U.S. Securities Firms 2023 Outlook:

Stable Ratings Through Uncertain Markets

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S&P Global Ratings

This report does not constitute a rating action

Contents

Mostly Constructive Based On Solid Capital And Liquidity

Key expectations

- Economic uncertainty and rising interest rates will likely drive elevated market volatility. Coming on top of 2022's decline in market values, this will hurt profitability for all but the technology-driven trading firms.
- Higher interest rates will continue to boost retail firms' profitability but may hurt firms' funding costs.
- The SEC's proposed market structure reforms, if enacted as proposed, could substantially curtail payment for order flow (PFOF), reducing discount brokers earnings, and it could also hurt wholesaler's margins.
- Despite these potential headwinds, we expect ratings to remain largely stable, with most firms maintaining solid capital and liquidity.
- Firms with a positive outlook signal those with ratings momentum if they demonstrate lower-than-peer exposure to cyclical conditions and improved business or financial strength.

Key assumptions

- Our U.S. GDP growth forecast is 1.8% for 2022 and -0.1% for 2023 (compared with 1.6% and 0.2%, respectively, in September).
- Economic momentum has slowed with a recession in 2023 increasingly likely. As extremely high prices damage purchasing power and aggressive Federal Reserve policy increases borrowing costs, we continue to expect a shallow recession for the U.S. economy in the first half of 2023.
- We expect the fed funds rate to peak at 5%-5.25% by second-quarter 2023 (previously our downside scenario). As prices stabilize, we expect the Fed to cut rates in late 2023. The risk is for more rate hikes this year and the next.
- SEC proposals, if adopted, will be implemented starting in 2024, but could be delayed if challenged.
- Market conditions are likely to remain volatile in the face of higher rates, quantitative tightening, geopolitical instability, and economic uncertainty.

Credit Conditions | North America

S&P Global U.S. Economic Forecast Overview

Key indicator (year % change)	2020	2021	2022f	2023f	2024f	2025f	2026f
Real GDP	(2.8)	5.9	1.8	(0.1)	1.4	1.8	1.9
Real consumer spending	(3.0)	8.3	2.7	0.8	1.2	1.7	1.9
Real equipment investment	(10.5)	10.3	4.6	(1.4)	(0.2)	2.0	2.8
Real nonresidential structures investment	(10.1)	(6.4)	(9.2)	(5.4)	0.7	1.5	2.0
Real residential investment	7.2	10.7	(10.4)	(14.3)	5.6	7.0	2.2
Core CPI	1.7	3.6	6.3	4.7	2.8	2.4	2.2
Unemployment rate (%)	8.1	5.4	3.7	4.9	5.3	4.8	4.6
Light vehicle sales (annual total in mil.)	14.5	14.9	13.7	14.7	15.7	16.0	16.4
10-year Treasury (%)	0.9	1.4	3.0	3.9	3.4	3.3	3.3

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 have lowered their expectations for real GDP growth multiple times in recent months.
- The November forecast suggests a shallow recession in the first half of 2023, accompanied by a fall in inflation.
- Downside scenario: If inflation is even more persistent than expected, despite a slowdown in growth, that could force the Federal Reserve to tighten more aggressively and cause a harder landing for the economy.

Key Risks

Extended depth or duration of economic downturn

Continued low issuance volumes limit underwriting revenue

Extended depth or duration of market corrections

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

SEC's proposed regulatory reforms damage retail and wholesale broker profitability

Continued market turbulence depresses retail investor engagement

Institutional Securities Firms | Key Expectations

Traditional institutional

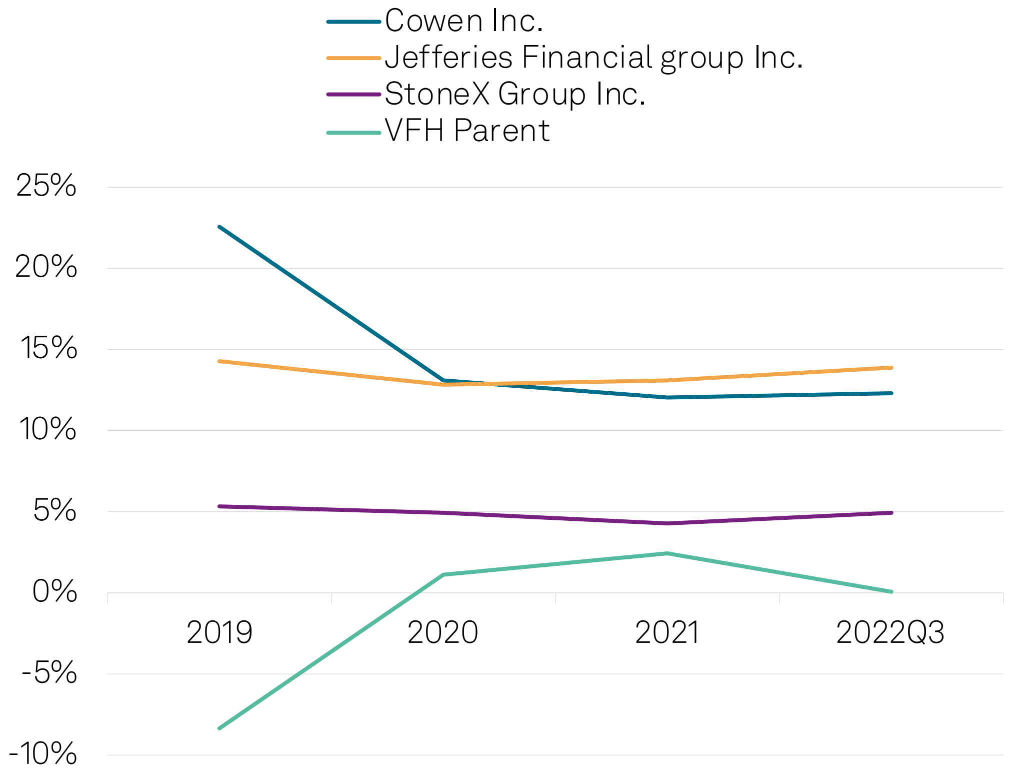
- Higher volatility and rising rates are not expected to materially boost trading revenue.
- Advisory is likely to continue to face headwinds from lower transaction volumes.
- Depressed equity and debt issuance volumes are likely to continue to hurt profitability at Jefferies, Cowen, Oppenheimer, and Cantor and, to a lesser extent, at Raymond James and Stifel.
- Elevated market volatility increases the potential for mark-to-market losses and market risk, which could pressure risk-adjusted capital (RAC) ratios.
- Firms are expected to manage their balance sheets and risk exposures to maintain supportive capital in the face of elevated market volatility.

Tech-driven trading firms

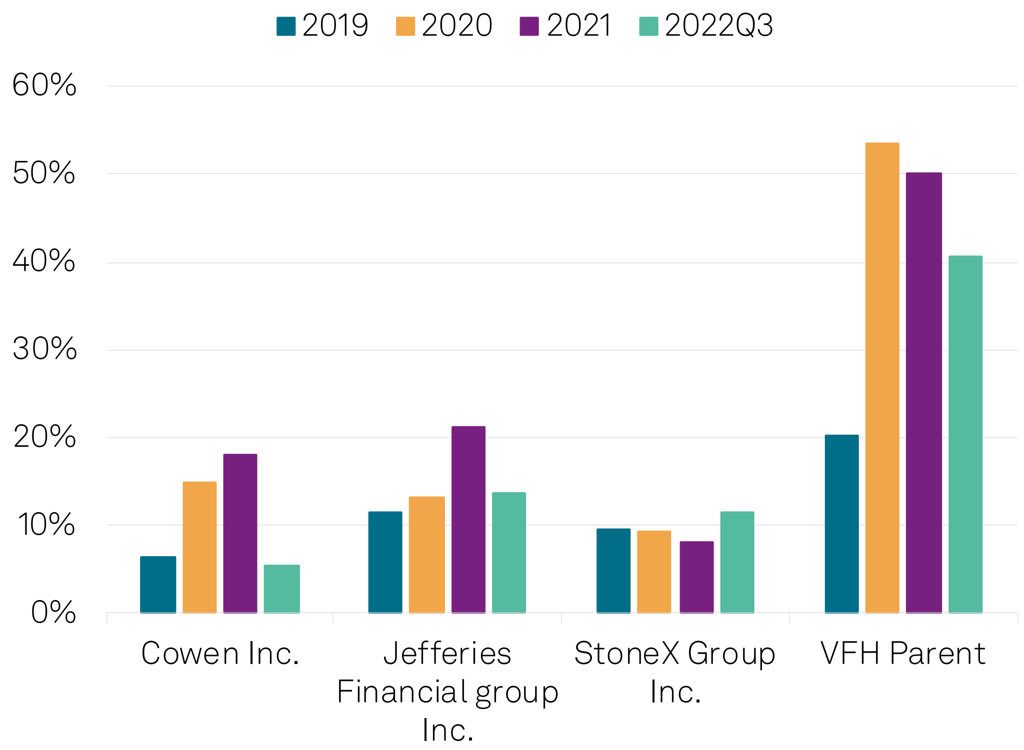
- Higher market volatility typically benefits profitability but increases market risk, which could lower RAC ratios.
- We expect more differentiation in performance trends given some divergence in mix of products and geographies traded among firms.
- Opportunities in crypto trading remain more limited and higher risk given the continued “crypto winter” and impact on crypto counterparties.
- SEC proposals, if enacted, could reduce the profitability of wholesaling U.S. retail orders, particularly for U.S. equities at incumbent market leaders VFH Parent and Citadel Securities, as well as others trying to get into the space.
- We expect continued expansion in products and geographies, but also some potential retrenchment given challenges in crypto and regulatory reforms' impact on wholesale U.S. retail equity orders.

Institutional Broker Leverage And Earnings Trends

Total Adjusted Capital To Adjusted Assets



Core Earnings/Operating Revenue



Source: S&P Global Ratings.

Retail Brokers | Key Expectations

All retail firms

- Client asset growth faces headwinds from market volatility, which potentially lowers retail investor participation.

Full commission brokers

- The continued shift to asset-based fee accounts increases recurring revenue but also heightens revenue exposure to a decline in market values.
- Higher rates are likely to reduce economic acquisition opportunities, which may slow debt growth.
- Market volatility hurts margin loan growth.

Discount brokers

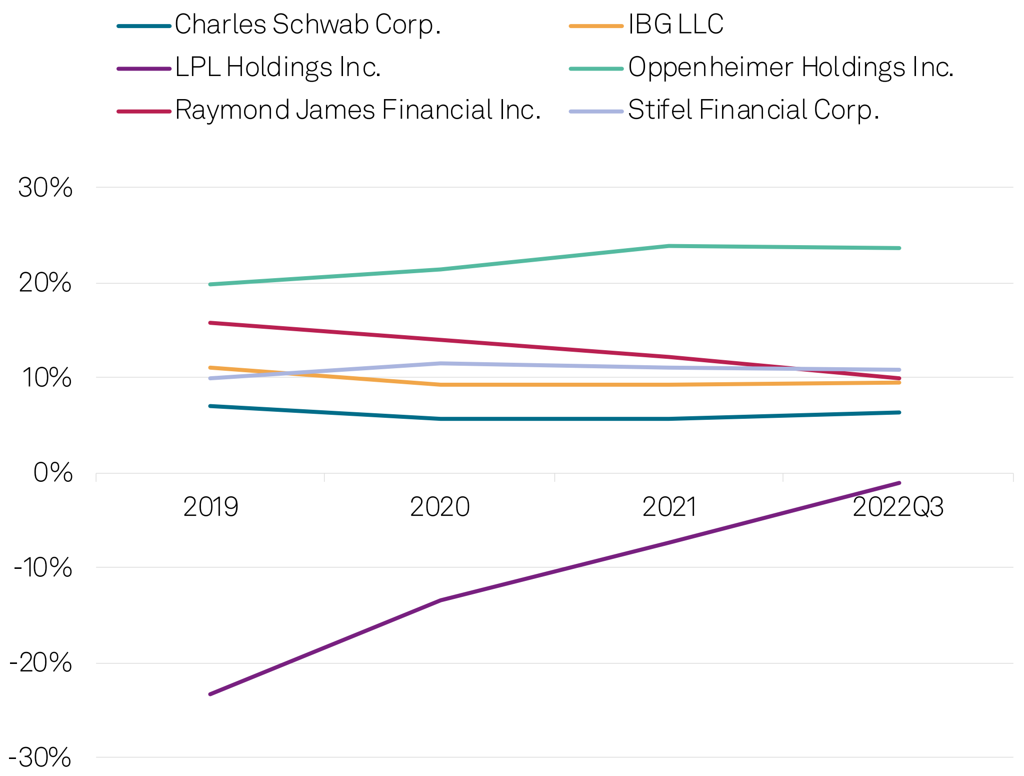
- SEC proposals could substantially reduce PFOF revenue at all but IBG, hurting profitability.
- Lower retail investor participation or options volume may further drive down trading revenue.
- Rising rates boost profitability, but less so at IBG because it passes on more to its clients.
- Market volatility hurts margin loan growth.

Independent brokers

- Wirehouse advisers going independent provides a tailwind to growth.
- The continued shift to asset-based fee accounts increases recurring revenue but also heightens revenue exposure to a decline in market values.
- Debt service capacity should rebound from rising rates, with growing revenue from clients' cash balances more than offsetting higher funding costs for the private equity-owned firms (Advisor Group, Aretec and to a lesser extent Kestra).
- A lack of near-term debt maturities limits refinancing risk.
- Consolidation in the subsector raises pressure to do debt-funded acquisitions that can weigh on financial strength.

Retail Broker Leverage And Earnings Trends

Total Adjusted Capital To Adjusted Assets



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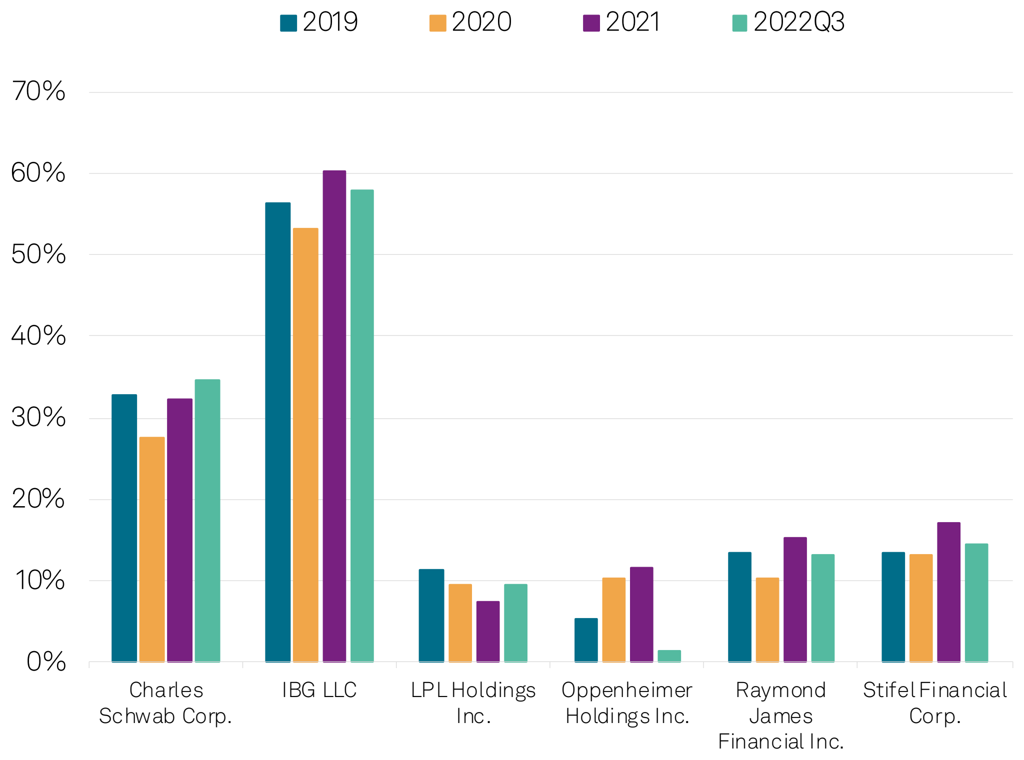
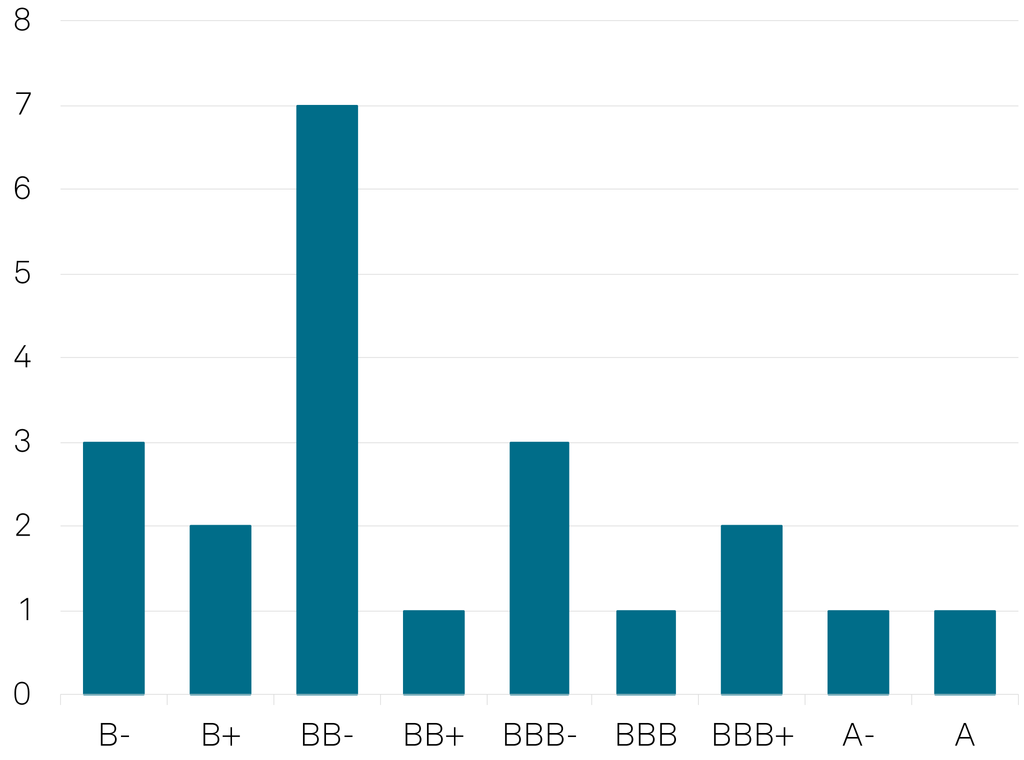


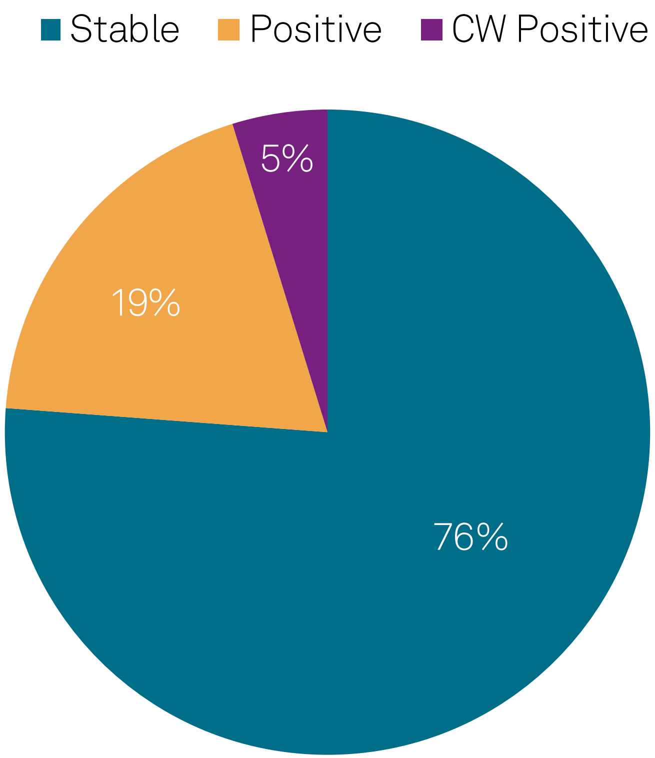
Source: S&P Global Ratings.

Ratings And Outlook Distribution

Rating Distribution



Outlook Distribution



Note: Ratings are as of Jan. 18, 2023. Source: S&P Global Ratings.

U.S. Securities Firms | Rating Factor Assessments

Company	Anchor	Business position	Capital and earnings	Risk position	Funding	Liquidity	Comparable ratings adj.	GCP	Additional factors	ICR (HoldCo)	Outlook
Advisor Group Holdings Inc.	bbb-	Adequate	Weak	Strong	Adequate	Adequate	0	b+	-2	B-	Stable
Ameriprise Financial, Inc.	--	--	--	--	--	--	--	--	--	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-	CW Positive
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	Adequate	Adequate	0	bb+	-2	BB-	Stable
IBG LLC	bbb-	Adequate	Very strong	Adequate	Adequate	Adequate	1	a-	-1	BBB+	Stable
Jane Street Group, LLC	bbb-	Moderate	Adequate	Adequate	Moderate	Adequate	1	bb+	-2	BB-	Positive
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+	Positive
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+	Positive
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

Note: Ratings are as of Jan. 18, 2023. 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.

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

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

- U.S. Banks Outlook 2023: A Strong Banking System Prepares For A Weakening Economy, Jan. 11, 2023
- Economic Research: Financial Fragility Of U.S. Households And Businesses Rose In Third-Quarter 2022, Jan. 6, 2023
- Credit Conditions North America Q1 2023: Worse Before It Gets Better, Dec. 1, 2022
- Economic Research: Global Macro Update: Surprising Resilience Unlikely To Last Into 2023, Nov. 30, 2022
- Economic Outlook U.S. Q1 2023: Tipping Toward Recession, Nov. 28, 2022
- Credit FAQ: What Goes Into Ratings On Technology-Driven Securities Trading Firms, Oct 24, 2022
- For U.S. Securities Firms, Ratings Should Remain Stable Despite Uncertain Markets, July 28, 2022

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