Aite Group - Key Trends in Capital Markets 2009

by Adam Honoré, Aite Group, February 2009

The capital markets changes in 2007 pale in comparison to what has unfolded in the markets in 2008. We have witnessed once-mighty financial services firms buckle and fall into bankruptcy or be rescued by another firm; the word "bailout" has become common vernacular, and market gyrations have left most firms and investors dazed and confused. The year 2009 will usher in a heavy focus on change and transparency. The financial markets have taken beatings on all fronts this year, particularly in the hedge fund and private equity sectors. Let us not forget the drag on investment banks and record layoffs sending pools of finance professionals scratching their heads in bewilderment. Many are wondering when and if the markets will recover to the levels reached in 2006. The gilded age of exorbitant bonuses, over-leveraging and high risk-taking are over on Wall Street.

Firms were once clamoring to get into complex collateralized debt obligations, and slicing and dicing mortgage-backed securities to reach record profits. Those very instruments have led to record write-downs and one of the driving forces in the market downturn. But it is not all bad news for 2009.

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Once the dust settles, risk management and new regulations will rise to the forefront as key initiatives. Budgets for many firms will reflect diminishing profits, and spending priorities will shift, with IT budgets focusing heavily on risk management. Firms will pull back on many new technology initiatives as firms focus to stop the bleeding on their balance sheets. Oversight will increase, if President Barack Obama's appointment of Mary L. Schapiro as chairperson of the Securities and Exchange Commission (SEC) is any indication of the direction regulatory forces are moving.

There will be significant changes in clearing as the markets usher in new regulations. The U.S. federal government has pushed for central counterparty clearing solutions and mandates for a centralized clearinghouse for futures. Electronic trading will continue in full force through 2009, and Aite Group sees significant growth in this space and record-setting volumes exchanging hands electronically. The post-MiFID European market will continue to see drastic changes, and European market fragmentation will continue to grow as new entrants fight for market share. Usage of algorithmic trading will increase in complexity in developed markets and be adopted more readily in emerging ones. Firms will also become more reliant on ancillary data for trading decisions. Sophisticated execution management systems will increase globally to streamline workflow and automate trading. The increase in automated trading will facilitate capital flow and increase the overall quantity of transactions.

Amid unsure markets, the number of registered investment advisors (RIAs) will grow by leaps and bounds. Besides clients looking for advice, a large number of brokers will be going independent. There will be significant changes in retirements and

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the retail securities sector. Retail investors and retirees have seen their lifelong investments and retirement diminish to a fraction of what they were once valued. Consumers will be seeking knowledgeable advice, which means more business for knowledgeable advisors and an opportunity for growth.

The market is likely to continue its swings as more credit issues unfold. This along with personnel changes in government and business, and the increasing sensitivity to risks in trading, will impact every facet of capital markets. Regulatory bodies will consolidate and increase their scrutiny of balance sheets and investment decisions at capital markets firms, and vendors with cash flow problems will struggle with longer sales cycles, causing some consolidation and contraction. Layoffs on Wall Street could also lead to technical innovation as independent developers with domain expertise try their hand at startup opportunities.

Firms with heavy emphasis on asset management fees will also struggle as they look for ways to diversify their revenue. Obviously, retail consumers close to retirement are some of the biggest losers in 2009. Woe unto any firm caught taking advantage of consumers or firms lacking decent compliance tools for broker oversight and fraud detection. Mary L. Schapiro was not soft in this area at FINRA, and is less likely to be so at the SEC. There are some potential winners: First, custodians servicing RIAs stand to gain from increased interest in breakaway brokers. Pockets of technology will continue to see spending, including institutional middle-office and risk management groups. Outsourcing and SaaS have a much better opportunity to see action in 2009 as firms look at areas to cut cost. Maintaining plumbing with expensive IT resources is a good place to consider whether or not the vendor might be better at managing their own software through a hosted arrangement. The trading world will also become more information-oriented as institutional traders try to manage volatility in their positions, and retail investors look for advice from experts and each other.

The coming year will see substantial changes in business models, regulatory frameworks, access to global markets, and people considered leaders in the industry. While 2009 is likely to be intimidating for capital markets, it will certainly not be boring.

Based on the past year's industry achievements and failures, as well as feedback from vendors and financial institutions, Aite Group has written an Impact Note presenting the top 10 key industry trends to look out for in 2009. For more information on this and other research reports and consulting services from Aite Group, please contact sales@aitegroup.com, or visit www.aitegroup.com.