

Exchanges

Live from FIA Boca 2023 Day 1: Regional banks, direct clearing, rates competition

Industry Overview

Takeaways from FIA Boca 2023 conference

Throughout this week, we are meeting with exchange executives, industry experts, and securities practitioners at the FIA Boca conference in Boca Raton, Florida. Among others, we have heard from the senior leadership of the CME Group, TMX Group, BGC Partners, Nasdaq, Intercontinental Exchange, London Stock Exchange, Singapore Exchange, Deutsche Boerse, and Euronext. In this note, we discuss our takeaways from Day 1.

Regional banking distress is a positive for CME: In the wake of the collapse of SVB and SBNY, CME Group (CME) set an all-time volume record, and these developments are likely also beneficial for interest rate hedging longer-term. Led by equity and interest rate futures, CME set an all-time record with 66M contracts traded on Mar 13. Although this record was driven by the temporary bouts of market volatility, we believe the events could also be modestly beneficial for rates derivative penetration. Today, many regional banks lack comprehensive hedging procedures. However, going forward, regional banks and their regulators will likely now be more vigilant about interest rate exposures and ensuring that the attendant risks are adequately managed. Nevertheless, we maintain our Underperform rating given the stock's premium valuation (23x our 23E earnings).

BGCP's rates futures exchange months away from launch: We expect BGC Partners' (BGCP) new rates futures exchange, Fenics Markets Xchange or FMX, to launch in a matter of months. The exchange challenges CME's monopoly on the trading of US rates futures. We believe it has a lot of the ingredients for success: (1) connectivity into all of the large dealers (via the existing Fenics platform), (2) dealer-owners who are incented to divert volumes, and (3) compelling cross-margining arrangements. However, we still expect it to face a steep uphill battle given CME's deep existing liquidity pool and the capital efficiencies that stem from its scale.

Rates macro set-up: With quantitative tightening, geopolitical uncertainty in Europe, persistent inflation, and a bank liquidity crunch, the lively macro backdrop should drive continued volume strength across rates products going forward. Longer term, we also expect a pickup in government deficit spending to grow the tradeable universe in rates, further supporting volumes. Additionally, the robust end market activity and strong dealer P&Ls may mitigate the risk of fee compression.

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Equity
United States
Exchanges

Craig Siegenthaler, CFA
Research Analyst
BofAS
+1 646 855 5004
craig.siegenthaler@bofa.com

Eli Abboud
Research Analyst
BofAS
+1 646 855 5791
eli.abboud@bofa.com

Mark McLaughlin, CFA
Research Analyst
BofAS
+1 646 855 4234
mark.mclaughlin@bofa.com

Maggie Cao
Research Analyst
BofAS
+1 646 855 5034
maggie.cao@bofa.com

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CFTC- Commodity Futures Trading
Commission

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Price objective basis & risk

CME Group Inc (CME;B-3-7;\$185.37)

Our primary valuation metric for US Exchanges is price to long-term earnings (2024E). We focus on long-term EPS because we prefer to normalize for any near-term factors, and it also provides credit for an additional two years of growth. We apply a 20x multiple on our 2024E EPS to derive our \$160 PO. Our multiple is based on the conservative assumption that CME trades in line with its peer group despite its lower growth prospects/earnings quality.

Downside risks are (1) depressed volumes, (2) lower earnings quality due to high transactional revenue composition, (3) mature markets and high market share stifling further growth, (4) trading at a premium to higher growth peers, (5) secular transition away from oil/fossil fuels where CME has high share and (6) regulatory risks (transaction tax, capital requirements).

Upside risks are (1) improving/elevated interest rate volumes due to quantitative tightening/inflation, (2) rebound in energy/metals volumes should there be a resolution in supply chain issues and the Russia/Ukraine conflict, (3) defensive qualities which drive stock outperformance in equity market drawdowns (e.g., 1Q22), and (4) potential for share gains in select markets: base metals after the LME debacle and cash after the DTCC cross-margining proposal is approved (estimated in 1Q23 versus 3Q22 prior target).

Analyst Certification

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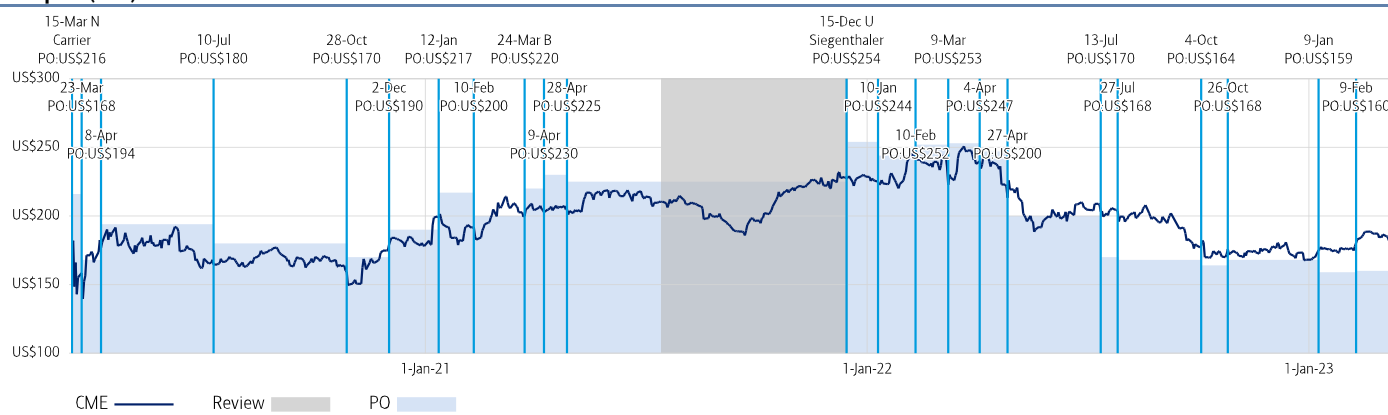
US - Brokers, Asset Managers, & Exchanges Coverage Cluster

Investment rating	Company	BofA Ticker	Bloomberg symbol	Analyst
BUY				
	Ameriprise Financial	AMP	AMP US	Craig Siegenthaler, CFA
	Ares Management Corp	ARES	ARES US	Craig Siegenthaler, CFA
	BlackRock, Inc.	BLK	BLK US	Craig Siegenthaler, CFA
	Blackstone	BX	BX US	Craig Siegenthaler, CFA
	Blue Owl Capital	OWL	OWL US	Craig Siegenthaler, CFA
	Interactive Brokers	IBKR	IBKR US	Craig Siegenthaler, CFA
	Intercontinental Exchange	ICE	ICE US	Craig Siegenthaler, CFA
	KKR & Co. Inc.	KKR	KKR US	Craig Siegenthaler, CFA
	TPG Inc	TPG	TPG US	Craig Siegenthaler, CFA
	Tradeweb Markets Inc.	TW	TW US	Craig Siegenthaler, CFA
	Victory Capital Holdings, Inc.	VCTR	VCTR US	Craig Siegenthaler, CFA
NEUTRAL				
	Affiliated Managers Group	AMG	AMG US	Craig Siegenthaler, CFA
	AllianceBernstein	AB	AB US	Craig Siegenthaler, CFA
	Apollo Global Management	APO	APO US	Craig Siegenthaler, CFA
	Invesco	IVZ	IVZ US	Craig Siegenthaler, CFA
	Janus Henderson Group	JHG	JHG US	Craig Siegenthaler, CFA
	Janus Henderson Group	JUHDY	JHG AU	Craig Siegenthaler, CFA
	LPL Financial Holdings	LPLA	LPLA US	Craig Siegenthaler, CFA
	Patria	PAX	PAX US	Craig Siegenthaler, CFA
UNDERPERFORM				
	Charles Schwab Corp.	SCHW	SCHW US	Craig Siegenthaler, CFA
	CME Group Inc	CME	CME US	Craig Siegenthaler, CFA
	Franklin Resources	BEN	BEN US	Craig Siegenthaler, CFA
	Nasdaq	NDAQ	NDAQ US	Craig Siegenthaler, CFA
	Robinhood Markets	HOOD	HOOD US	Craig Siegenthaler, CFA
	T. Rowe Price	TROW	TROW US	Craig Siegenthaler, CFA
	The Carlyle Group	CG	CG US	Craig Siegenthaler, CFA
RSTR				
	Focus Financial Partners	FOCS	FOCS US	Craig Siegenthaler, CFA

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CME Group Inc (CME) Price Chart



B: Buy, N: Neutral, U: Underperform, PO: Price Objective, NA: No longer valid, NR: No Rating

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Equity Investment Rating Distribution: Financial Services Group (as of 31 Dec 2022)

Coverage Universe	Count	Percent	Inv. Banking Relationships ^{R1}	Count	Percent
Buy	151	53.36%	Buy	100	66.23%
Hold	71	25.09%	Hold	43	60.56%
Sell	61	21.55%	Sell	42	68.85%

Equity Investment Rating Distribution: Global Group (as of 31 Dec 2022)

Coverage Universe	Count	Percent	Inv. Banking Relationships ^{R1}	Count	Percent
Buy	1853	52.58%	Buy	1040	56.13%
Hold	840	23.84%	Hold	493	58.69%
Sell	831	23.58%	Sell	404	48.62%

^{R1} Issuers that were investment banking clients of BofA Securities or one of its affiliates within the past 12 months. For purposes of this Investment Rating Distribution, the coverage universe includes only stocks. A stock rated Neutral is included as a Hold, and a stock rated Underperform is included as a Sell.

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Investment rating	Total return expectation (within 12-month period of date of initial rating)	Ratings dispersion guidelines for coverage cluster ^{R2}
Buy	≥ 10%	≤ 70%
Neutral	≥ 0%	≤ 30%
Underperform	N/A	≥ 20%

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