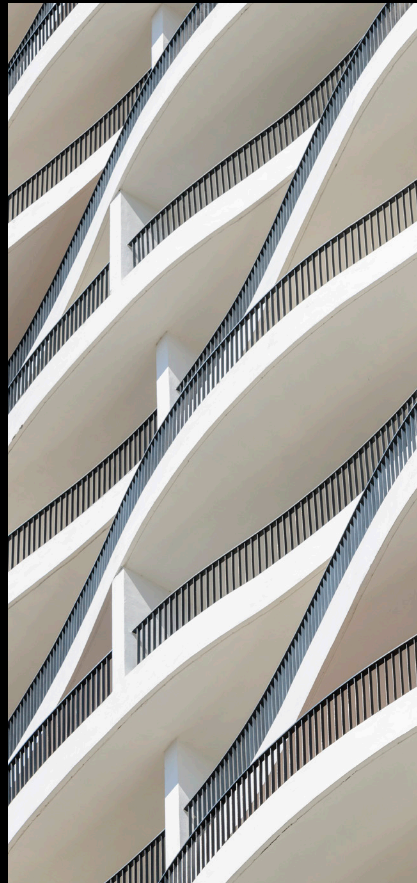
See the Big Picture

2024 Capital Markets Outlook: Issuance looks to rebound despite notably higher rates



A look ahead to the key strategic trends and opportunities expected to drive capital markets through 2024 and beyond.

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Table of contents

Investors largely waiting for clarity on rates 3

The Take 3

Debt issuance finds floor after tough 2022 4

Changes in investment grade financials bond maturity and coupon 4

Equity issuance remains depressed 5

Global IPO activity since Q3 2021 5

Higher rates, economic uncertainty and banking trepidation prompt investor caution 6

Real GDP 6

Looking into the crystal ball 7

Sector spotlight – Focus on issuance in the rate-sensitive utilities sector 8

Average US utility authorized ROEs; 30-year US Treasury bond yields 8

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Investors largely waiting for clarity on rates

Capital markets have stabilized in recent months after experiencing considerable turmoil during the liquidity crunch that US banks faced earlier this year.

Issuance activity has been relatively healthy in the debt markets, where credit spreads have tightened even as interest rates have increased notably over the last 18 months. Global equity issuance, however, has been far more depressed. While there are some signs of life from the downtrodden IPO market, investors remain hesitant to support many new equity issuances given concerns over economic stability.

Global economic growth has proven more resilient than first anticipated heading into 2023 in both advanced and emerging market economies. Banking sector upheaval in the US early this year has given way to relative stability and robust macroeconomic data, supporting the Federal Reserve's aggressive monetary policy tightening to curb inflation. But investors are still waiting to see how economies and markets digest a higher-for-longer interest rate environment and whether central banks, particularly the Fed, require further action to temper inflation before becoming more supportive of new deal activity.

The Take

Corporates maintained access to debt markets in 2023 despite significant interest rate increases and the US banking sector's liquidity crunch during the spring, but equity issuance has plummeted. Market volatility could ease and investor support for new transactions could grow as inflation declines and the Federal Reserve ends its rate-hike cycle, provided that economic conditions continue to hold up in a higher-for-longer interest rate environment.

Debt issuance finds floor after tough 2022

US equities have best demonstrated the calmer sentiment in the markets. The S&P 500 moved 2.5% or more in a single session 17 times through the first nine months of 2022, but that feat has not occurred once in 2023. Credit spreads have also tightened in 2023, with the average US high yield credit spreads closing 150 basis points tighter than the widest level recorded last year, which was 565 basis points on July 5, 2022.

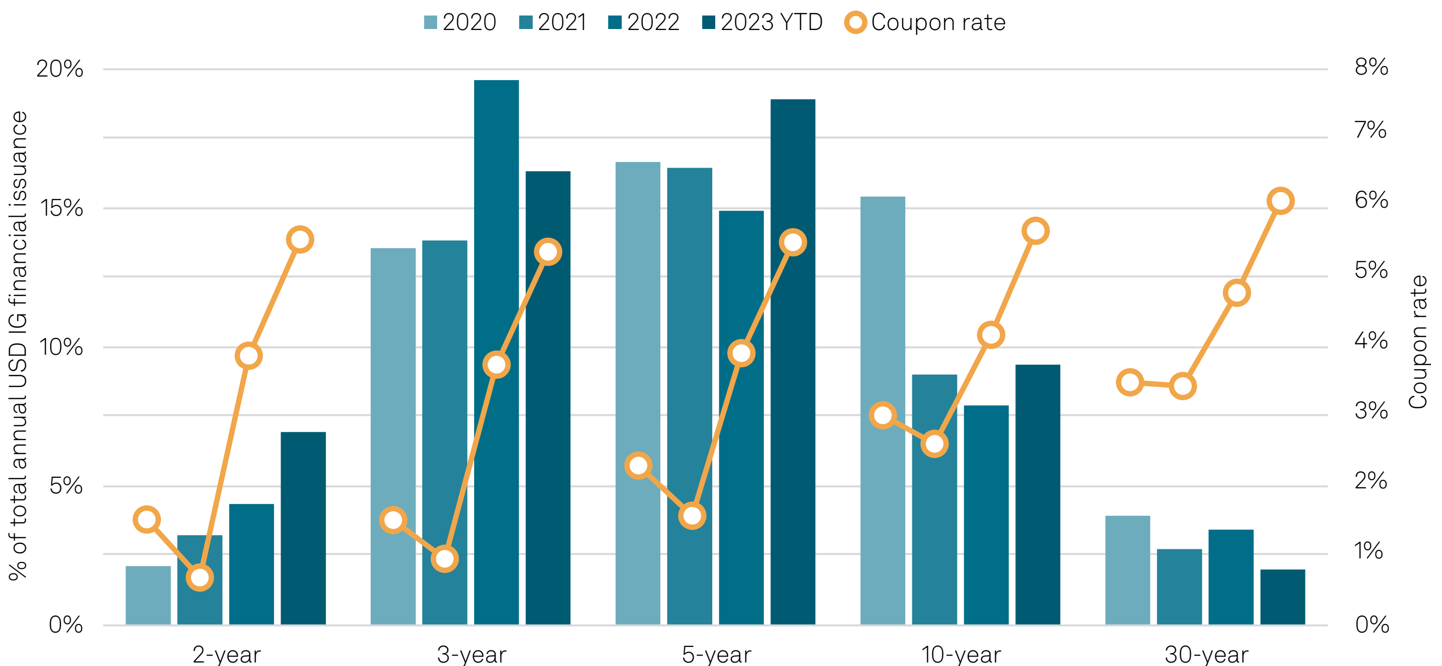
Markets have digested higher interest rates much better this year compared to the shock in 2022. Average yields on corporate bonds have risen just 63 basis points in the first nine months of 2023 for investment-grade debt and 23 bps in the high-yield market, compared to increases of 270 bps and 432 bps, respectively, in 2022.

Corporate bond issuance stabilized in 2023 after a massive drop off in 2022 following the surge fueled by ultra-low interest rates and the Fed's bond-buying program. Investment grade issuance is down just 1.5% year over year at $1 trillion through the first nine months of 2023, compared to the 15% drop in 2022 from 2021. In the high-yield market, issuance has climbed 45% year over year in 2023 through the end of September, a recovery from an 80% year-over-year drop in 2022.

The manufacturing sector has been the most active in investment grade and high yield bonds in 2023, with $114.6 billion and $31.5 billion in new debt issued in those respective markets. The investment grade oil and gas and mining sectors have recorded the largest year-over-year increases, soaring 263% to $5.4 billion and 218% to $30.8 billion, respectively. The investment grade retail sector declined the most, falling 47% to $25.5 billion, followed by the high-yield transportation sector, which dropped 28% to $7.0 billion.

Investment grade companies have also become increasingly reliant on 5-year bonds instead of longer-term debt, likely a reflection of the ongoing yield curve inversion between the 2-year and 10-year US Treasurys that began in July 2022. Issuance of 5-year bonds grew to 18.9% of total investment-grade issuance in 2023 from 14.9% a year earlier. By comparison, the share of 3-year debt issuance dropped to 16.3% in 2023 from 19.6% in 2022. The relative share of 10-year debt has also fallen from its recent peak of 15.4% in 2020 when rates were at historical lows. Since then, debt with a 10-year maturity has represented less than 10% of total investment grade debt issuance.

Changes in investment grade financials bond maturity and coupon



IG =Investment Grade
Data compiled Oct. 9, 2023.
Source: S&P Global Market Intelligence
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Equity issuance remains depressed

Global equity issuance has been under pressure since the Fed began raising interest rates in the first quarter of 2022. The aggregate amount of global equity issued has come in below $101 billion in each of the last seven quarters through the end of the third quarter of 2023. That is less than half of the more than $215 billion in global equity deals in each quarter of 2021.

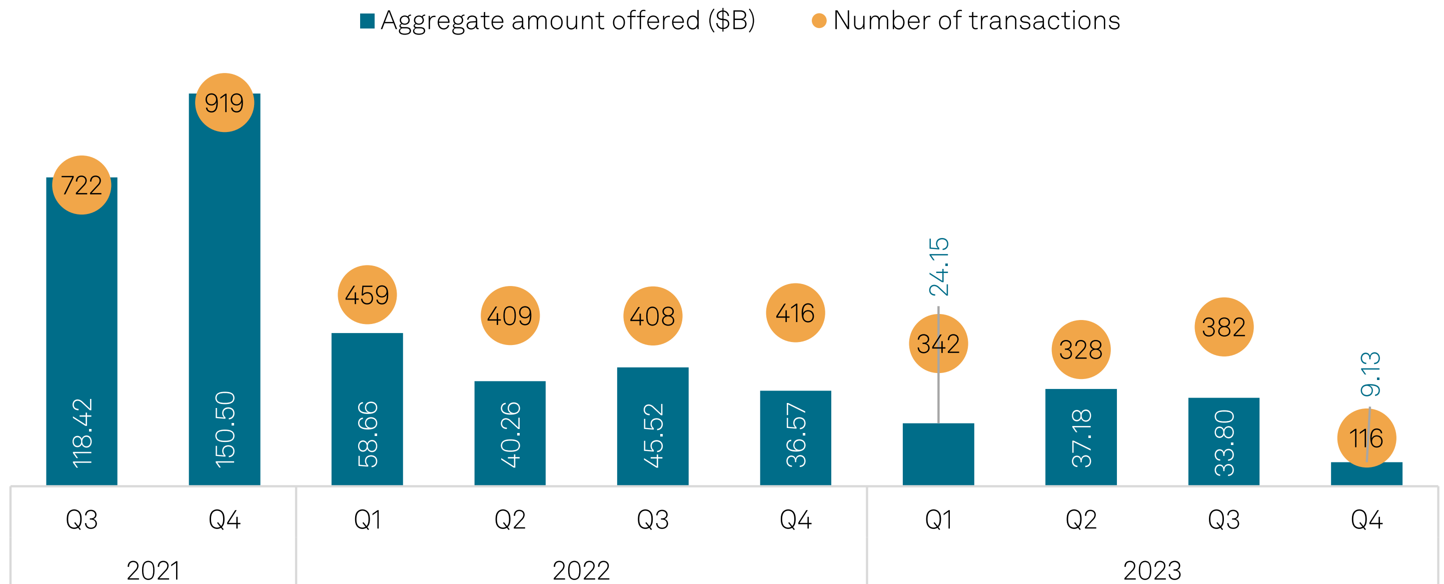
Equities took hits in 2022 in the face of swift rate increases and elevated inflation. Investors have remained risk adverse with turmoil in the banking sector, economic uncertainty and higher financing costs limiting returns.

The S&P 500 plunged by close to 25% through the first three quarters of 2022, and the total value of global equity deals dropped 65% when compared to the same period in 2021. Even though valuations recovered in 2023, with the S&P 500 rising nearly 12% in the first nine months of this year, the total value of global equity deals has fallen further, dropping 29% from the same period in 2022. The total value of deals in the third quarter alone dropped 35% from the prior quarter.

There are some signs of life in the IPO market. While the number of IPOs and the total value raised has fallen considerably through the first nine months of 2023, activity rebounded in the third quarter, which saw the first quarter-over-quarter increase since the fourth quarter of 2021.

The largest IPO of 2023 thus far came in the third quarter, with British chip designer ARM Holdings PLC completing a $5.23 billion offering in September. Consumer health company Kenvue's Inc. spinoff from Johnson & Johnson in the second quarter was the second-largest deal of the year, valued at $4.37 billion. Two China-based semiconductor companies also executed $1 billion-plus IPOs in the second quarter.

Global IPO activity since Q3 2021



Data compiled Nov. 1, 2023.
Analysis includes global initial public offerings completed between July 1, 2021, and Oct. 31, 2023.
Excludes private placements.
Aggregate amount offered includes overallotments.
Source: S&P Global Market Intelligence.

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Higher rates, economic uncertainty and banking trepidation prompt investor caution

The worst fears that erupted following the March liquidity crunch were not realized. While banks remain cautious about the near-term outlook, as indicated by higher provisioning and tighter lending standards, depositor confidence in the banking system has stabilized. Deposit outflows have persisted, however, due to higher yielding alternatives available in the Treasury and money markets.

Leading indicators in the rest of the world generally show a loss of momentum heading into 2024, with the deteriorating growth outlook for the eurozone and the faltering recovery in mainland China highlighting the effects of tighter financial conditions.

While higher interest rates have tightened financial conditions, the expected lending slowdown and increase in nonperforming loans have been both milder than anticipated so far in 2023 and taken longer to materialize. Recent trends point to more deterioration in 2024 as the lagged impact of higher interest rates and the quickly waning effect of COVID-19-related support measures weighs on debt servicing capacity.

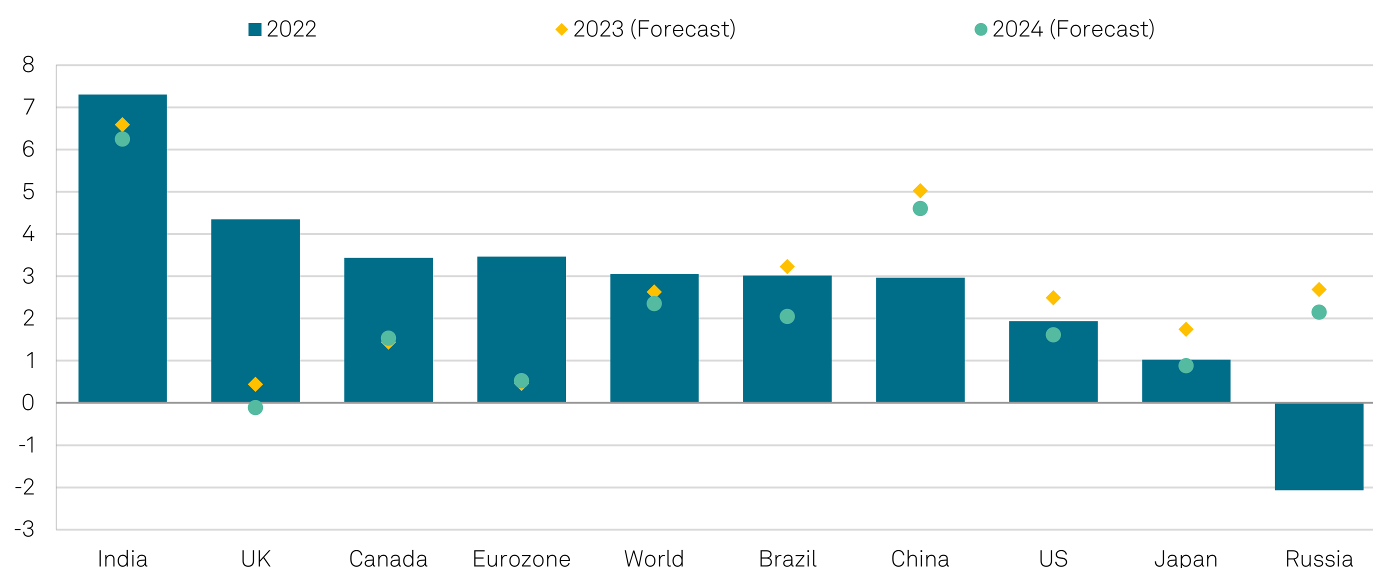
Credit quality has slipped across the globe this year, with most banking sectors reporting higher nonperforming loans than at the end of 2022. However, the increase has come off an incredibly low base and more than 70% of banking sectors continue to report stronger credit metrics than they witnessed before the pandemic.

Bankruptcy filings are up in the US and Europe, and credit growth has decelerated sharply in most banking sectors. This continued tightening in credit conditions will contribute to further bringing down inflation in 2024, albeit not as quickly as in 2023, facilitating a broader monetary policy pivot that has already begun in Latin America and Eastern Europe where monetary policy tightening started earlier than in advanced economies. Both inflation and inflation expectations have been largely controlled in those regions.

Overall, the outlook for 2024 remains patchy with weaker growth expected in most major economies, including the US. Even as central banks reach peak cyclical policy rates, most are maintaining biases toward tightening, and S&P Global Market Intelligence economists expect unemployment to edge up next year in the US and other advanced economies.

Sticky core inflation means that rate cuts in advanced economies remain some way off. The lagged effects of tighter financial conditions will continue to weigh on economic activity, leading to additional asset quality deterioration in most regions of the globe next year. Downside risks include inflation persistence, tighter-for-longer financial conditions, commercial real estate uncertainty in advanced economies, and sovereign debt vulnerabilities in emerging and frontier markets.

Real GDP (%annual change)



Data compiled Nov. 2, 2023.
Source: S&P Global Market Intelligence.
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Looking into the crystal ball

Resurgent IPO activity in the third quarter offered some hope for a rebound in capital markets activity, but continued increases in long-term rates resulting in a bear-steepening of the US yield curve have cemented that interest rates are likely to remain higher for longer. Bear steepening of the yield curve occurs when long-term rates rise more quickly than short-term rates and the phenomenon often precedes a recession. Increased capital costs could limit risk appetite. Rising geopolitical tensions in the Middle East following the Oct. 7 Hamas attacks on Israel and Israel's subsequent declaration of war could lead to more caution as well.

Seventy percent of investors surveyed in S&P Global's Investment Manager Index October 2023 Edition said their investment appetite would either increase or strongly increase if the federal funds rate stabilized. Recent comments by Fed officials suggest that moment is near. Fed Chair Jerome Powell on Oct. 19 said that while rates might not have been "high enough for long enough, "the labor market is gradually cooling by many measures and the recent run-up in rates on longer-dated US Treasurys represented tighter financial conditions.

The US economy, home to the largest capital markets in the world, remains on strong footing as evidenced by continued monthly job gains and the Atlanta Fed's GDP now, which forecasts nearly 5% growth in the third quarter. If economic growth persists in the face of uncertainty and the Fed can end its tightening cycle sooner than anticipated, investor sentiment should improve, leading to a resurgence in issuance activity.

Sector spotlight – Focus on issuance in the rate-sensitive utilities sector

Persistently high inflation and rapidly rising interest rates present unique hurdles for the capital-intensive, economically regulated US electric, gas and water utility sector.

The sector is in the midst of a prolonged period of aggressive capital spending aimed at addressing the impacts of increasingly severe weather events, funding programs to bolster infrastructure reliability, improving resiliency and safety, facilitating the deployment of new technologies and modernizing the grid to accommodate new resources.

Forecasts through 2025 point to more than $170 billion in annual spending for the 46 energy utility holding companies that Regulatory Research Associates, a group within S&P Global Commodity Insights, — follows, which would amount to nearly 3x the $60 billion spent in 2012.

Raising utility rates to sufficiently fund investments is rendered even more difficult by the heightened level of inflation and interest rates. These factors put upward pressure on rates and shrink customer and regulator tolerance for rate increases, which in turn pressures authorized returns on equity (ROEs), a key metric tracked by utility investors.

Rate case activity reached record-setting levels in 2021 and 2022, with more than 140 cases filed each year and utilities seeking rate increases aggregating to $14.8 billion in 2021 and $16.8 billion in 2022. With requested increases totaling more than $13 billion through June 30, full year 2023 is poised to exceed 2022.

Over the 40-plus years that RRA has tracked rate case activity, utility authorized ROEs have generally followed the overall direction of interest rate changes. While ROEs edged up in 2023, the spread between returns and Treasurys narrowed to less than 600 basis points.

This phenomenon is likely to continue through the rest of 2023 and into 2024, where authorized ROEs may rise in response to higher interest rates, but the spread between authorized ROEs and interest rates continues to narrow, as regulators work to mitigate the impacts on customer bills.

The last time the industry faced similar circumstances — high inflation, rising interest rates and aggressive utility capital spending programs — was during the 1980s generation construction boom. Planned capital spending in the 1980s was needed to accommodate anticipated rapid demand growth associated with an expanding economy. Such spending today is primarily related to upgrading existing infrastructure and transitioning from one resource type to another.

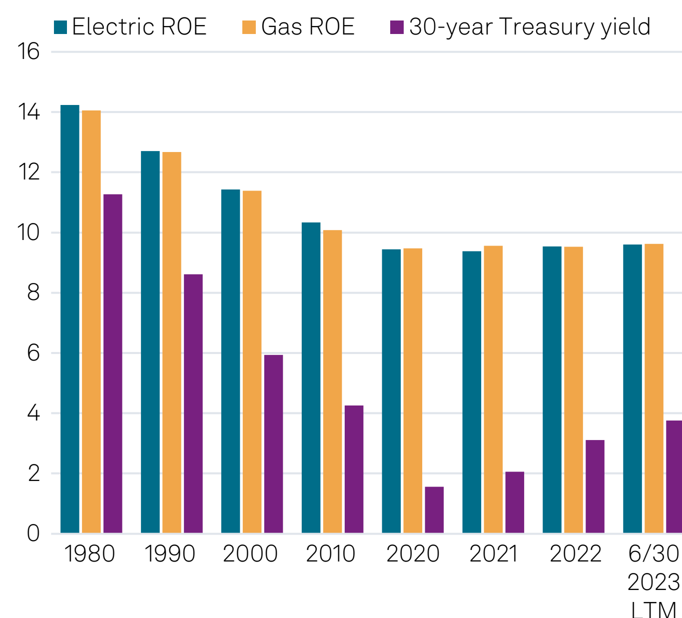
Against this backdrop, regulated utilities have been opportunistic in refinancing debt in 2023, taking advantage of windows of liquidity in the market to refinance and extend maturities on debt that would otherwise come due in the middle of the decade.

The appetite for utility debt has been robust among buyers of corporate bonds, as many other companies with similar low-volatility return profiles are staying out of the debt market in the hope that interest rates will decline before they refinance existing low-cost debt.

Higher long-term forecasts for electricity demand, combined with incentives available to defray capital costs in the US Inflation Reduction Act, have given utilities some headroom for borrowing in 2023 to finance project capital expenditure even if they do expect interest rates to weaken slightly into the coming year.

Average US utility authorized ROEs; 30-year US Treasury bond yields (%)

Select calendar years, 1980-2022,
LTM June 30, 2023



Data compiled July 26, 2023.
ROE=return on equity; LTM = last 12 months.
Source: Regulatory Research Associates, a group within S&P Global Commodity Insights.
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