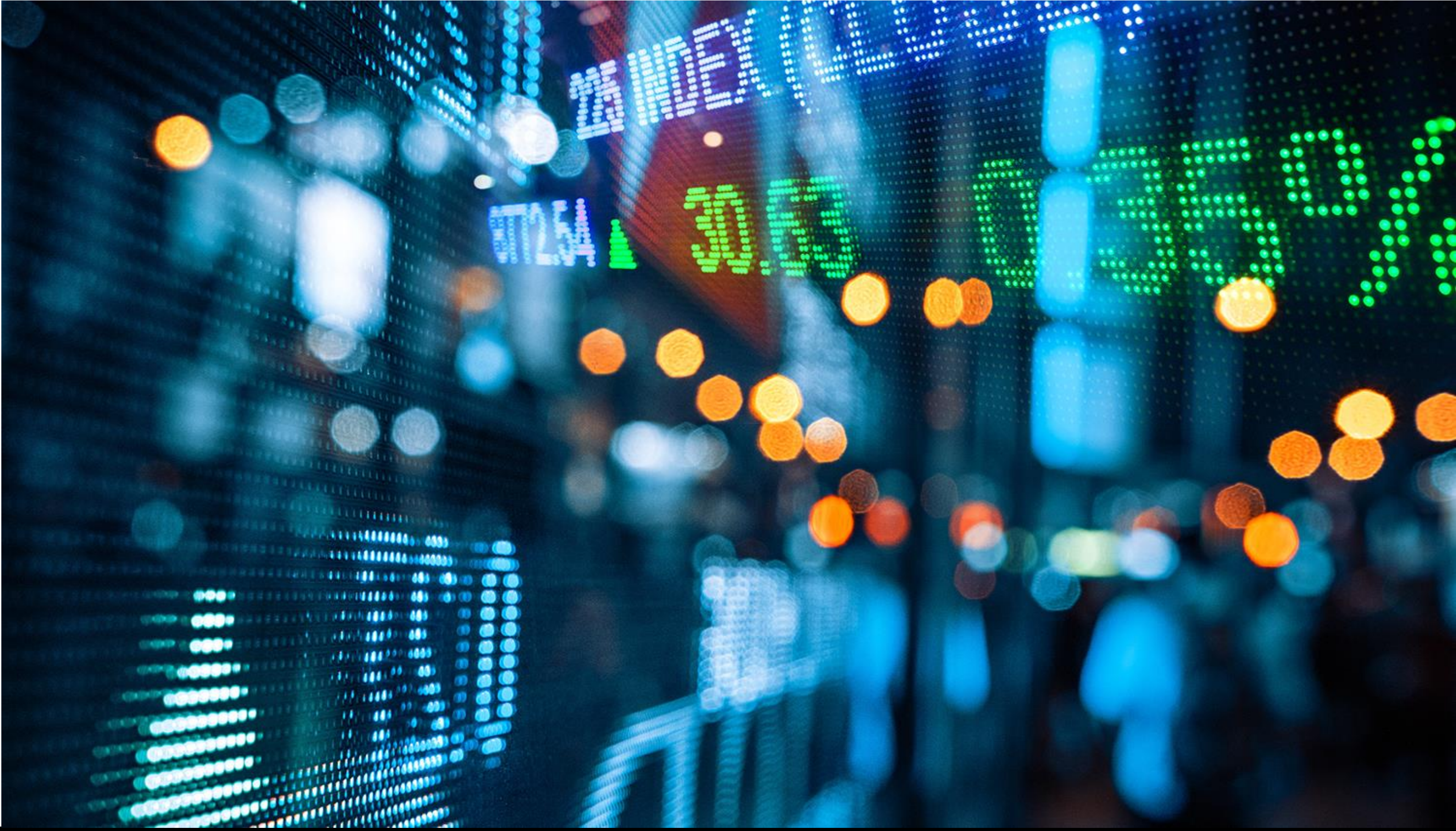

SIFMA Insights

The Capital Markets Conference Debrief

Perspectives & Key Themes from Analysts, Executives & Market Participants

November 2019

Recently, SIFMA hosted its Annual Meeting, The Capital Markets Conference. With two days of presentations and events and hundreds of attendees, we gained insights into top-of-mind topics for market participants. Inside this note, we recap just some of what was seen and heard, as well as key themes heard throughout the year.

To see details from topics SIFMA has covered throughout the year, please see SIFMA Insights at (list of Insights reports in the Appendix of this note): https://www.sifma.org/insights/

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SIFMA Insights can be found at: https://www.sifma.org/insights

SIFMA is the leading trade association for broker-dealers, investment banks and asset managers operating in the U.S. and global capital markets. On behalf of our industry's nearly 1 million employees, we advocate on legislation, regulation and business policy, affecting retail and institutional investors, equity and fixed income markets and related products and services. We serve as an industry coordinating body to promote fair and orderly markets, informed regulatory compliance, and efficient market operations and resiliency. We also provide a forum for industry policy and professional development. SIFMA, with offices in New York and Washington, D.C., is the U.S. regional member of the Global Financial Markets Association (GFMA). For more information, visit http://www.sifma.org.

The Analyst Outlook

Below we recap key themes from our panel of analysts, an economist and a money manager.[1]

Economy: In general, panelists believe the U.S. economy is in a good place. It is a split picture though. The consumer is doing well – most people are working, real wage growth is "ok" and consumer confidence is high. On the other side, business investment is weak and down substantially from 2018 (down almost 80%). Net trade (= exports – imports) is down almost 1%, albeit decelerating more modestly in 3Q19. And uncertainties remain. Global growth continues to slow. The U.S./China trade dispute continues. The Fed persistently misses its inflation target. Summing this all up panelists expect the Fed to carefully watch the data to determine their next move. (Although, panelists note the lingering effects of the U.S./China trade skirmish should keep the Fed from raising rates any time soon.) As to the probability of timing for the next recession, panelists noted that it is natural that statistically probability rises as we get longer into the cycle. However, as it takes ten years to fully recover from a major financial crisis, the cycle may not necessarily be as aged as it appears on paper. That said, the days of 3%+ GDP growth "are over", with stats adding up for a possible recession in late-2020/2021.

Policy: Panelists placed the regulatory/legislative environment in the moderate-to-good position. They noted the U.S./Mexico/Canada trade agreement (USMCA) has started to gain traction and would probably pass. However, it is not a game changer for the economy or markets – it would be the failure to pass that could have potential negative consequences, as President Trump could then withdraw the U.S. from the North American Free Trade Agreement (NAFTA). Passing USMCA simply takes a negative off the plate. Panelists expect a modest trade deal with China in the short term, but also noted that China needs to be thought of as a long term deal. And of course U.S./European trade tensions linger. On the prudential regulation side, panelists consider it a stable environment but much better than the years after the passing of the Dodd Frank Act (for example: the Crapo bill benefitted smaller regional and community banks; regulators finished revising the supplemental leverage ratio for custody banks; etc.). However, we are late in the Congressional cycle, and regulatory recalibrations that are not finalized, such as the Volcker Rule, could be put at risk of being overturned in a new Congress.

[1] Panelists: Christian Bolu, Sr. Analyst US Capital Markets Autonomous Research; Brian Gardner, MD Washington Research KBW; Guy Moszkowski, Founder & Former Director of Research Autonomous Research US; Katie Nixon, EVP & CIO Northern Trust; Dana Peterson, Global Economist Citi

Markets: Structurally for capital markets, panelists discussed three key themes. First, public markets have become more passive while private markets have become more active. Public markets are now closer to 40% passive, up from ~20% a decade ago, as investors turn to lower fee products for cheaper investment options. Given low returns across many asset classes, asset allocators are actively putting money into private markets to search for yield. Next, markets are experiencing "zero everything". The last two decades have brought a deflationary spiral of fees for market participants across the industry. This year took the biscuit, as electronic brokers and an asset manager took commissions to $0 (albeit this is great for investors).[2] So how do these firms make money in this environment? The electronic brokers have essentially become bank-like, acting as asset gatherers and earning money off of uninvested cash balances. Panelists expect fee pressure to continue. For firms to charge more, they are going to have to provide additional value to clients. Finally, panelists noted that markets are experiencing the death of the well behaved drawdown. We saw the equity markets dropped ~9% in December 2018. The repo market rate jumped to ~10% in September of this year. Panelists attributed these events to the lack of active capital in markets, given regulations, preventing intermediaries from stepping in to quickly correct markets as they have done in the past. In other words, there is a false sense of the level of active liquidity in some markets should they come under stress.

Investing: Panelists labeled the environment "slower and lower". The world is slowing economically, and returns are lower than historic levels. While regression analyses on GDP and market performance show no correlation – markets are driven by earnings and valuation, and valuation is what matters over the long run – this is not necessarily the case in the short term. Panelists indicated slowing growth can be viewed as a positive for risk assets as it means less chance of inciting a Fed "mistake", but returns are driven by earnings. Panelists noted it remains a benign environment for bonds, and fixed income has become a critical component of a client's portfolio as it provides durable diversification they cannot get in risk assets. In equities, the tide has turned as clients move to overweight the U.S. Moving forward, uncertainty remains and 2020 will bring lots of distractions with the election noise. And the trade risk is ongoing. It has a real impact on profits/earnings and therefore valuations, with another indirect impact on confidence for both investors and company management teams.

Elections: Panelists noted that investors are already asking about next year and the elections. While not all presidential candidates have distributed detailed plans, the panel addressed some of the recommendations that have been published (as we understand them today). A few areas which could undermine current investment base cases include: adding new stringent regulations to private equity, breaking up the big banks, financial transaction tax, rolling back regulatory recalibrations for smaller regional/community banks, etc. Again, these are only candidate talking points during the debates, with limited published details. Additionally, the nomination remains up for grabs, and history shows the process to be very fluid and hard to predict a final presidential winner. For right now, election noise just adds another layer of uncertainty and distraction away from fundamentals when making investment decisions.

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[2] We note that the conference was held prior to the announcement that Charles Schwab would acquire TD Ameritrade

The Executive View

Below we recap key themes from our panel of industry executives.[3]

Clients: Much work has been done since the crisis to show the industry and outsiders that financial institutions act on behalf of their clients first. (We note that this is not a change in practices, as firms have always acted on behalf of clients; rather it is a focus on changing the negative perception of the industry.) Firms have spent a significant amount of time educating clients that the industry is indeed client centric. One example is Regulation Best Interest. The industry worked with the SEC, and the outcome was a significantly enhanced standard that protects investors while preserving their choice. In general, panelists noted that they feel good about where the industry is today.

Regulations: Panelists indicated regulatory recalibration is needed to remove frictions in markets, as some regulations have negatively impacted market liquidity. For example, corporate bonds used to have a larger number of issues trading in size, but that has come down post crisis. This created liquidity concerns for the asset management community, albeit electric trading has helped improve the situation somewhat. While panelists note that the industry needs sound regulations, this must be balanced with ensuring markets function efficiently. An area of concern is that the industry had to “overreach” to invest into compliance related areas, leaving them “behind” in investing in other areas which could be influencing the future of capital markets.

Technology: One area which already is and will continue to change the industry is advancements in technology. Technology has always played a key role in financial services – from the birth of screens decades ago (versus calling your broker to get a price quote) to the fintech applications of today – and firms have continued to adopt new technologies to create efficiencies and better serve clients. Panelists indicated that the game is a lot faster today. Technology provides opportunities for firms to increase transaction speeds and continue lowering costs for investors, though panelists indicated this needs to be balanced with human involvement to make “decisive decisions” when needed. Technology assists firms of all types in gathering, cleaning and protecting data. Further, technology has assisted with the democratization of markets, opening up access to individual investors of all income levels. As to competition from nontraditional financial institutions, panelists feel it is good for the industry as a whole, as long as everyone is playing by the same rules. The addition of fintech players provides firms the option to build, buy or partner, depending upon their technology needs and budgets. These enables firms of all sizes to adopt systems to better serve their customers.

Prices: Panelists indicated the industry has seen price compression across the board. Only 10 years ago, some trades were ~$18 per trade. Now they are $0, which is a quick transition period. While it is still early days, zero commissions are a positive for investors. Conversely, when the institutional space flirts with zero, it could cause firms to underinvest. The industry needs a balance – firms want to provide customers with low costs and high-level service, but they need to earn money to invest in system maintenance, compliance, new technologies, cyber security, etc. Therefore, panelists do not expect further price compression in the institutional space.

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[3] Panelists: Michael Durbin, Head of Fidelity Institutional; Charlotte McLaughlin, President & CEO PNC Capital Markets; Craig Messinger, Vice Chairman Virtu Financial; James Reynolds, Jr. Chairman & CEO Loop Capital Markets

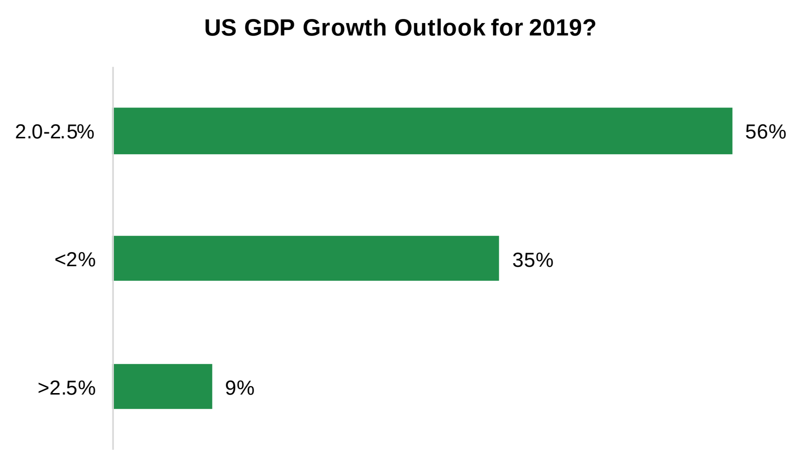
The Audience Perspective

We polled the conference audience to gain their insights on macro factors influencing the economy and market sentiment. In general, market participants still feel good about the U.S. economy and expect markets to continue to expand in the coming year. That said, slowing global growth and trade policy continue to rank highest as the market impact factors to watch.

Economic Environment[4]

Q: Real GDP growth in 2017 was 2.8% and dropped to 2.5% in 2018 (on a 4Q/4Q basis). Where do you expect 2019 to wind up?

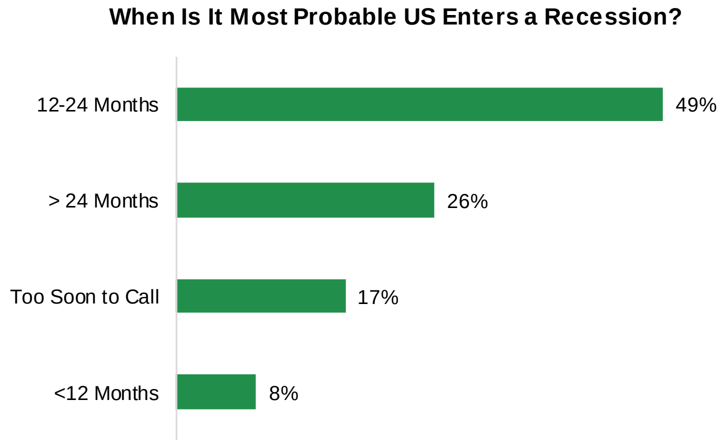
A: Over half of respondents expect the U.S. economy to finish up 2019 with growth in the 2.0-2.5% range.



[4] On December 4, SIFMA will release its end-year economic outlook report, with results from a survey of over 20 chief economists on the street: https://www.sifma.org/research/

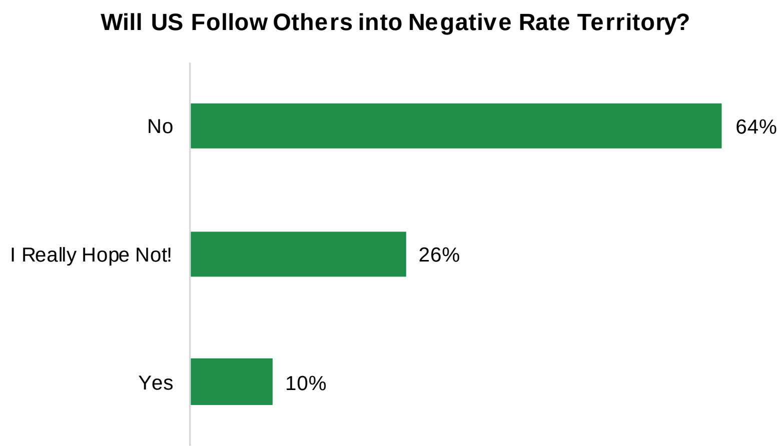
Q: We're in the longest economic expansion in history. When do you think it is most probable we will enter a recession?

A: Almost half of respondents place the probability of the U.S. entering a recession in the next 12-24 months.



Q: Do you think the U.S. will follow other nations and take us into negative rate territory?

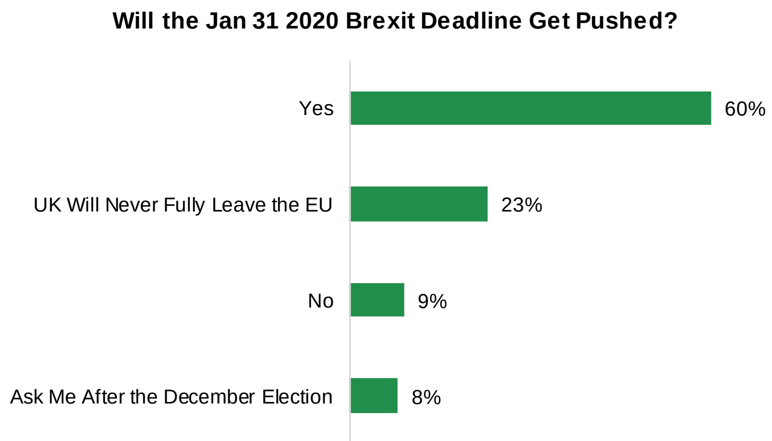
A: 90% of respondents are in the no camp, split across a straight no (64%) and I really hope not (26%).



Macro Events

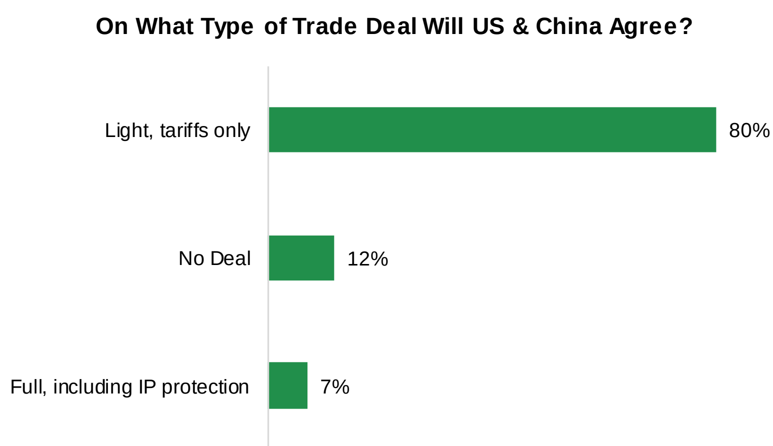
Q: The Brexit vote occurred in June 2016. The original deadline was March 29, 2019 but has been delayed multiple times. Do you think the January 31, 2020 deadline will get pushed as well?

A: 60% of respondents believe the January 31, 2020 Brexit deadline will again be delayed, with 23% responding they do not believe the UK will ever leave the EU.



Q: What type of trade deal do you expect the US and China to eventually agree on?

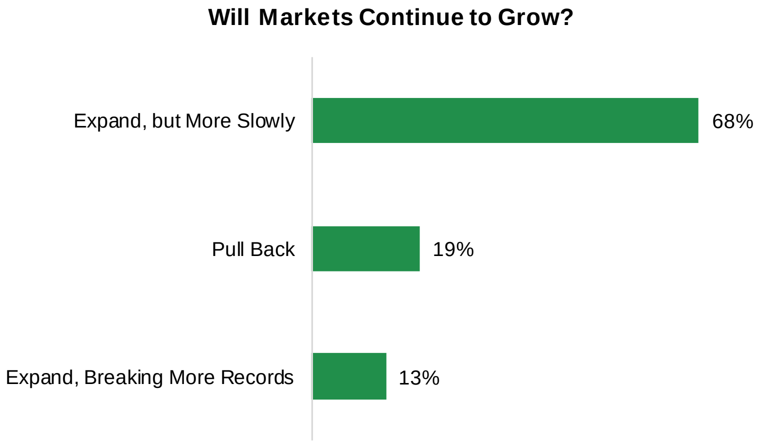
A: 80% of respondents believe the U.S. and China will eventually agree on a light deal, around only eliminating tariffs and working to reduce the U.S. trade deficit with China.



Putting It All Together

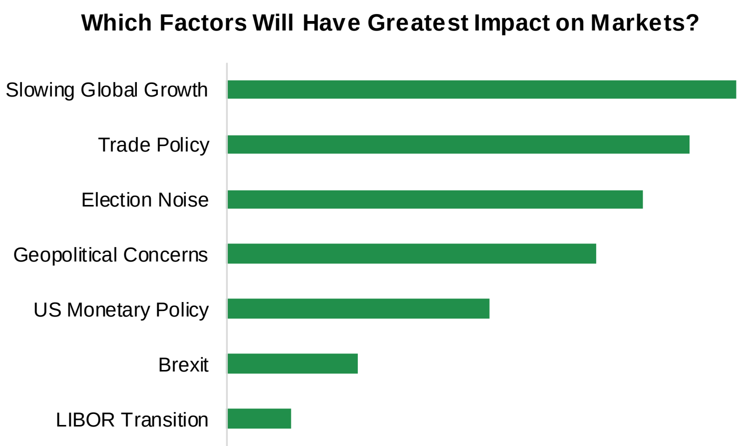
Q: What does this all mean for market sentiment? Using the three major indices as a proxy - the S&P 500, Nasdaq and Dow - do you expect markets to continue to grow?

A: 69% of respondents expect markets to continue expanding next year, but at a slower pace.



Q: Finally, which factors will have the greatest impact on markets in the coming year?

A: Slowing global growth and trade policy came in #1 and #2 respectively, with election noise and geopolitical concerns also weighing on the minds of market participants.



The Key Market Themes for the Year

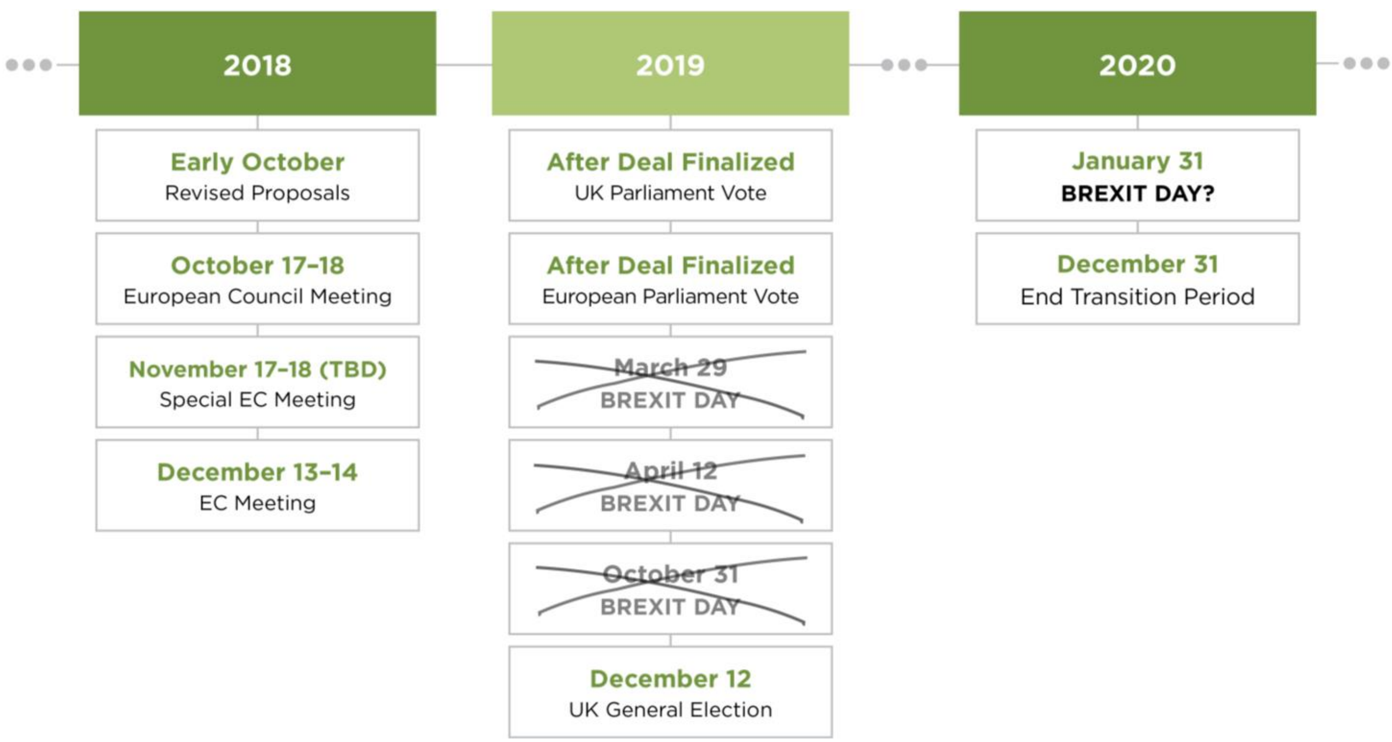
In this section, we look back at key themes for the year and asses how the conversation has changed.

Brexit: Delay, Delay, Delay…Repeat

A year ago at the SIFMA Annual Meeting, the uncertainties around Brexit were in focus, with market participants questioning whether we should be bracing for a hard Brexit. A year later – and 3 years and 5 months after the June 2016 U.K. Referendum – and we are still wondering what Brexit will look like (hard or soft) and when it will happen. Below we've updated our old graphic from the debrief note a year ago, marking the changes we have witnessed since then. Delays appear to be the only constant, with one conference goer stating Brexit creates more dates than match.com!

Meanwhile, financial institutions continue to prepare for the unknown. Firms have spent hundreds of millions of dollars preparing for Brexit (new subsidiaries/branches, licenses, etc.), ensuring the infrastructure is in place for when Brexit day finally arrives. Yet, the future regulatory environment remains unclear; for example, what does fully self-sufficient mean for EU subsidiaries? The future of market structure remains unclear; for example, could EU regulators force trading of dual listed stocks to the EU? And the future status of temporary exemptions remains unclear; for example, the U.K. granted European firms temporary permission to continue operating in the U.K., but the EU has not formally reciprocated.

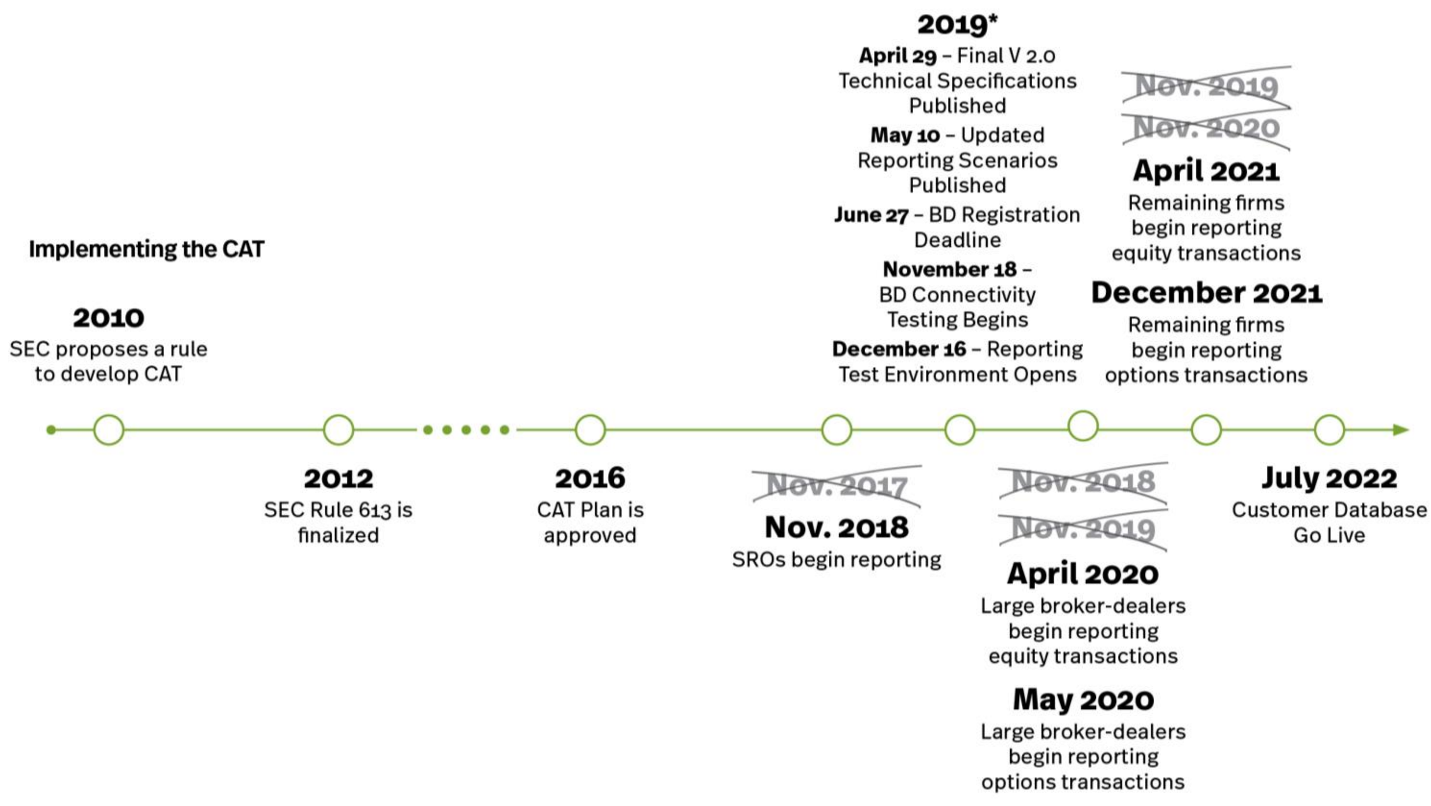
What has not changed throughout the year – and what is clear to firms – is that Brexit remains a top issue for market participants.



CAT: The SEC Heard You on PII, but Issues Remain

One thing that has not changed is that the industry remains concerned with the consolidated audit trail's (CAT) ability to protect personally identifiable information (PII). The CAT will allow the SEC and FINRA to monitor every aspect of the trade lifecycle, from execution to settlement, and across all market players (broker-dealers, exchanges, investors). As such, it will create the world's largest database of U.S. equity and multi-listed listed options transactions, with data from over 100 million institutional and individual investor accounts. That is a lot of data to protect!

Speaking at our conference, SEC Chairman Jay Clayton reiterated that he believes it is necessary for regulators to be able to do market reconstruction across markets. However, after listening to concerns from market participants, the SEC is committed to collecting only "phone book" information to minimize collection of sensitive PII. The SEC, having recently hired a new vendor to build the customer database, still needs to resolve the data protection and liability issues. This bifurcates the timeline. The transaction database will begin as planned next year. Then, the customer database should go live in 2022, once the SEC can ensure data will be protected.



Note: BD = broker-dealer. *In 2019, the dates are for transactions only, not the customer database

Cyber: Continuing to Fight the Good Fight

Cybersecurity Ventures predicts global spending on cybersecurity products and services (across all industries) will exceed $1 trillion cumulatively from 2017 to 2021, a 12-15% Y/Y growth rate through 2021 (Cybercrime Magazine, June 2019). The financial services industry alone is spending tens of billions on cyber security. A May 2019 Deloitte survey found financial institutions are spending 6-14% of their IT budget on cybersecurity (10% average) or 0.2-0.9% of revenue (0.3% average).

This high level of spending coupled with industry collaboration puts financial services ahead of other industries in combating cybercrime. Cyber security is a shared interest in financial services, with firms working together rather than competing. The level of information sharing and cooperation between private and public (regulators; government agencies, like U.S. Treasury, Homeland Security) sectors is at an all-time high, with informal and formal processes in place. Informally, financial institutions experiencing an issue can call another firm to see if they had the same issue or know of an existing remedy. This also acts as an early warning system amongst market participants.

More formally, joint exercises exist to make market participants aware of existing threats but also develop and practice procedures should an attack occur. Cyber security knows no boundaries. Therefore, SIFMA's Quantum Dawn exercise – which builds coordination capabilities among key financial institutions, regulatory agencies, central banks and government agencies to keep markets operating in the event of an attack – went global this year. This time the exercise emphasized cross jurisdiction communication and coordination across participants in North America, Europe and Asia. The industry processes keep improving, as the fight to combat cyber-attacks continues.

Fintech: Getting the Pieces in Place & Considering All Opportunities

The industry continues to analyze how fintech solutions can increase efficiencies in the back office, serve clients, manage risk or meet regulatory reporting requirements. As we moved through the year, the industry has made progress implementing some applications, and focus has shifted to prioritizing others. The ABCDs of fintech (as trademarked by Broadridge) – AI, blockchain, cloud and data/digitization – continue to develop.

Robotics and Robotic Process Automation (RPA) are currently being used by many financial institutions. Automation via these capabilities benefits firms by improving procedures and decreasing the time it takes to perform tasks, enabling employees to spend more time working with their clients. They also help firms increase transparency and reduce operational risk. We, therefore, expect the uptake of robotics/RPA to continue.

Cloud architecture in its various forms has become a bigger focus of financial institutions. One panelist indicated they never imagined a pace this fast to adopt cloud computing. Cloud enables firms to leverage infrastructures of specialized providers and can also provide a platform for partnerships with other innovative technology providers, explaining the appeal for many firms. As firms continue to expand their applications of artificial intelligence (AI), they remained focused on building the internal governance and oversight models to manage them. Blockchain continues to be examined but is a longer term play (there are some interesting use cases in repo and other areas).

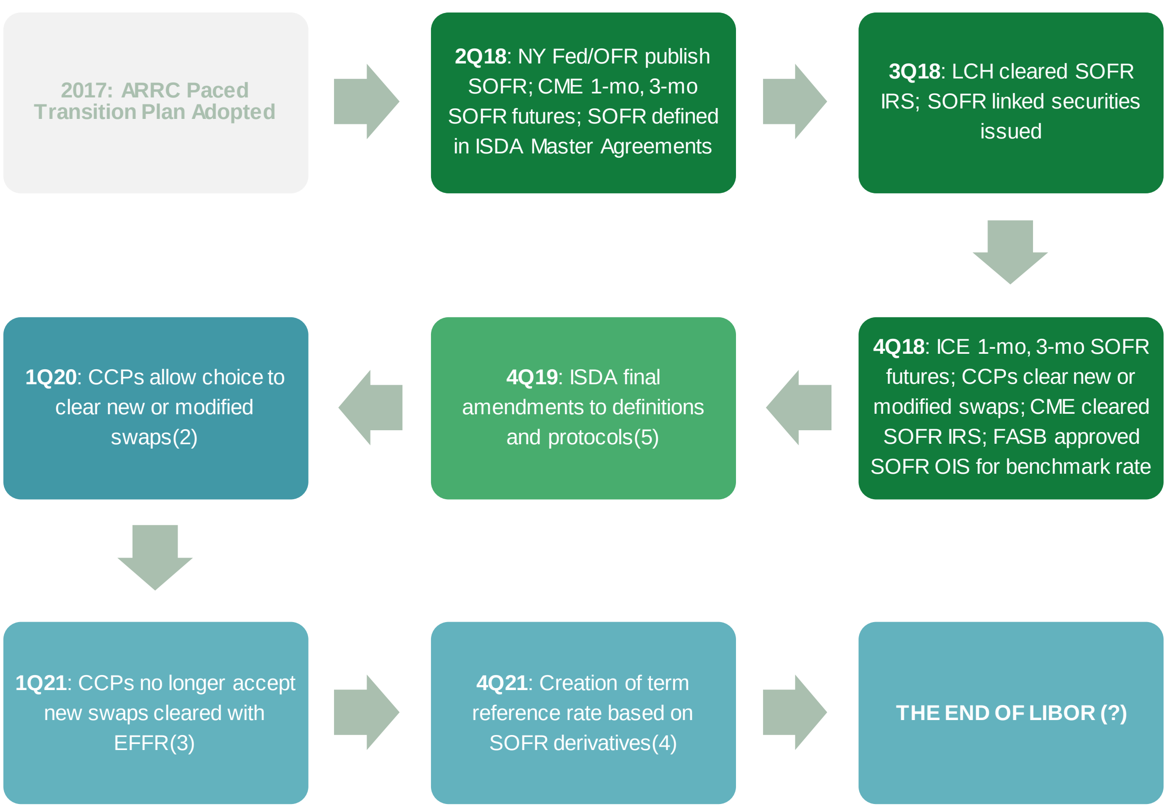
And of course, data remains the new oil. Firms continue to explore ways to bring together data from disparate systems and increase efficiencies in gathering, cleansing and analyzing data. With the continual increase in the amount of data collected, data protection remains top of mind. As such, one panelist indicated the S in ABCDs should be capitalized to include security.

LIBOR Transition: Now <775 Days Until LIBOR's (Potential) End

A year ago, market participants were starting to get their arms around the concept of the U.S. transition to the Secured Overnight Financing Rate (SOFR) from the London Interbank Offered Rate (LIBOR). Exchanges and clearing houses began launching SOFR futures/swaps; CME SOFR futures open interest now reached over 500,000 contracts. Questions abound around what the transition would mean and who would be impacted; now the Alternative Reference Rates Committee (ARRC) and other players have spent (and will continue to spend) a significant amount of time educating market participants, in particular end users and smaller financial institutions.

While questions remain and actions still need to be taken, market participants are further along in the discussion. The ARRC published fallback language for new transactions of syndicated loans, bilateral loans, FRNs, securitization & adjustable rate mortgages. Regulators (FASB, IRS, SEC, federal banking) published guidance/relief proposals to aid the transition. There is more to come – ex: CCPs expected to change cleared swap discounting to SOFR in 2H20, projected to drive significant trading activity of SOFR swaps/futures. As legacy issues remain challenging, the ARRC is considering the viability of a legislative solution to assist in transitioning existing deals.

The conversation has shifted and now includes a focus on timeline. The ARRC, regulators and market participants are stressing the importance for firms of all sizes to prepare for LIBOR's end. At SIFMA's LIBOR Briefing in July, President and CEO Federal Reserve Bank of New York John Williams started an unofficial official clock countdown when he stressed that firms need to get moving, as 900 days is not really as long as one might think in financial services. And the clock continues to tick down.



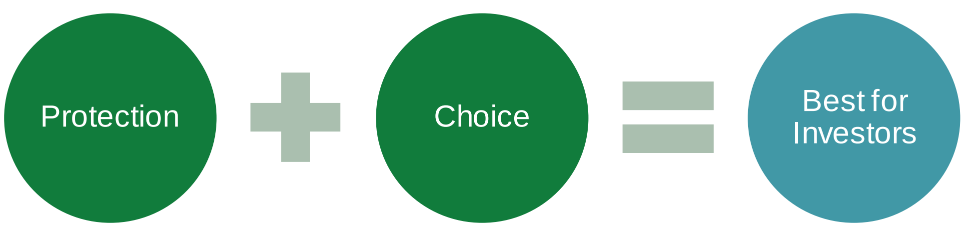
Source: ARRC. Note: OIS = overnight index swap. EFFR = effective Fed Funds rate. PAI = price alignment interest. IRS referencing SOFR = with PAI & discounting linked to EFFR. Swaps clearing = in current EFFR or SOFR PAI/discounting. 1Q21 = PAI/discounting, except to close out legacy contracts. Term reference rate = dependent upon sufficient liquidity in SOFR derivatives markets to determine a robust rate.

Reg BI: Staying the Course – Protecting Investors While Preserving Choice

The messaging from market participants and SIFMA around Regulation Best Interest (Reg BI, the SEC's best interest standard) has not changed throughout the year. Ensuring investors are protected in their dealings with financial professionals remains a universal goal. Reg BI goes a long way to ensuring investors are protected in their dealings with financial professionals by significantly raising the bar on investor protection while preserving choice.

Reg BI exceeds the existing FINRA suitability standard to the benefit and for the protection of individual investors. It enhances broker-dealer conduct standards by adding new and heightened care, disclosure, and conflicts-of-interest obligations, meaning broker-dealers cannot put their interests ahead of the interests of investors and must weigh the cost of a security or strategy in determining whether to recommend the security or strategy. Coupled with frequent regulatory exams for broker-dealers, SEC and FINRA oversight and enforcement and the private right of action given to individual investors through FINRA arbitration, Reg BI establishes a true best interest standard with real teeth.

However, as market participants understand today, prospective conflicts exist between the SEC's final rules, state legislative and regulatory proposals and private standard setters. This leaves financial institutions scratching their heads as to how to comply with potentially multiple conflicting standards. Reg BI is sound and understandable by clients, and, importantly, establishes a uniform, nationwide best interest standard. The best way to protect investors and avoid investor confusion is to allow the standard established by the primary federal regulatory agency, the SEC, to govern. Reg BI will best protect and serve clients by preserving their access to and choice of financial advice, while ensuring their interests always comes first.



Appendix: Terms to Know

CFTC	Commodity Futures Trading Commission
Fed	Federal Reserve System
FINRA	Financial Industry Regulatory Authority
SEC	Securities and Exchange Commission
CAGR	Compound Annual Growth Rate
FTT	Financial Transaction Tax
Reg BI	Regulation Best Interest

Fintech	Financial Technology
AI	Artificial Intelligence
Cloud	Cloud Computing
Cyber	Cyber Security
DLT	Distributed Ledger Technology*
PII	Personally Identifiable Information
Regtech	Regulatory Technology
RPA	Robotic Process Automation

CCAR	Comprehensive Capital Analysis and Review
CET1	Common Equity Tier 1
G-SIB	Global Systemically Important Bank
TLAC	Total Loss-Absorbing Capacity
SA-CCR	Standardized Approach for Counterparty Credit Risk
SLR	Supplemental Leverage Ratio
eSLR	Enhanced Supplemental Leverage Ratio
SCB	Stress Capital Buffer
FRTB	Fundamental Review of the Trading Book
GMS	Global Market Shock
LCD	Large Counterparty Default

* Blockchain is one type of DLT

EMS	Equity Market Structure
ADV	Average Daily Trading Volume
AUM	Assets Under Management
CAT	Consolidated Audit Trail
ECM	Equity Capital Markets
ETF	Exchange-Traded Fund
IPO	Initial Public Offering
Reg NMS	Regulation National Market System
SIP	Security Information Processor
SRO	Self Regulatory Organization

FIMS	Fixed Income Market Structure
FICC	Fixed Income, Currencies and Commodities
DCM	Debt Capital Markets
ABS	Asset-Backed Securities
Agency	Federal Agency Securities
ARRC	Alternative Reference Rates Committee
Corporates	Corporate Bonds
GCF Repo	General Collateral Financing Repo
LIBOR	London Interbank Offered Rate
MBS	Mortgage-Backed Security
MM	Money Markets
Munis	Municipal Securities
Repo	Repurchase Agreement
SOFR	Secured Overnight Financing Rate
TMPG	Treasury Market Practices Group
UST	U.S. Treasury Securities

Appendix: SIFMA Insights Research Reports

SIFMA Insights Market Structure Primers: https://www.sifma.org/primers

- Global Capital Markets & Financial Institutions
- Electronic Trading
- US Capital Formation & Listings Exchanges
- US Equity
- US Multi-Listed Options
- US ETF
- US Fixed Income
- SOFR: The Transition from LIBOR

Select 2019 SIFMA Insights: https://www.sifma.org/insights

- The Ramifications of a Financial Transaction Tax
- Who Owns Stocks in America? Individual Investors: A Chart Book on Stock Ownership
- Spotlight: The History of the EU & Brexit Timeline
- Spotlight: Building Resilience with a Culture of Cyber Awareness
- The Importance of FBOs to US Capital Markets

Economic Research: https://www.sifma.org/resources/archive/research/

- US Economic Survey, Mid-Year 2019
- US Economic Survey, End-Year 2019 (publishing December 4)

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