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Top Market Structure Trends to Watch in 2024

Our hats are off to those analysts who need to make market predictions. While we fully appreciate the rigor that goes into interest rate and year-end S&P 500 forecasts, markets have been so unpredictable and come with so many unknown unknowns that speculating in precise terms feels like a fool's errand. With that in mind, our conversations with clients and ongoing research have directed us to these 10 market structure trends that will consume much of our effort in 2024.

1 U.S. Regulations Must Speed Up or Die, Ahead of U.S. Elections

Since assuming the role of SEC Chair in 2021, Gary Gensler has been a driving force behind a series of aggressive regulatory initiatives aimed at addressing what he perceives as fundamental flaws in the current market structure. His tenure has been marked by a proactive approach, evident in numerous proposed rule changes and concept releases spanning equities, fixed income, FX, and digital assets. However, as a Democrat, his political prospects at the SEC are uncertain and, in part, tied to President Biden's potential reelection next year. If Republicans gain control of the White House, Chair Gensler would likely be replaced by a nominee from their own party.

As President Biden's reelection poll numbers continue to trend downward, the SEC Chair will be compelled to make a forward-looking decision about how aggressively to propose regulations, given the shifting political dynamics. If he believes his time in office is limited, he may be more inclined to swiftly push through aggressive reforms, understanding that his successor may be less likely to implement them. On the other hand, if he sees a path to victory, he may adopt a more measured and cautious approach to secure industry consensus or buy-in for the SEC's proposals. Ultimately, the extent to which the Chair feels pressure to act more quickly or slow his pace will depend on his assessment of his own political future.

GUI Search is Out, AI Search is In

Twenty-five years ago, most traders did their analysis and trading with command-line codes that few outside the business would understand. Those processes transformed into much more user-friendly interfaces that allowed pointing-and-clicking and, in some few cases, leveraged ATM-style touch screens. Generative AI is on the cusp of taking traders back to the future.

The use cases for AI in general and generative AI more specifically are numerous within capital markets. But in 2024, the ability to search through complex datasets and huge databases by simply telling the computer what you want in plain English (or French or German…) is the killer app. Data availability in financial markets has grown at an exponential rate, ever since the internet found its way onto trading desks. But with the volume of data has come overly complex search tools with so many filters you need a search engine to search the filters. Generative AI is already changing that.

Are you trying to find the most actively traded stocks in Switzerland with a PE ratio over 10, an issue size over $1 billion, a CEO over 40, and a debt load that has declined over the past decade? Check boxes and dropdowns are out. Plain language search is in—and it might just make market participants smarter and faster than they already are by putting data to use that last year remained buried in the cloud.

The Exchange Buying Spree Continues

Our 2021 market structure trends to watch pointed out that exchanges were in the midst of an identity crisis, with every major global exchange increasingly shifting their revenue mix away from matching buyers and sellers and more toward—well—almost everything else. Three years later, that shift is in full swing with large, non-exchange trading venues joining the fray. LSEG is now a global data powerhouse. ICE is modernizing the U.S. mortgage market. Nasdaq is in the risk management business. MarketAxess and Tradeweb both bought algo providers. And those are only a few examples, each dramatically oversimplifying the transformation.

2024 will bring more buying. Unique data, analytics and workflow tools are all industry growth areas. Consolidating liquidity in competitive markets like stocks, options and bonds could make financial sense. And we fully expect the global exchange groups and non-exchange trading venues alike to seek out new asset classes where e-trading is either emerging (e.g., leveraged loans) or could in time meet the criteria for electronification (e.g., asset-backed securities).

Private Markets Aren’t So Private Anymore

Private markets—primarily private equity and private credit—bring to mind large institutional investors and nonbanks with huge amounts of capital to put to work. Retail investors weren’t invited to the party. Banks, by definition, were also not involved because they could not invest in these markets (remember the Volker Rule?), and the hallmark of private markets has been that nonbanks are providing the capital. While all of that is still true, it is no longer the whole story.

Distributed ledger technology popularized the idea that real-world assets could be fractionalized—an amazing development. Fintech providers are now able to offer retail investors access to private markets with minimums that your average accredited investor can put to work. ETF and mutual fund providers have also increased private market access for retail investors, investing in those assets as an institution with retail investors putting money into the funds via their brokerage account. There is more to come here on both fronts.

The banks also want in on the nonbank market, ironic though that may be. Banks making private equity investments isn't particularly new, but bank involvement in private credit markets is eye-opening. Banks putting money in private credit funds at nonbanks that then lend that money to corporations shows that banks have found a way into a market that is hot and has, until now, excluded them.

Workflow Automation Becomes the Priority

The march of electronic trading and increasingly sophisticated trading tools have been well documented in our research for over a decade, and the progress has been impressive. The focus on the front office has not always translated into a focus on the middle and back offices—but this is changing. The focus has transitioned from electronifying the matching of buyers and sellers to a more holistic goal of automating workflows. Big industry initiatives have driven some of the focus; Central Securities Depository Regulation (CSDR), Uncleared Margin Rules (UMR), and the shortened settlement cycle in the U.S. are all examples of regulation requiring improved operational efficiency.

But the focus on post-trade workflow automation is not simply tactical compliance, it is also a recognition that operational automation can support profit growth. Portfolio trading, for instance, is much more about workflow than it is about liquidity-seeking. The focus is about building the portfolio, making adjustments based on dealer prices and ensuring the complex basket is executed and booked with no errors. APIs, middleware and distributed ledger technology have all played a part in operational redesigns. Not only are these ways to reduce people costs, but also ways to better manage risk and improve front-office performance.

The Market Still Cares About Crypto and Blockchain for Capital Markets

Despite reduced retail and financial advisor interest in trading and investing in crypto, the adoption of blockchain technology continues (sometimes quietly) in capital markets. The pace has been robust, despite many firms, particularly in the U.S., maintaining a low profile at home or else focusing their efforts in different jurisdictions.

Progress toward the tokenization of financial instruments is particularly interesting. For instance, corporate and government bonds "on chain" represent a small portion of the traditional market, but that small portion is growing. Traditional financial institutions, often perceived as slow to adopt innovations, are now making decisive moves into production beyond proofs of concept (POCs), pilots and sandboxes. The most recent evidence is a bank-issued stablecoin (a cryptocurrency with a stable price) and a wholesale Swiss CBDC (central bank digital currency) being used to settle bond transactions.

These are signals that a significant turning point is coming, emphasizing that tokenizing financial assets extends far beyond real estate, art, venture capital, and private equity. As we delve into this transformative journey, the center of gravity may not ultimately be New York or London. The market is closely watching developments in places like Singapore and Switzerland, as regulators in the U.S. and U.K. still leave potential market participants in search of clarity.

Central Clearing Tries to Grow

Central clearing reduces counterparty risk and often increases market efficiency. Following the global financial crisis, clearing became a major focus, and 15 years later, much of the swaps market is now processed through a clearinghouse, resulting in a more robust market. Recent market upheavals have once again brought clearing into the spotlight. FX derivatives, U.S. Treasuries and repo transactions will all see more clearing going forward.

Uncleared margin rules, which began taking effect in 2016, have increased the cost of trading derivatives over the counter, which in turn has driven banks and investors alike to clear more trades than they did before. Taking a different approach, the SEC recently announced it will require more U.S. Treasury and repo trades to clear. Reducing counterparty risk for swaps contracts is a no-brainer. Bilateral exposure to another counterparty can last years. Repo trades are, by definition, short term, so they carry less counterparty risk than swaps, but the market's importance is so great that streamlining the plumbing via central clearing is generally supported by most market participants.

For the Treasury market, the benefits are less obvious. The market is systemically important, sure. And counterparties can go offline, like ICBC. But counterparty exposure is minimal given the lack of leverage, trade netting and one-day settlement. The cost of changing the current market structure is high, and clearing wouldn't have helped ICBC. Nevertheless, Treasury clearing mandates will take effect in 2026 and, if all goes well, market participation and transparency will grow, creating the long-term ROI the SEC is hoping for.

T+1 Prematurely Creates T+0 Talk

The upcoming move to T+1 settlement for U.S. securities has already ignited discussions about the feasibility of shortening the cycle even further to same-day settlement. While T+1 is considered a significant step toward reducing market and counterparty risk and improving efficiencies, T+0 would represent a more radical transformation with far-reaching implications and potential unintended consequences.

Though the industry has decades of experience in shortening settlements, the movement toward T+1 is already a significant undertaking. Coalition Greenwich research in the fall of 2023 found that less than one-third of participants believe capital markets professionals have the capabilities in place to be ready for the T+1 go-live date. It remains to be seen whether markets are prepared for an even shorter settlement cycle that would present significant challenges that demand careful consideration before becoming a viable reality. Today's technology makes many things possible that aren't a good idea, and T+0—at least for now—is one of them.

The focus for the foreseeable future should be first on successfully implementing T+1 and thoroughly evaluating its impact on the markets. When T+1 is firmly established, regulators and industry participants alike can look forward to the next phases of market efficiency.

Cheap Capital is Harder to Find

Policymakers want markets to remain liquid and lending to remain robust, while simultaneously increasing the cost for banks necessary to make those things a reality. Attention on the cost of capital isn't new, but the SVB failure and Basel III endgame on top of existing capital rules mean that banks hoping for capital relief are out of luck.

The buy side will see impacts too. The higher cost of capital may force banks to remediate some relationships, incorporate capital charges into pricing and encourage their clients to trade in a more capital-sensitive manner (another driver for clearing). Further, banks will likely reconsider their position in balance-sheet intensive businesses and potentially exit some vital to the financial markets as a whole.

While some of the doom and gloom scenarios are real, the end result will be much more nuanced and bring with it some positive change. Banks will put even more effort into building and buying technology that helps them optimize capital usage in real time, making each dollar go a little bit further. This could eventually help clients access the risk exposure they need more cheaply, with banks incentivized to show their true costs for each trade.

10 Buy, Build and Integrate Replaces Buy vs. Build

The "buy, build and integrate" approach has gained traction as both buy- and sell-side firms combine pre-built platforms with proprietary technology systems. Even larger firms that have often built their own fully proprietary systems are increasingly considering integrating specialized third-party platforms due to their cost-effectiveness and functionality.

This approach provides a middle ground, leveraging a pre-built foundation that can be expanded and tailored through additional development or integration with internal systems. It grants firms greater control, flexibility and adaptability while reducing development time and costs. However, customization and development efforts require resources, expertise and collaboration with vendors.

Therefore, factors such as integration ease and reliability of these hybrid systems are gaining more importance, while successful providers prioritize ease-of-use, scalability, customization, comprehensive training, and high-quality support. Collaboration and customer-focused approaches will continue to be essential for building long-term relationships and unlocking growth opportunities.

The Search for "Normal" Continues

If normal market conditions ever existed, they certainly haven't shown themselves since at least 2019. The pandemic's onset in 2020 left many anxiously waiting for life and financial markets to go back to the way they once were.

"Life" is finding a new normal as we head into 2024. Trading floors are full once more, but trains are still half empty on Monday and Friday. Seeing clients and partners in person is again important, but Zoom will often suffice in a way it didn't in 2019. So, while pandemic restrictions are done, we live in a new world.

Markets are still looking for their new normal. Good news is bad news until it's good again. Oscillations between bull and bear markets happen frequently and often defy conventional wisdom. The 60/40 portfolio died but came back to life just as quickly. And the Fed/inflation/QE/QT/rate rise/rate pause/rate cut conversation feels never-ending and increasingly tedious.

On their own, some of these things are normal, but in combination, the current environment remains unique, and 2024 is well placed to carry the market's abnormal nature forward.

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