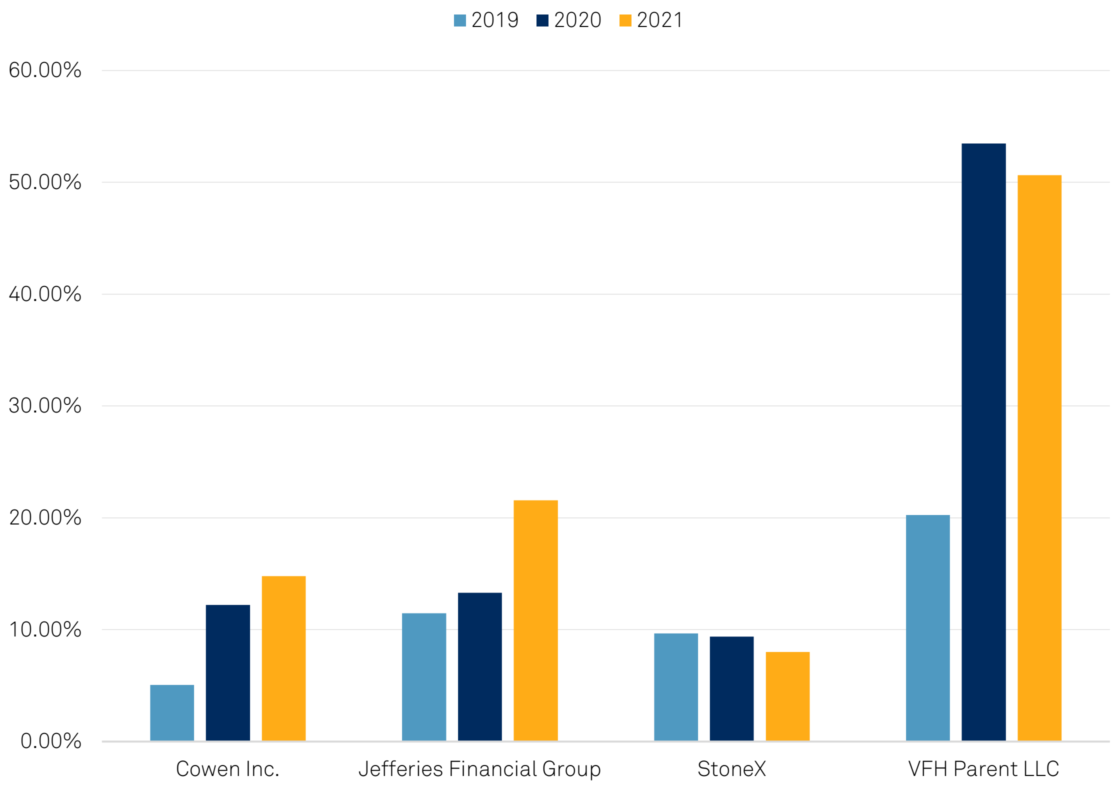
Institutional Broker Capital And Earnings Trends

Total Adjusted Capital (TAC)/Adjusted Assets



Source: S&P Global Ratings.

Core Earnings/Operating Revenue



Source: S&P Global Ratings.

S&P Global
Ratings

Retail Brokers: Key Developments

All retail firms

- Higher rates will boost bottom lines, more so for discount and independent brokers.
- We expect client assets growth to slow compared with 2021, which benefited from market run-up and increased retail investor participation.

Full commission brokers

- The continued shift to asset-based fee accounts increases recurring revenue, but it heightens revenue exposure to a decline in market values.
- Higher rates likely will reduce economic acquisition opportunities, which may slow debt growth.
- Market correction would increase losses on margin loans.

Discount brokers

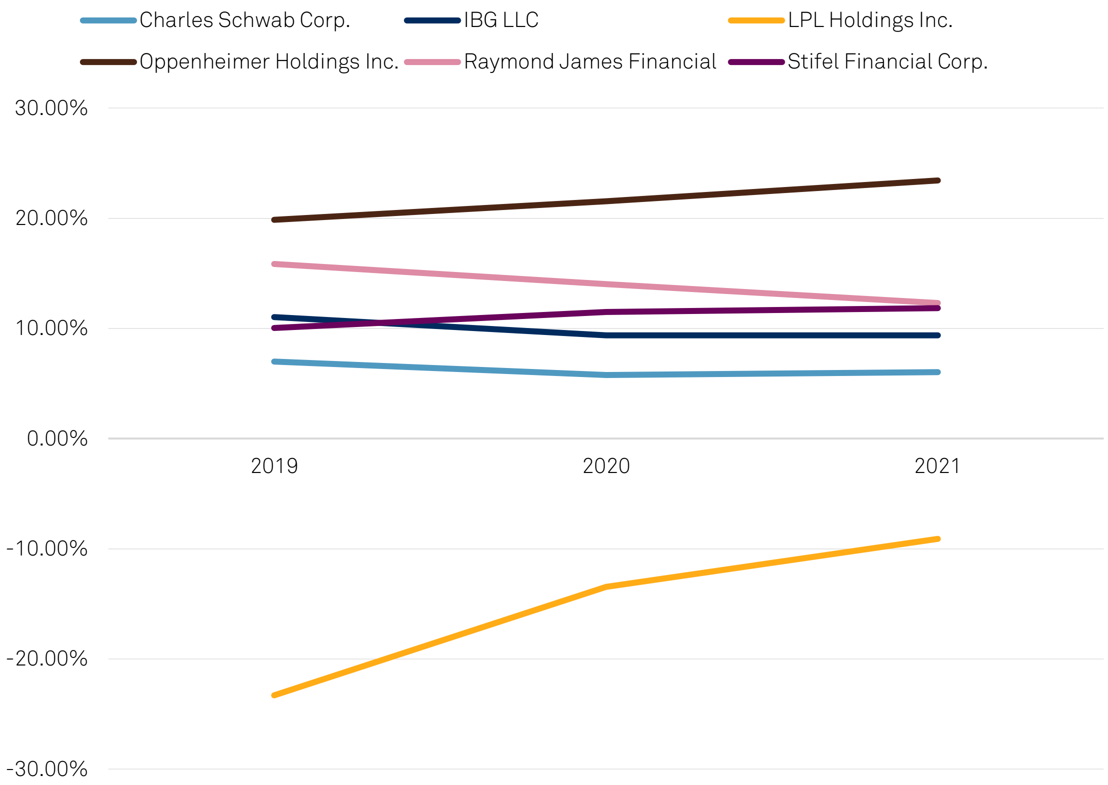
- Consolidation and reduced commissions have concentrated the sector.
- Pressure to take less PFOF would hurt profitability.
- Retail investor participation will drive trading revenue.
- Rising rates boost profitability, but less at IBG because it passes on more to its clients.
- Market correction would increase losses on margin loans.

Independent brokers

- Wirehouse advisors going independent provides a tailwind to growth.
- The continued shift to asset-based fee accounts increases recurring revenue, but it heightens revenue exposure to a decline in market values.
- Private equity-owned firms' debt service capacity (Kestra, Advisor Group, and Aretec) should benefit from rising rates, even if market values decline some.
- Consolidation in the subsector maintains pressure to acquire at the expense of financial strength.

Retail Broker Capital And Earnings Trends

TAC/Adjusted Assets



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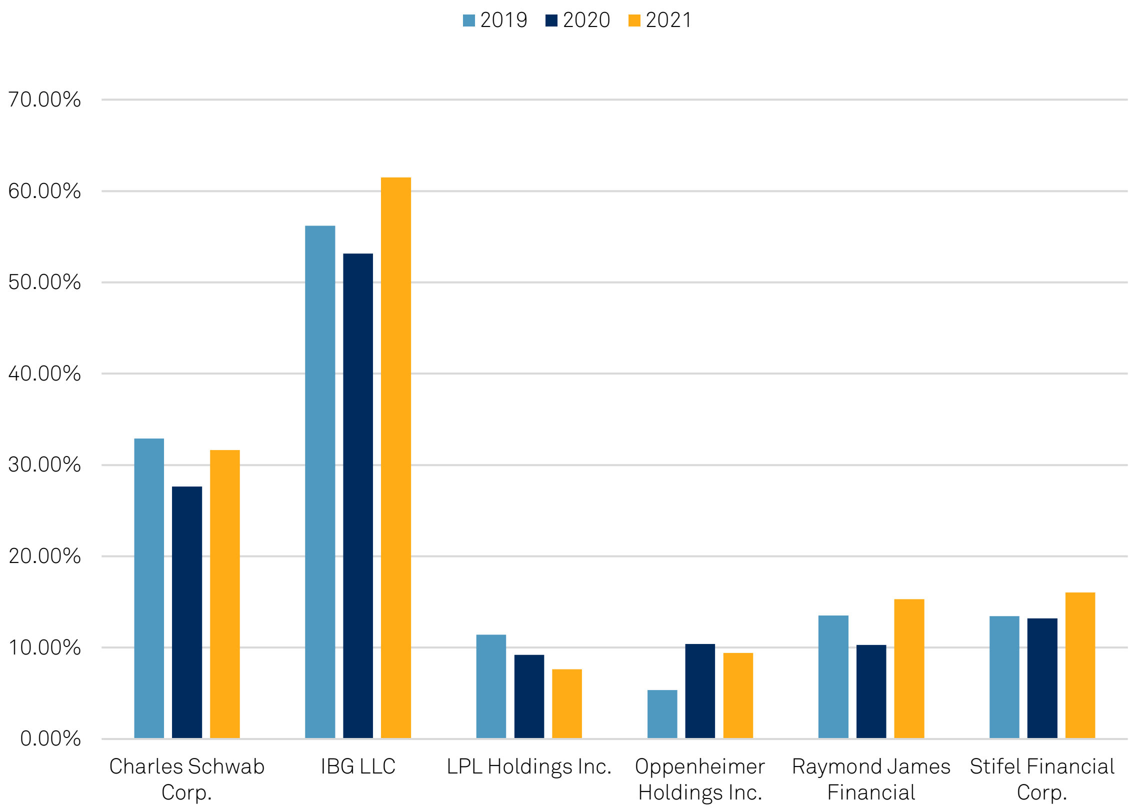
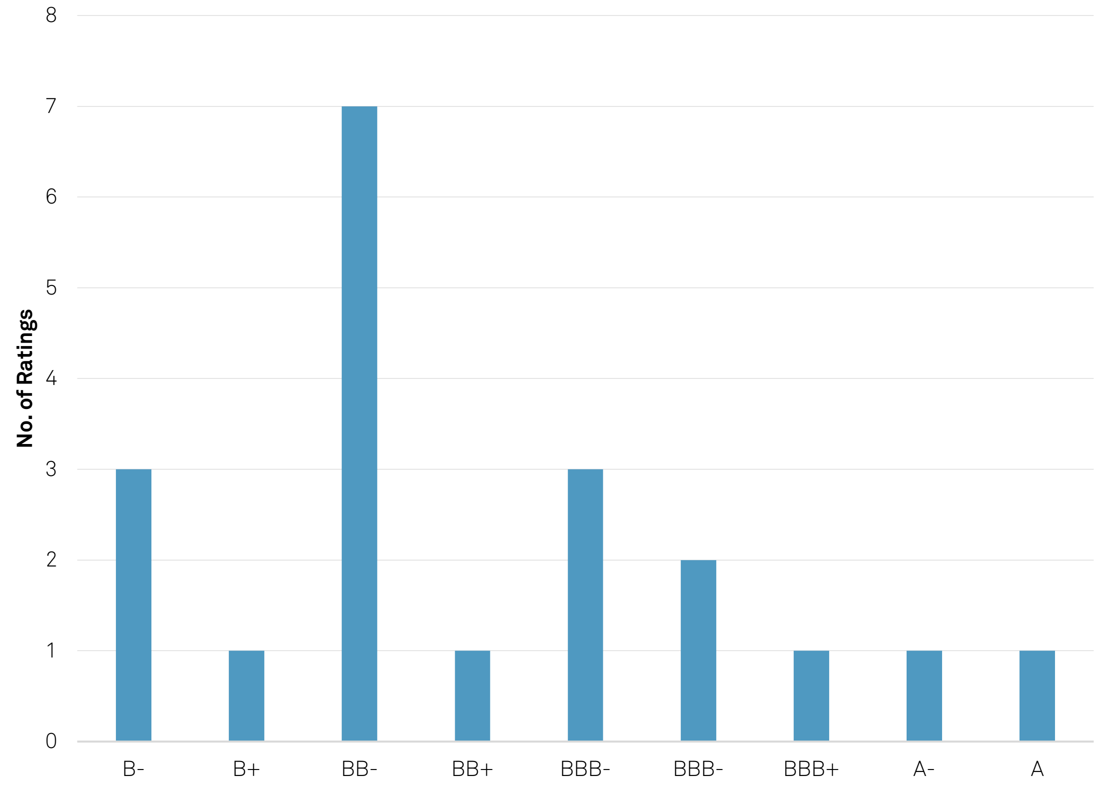
Core Earnings/Operating Revenue



Source: S&P Global Ratings.

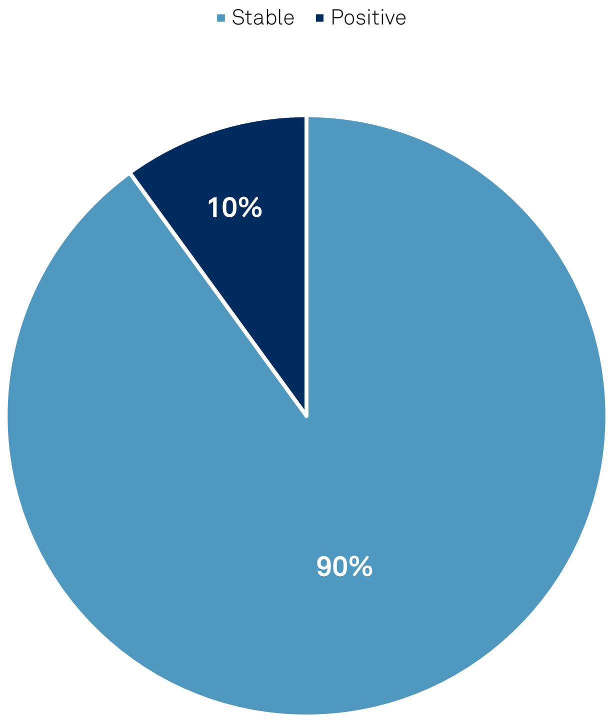
U.S. Securities Firms Rating And Outlook Distributions

Rating Distribution



Ratings as of Jan. 20, 2022. Source: S&P Global Ratings.

Outlook Distribution



Source: S&P Global Ratings.

Rating Factor Assessments
U.S. Securities Firms

Company	Anchor	Business position	Capital and earnings	Risk position	Funding	Liquidity	Comparable ratings adj.	GCP	Group influence	ICR (HoldCo)	Outlook
Advisor Group Holdings Inc.	bbb-	Adequate	Weak	Strong	Adequate	Adequate	0	b+	-2	**B-**	**Stable**
Ameriprise Financial, Inc.	bbb-	Very Strong	Adequate	Strong	Strong	Adequate	0	a+	-2	**A-**	**Stable**
Aretec Group Inc.	bbb-	Adequate	Weak	Strong	Adequate	Adequate	0	b+	-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	Strong	Very Strong	Strong	-1	a+	-1	**A**	**Stable**
Citadel Securities LP	bbb-	Adequate	Strong	Adequate	Moderate	Adequate	1	bbb	-1	**BBB-**	**Stable**
Cowen Inc.	bbb-	Moderate	Adequate	Adequate	Moderate	Adequate	1	bb+	-2	**BB-**	**Stable**
DRW Holdings, LLC	bbb-	Moderate	Adequate	Moderate	Moderate	Adequate	1	bb	-1	**BB-**	**Stable**
Hudson River Trading LLC	bbb-	Moderate	Adequate	Adequate	Adequate	Adequate	0	bb+	-2	**BB-**	**Stable**
IBG LLC	bbb-	Adequate	Very strong	Adequate	Adequate	Adequate	0	bbb+	-1	**BBB**	**Positive**
Jane Street Group, LLC	bbb-	Moderate	Adequate	Adequate	Moderate	Adequate	1	bb+	-2	**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	0	bbb-	-1	**BB+**	**Stable**
Oppenheimer Holdings Inc.	bbb-	Adequate	Strong	Adequate	Adequate	Moderate	-1	bb+	-2	**BB-**	**Stable**
Raymond James Financial Inc.	bbb-	Strong	Strong	Adequate	Strong	Strong	0	a-	-1	**BBB+**	**Stable**
Stifel Financial Corp.	bbb-	Adequate	Strong	Moderate	Strong	Strong	0	bbb	-1	**BBB-**	**Positive**
StoneX Group Inc.	bbb-	Adequate	Adequate	Moderate	Adequate	Adequate	0	bb+	-2	**BB-**	**Stable**
VFH Parent LLC	bbb-	Adequate	Constrained	Adequate	Moderate	Adequate	1	bb	-2	**B+**	**Stable**

Ratings as of Jan. 20, 2022. Source: S&P Global Ratings.

U.S. Securities Firms: Subsectors List

Institutional brokers

Traditional

- Cantor Fitzgerald L.P.
- Cowen Inc.
- Jefferies Financial Group
- StoneX Group Inc.

Technology-driven trading

- Citadel Securities L.P.
- DRW Holdings LLC
- Hudson River Trading LLC
- Jane Street Group LLC
- Jump Financial LLC
- VFH Parent LLC (Virtu Financial)

Retail brokers

Independent

- Advisor Group Holdings, Inc.
- Kestra Advisor Services Holdings A Inc.
- LPL Holdings Inc
- Ameriprise Financial Inc.
- Aretec Group, Inc.

Discount

- Charles Schwab Corp.
- IBG LLC

Full commission

- Oppenheimer Holdings Inc.
- Raymond James Financial Inc.
- Stifel Financial Corp.

Related Research

- Economic Research: U.S. Real-Time Data: High Prices Dampen Economic Activity And Moods, Jan. 28, 2022
- Economic Research: The Federal Open Market Committee's Policy Rocket Heads To The Launchpad, Jan. 26, 2022
- Economic Research: U.S. Economic Roundup: Tight Job Market Allows For More Fed Tightening, Jan. 10, 2022
- U.S. Institutional And Retail Securities Firms Ratings Affirmed Under Revised Criteria, Dec. 15, 2021
- Global Credit Outlook 2022: Aftershocks, Future Shocks, And Transitions, Nov. 30, 2021
- Economic Outlook U.S. Q1 2022: Cruising At A Lower Altitude, Nov. 29, 2021
- North American Financial Institutions Monitor 4Q 2021: Riding The Economy's Tailwind And Aiming For A Smooth Landing, Oct. 20, 2021

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