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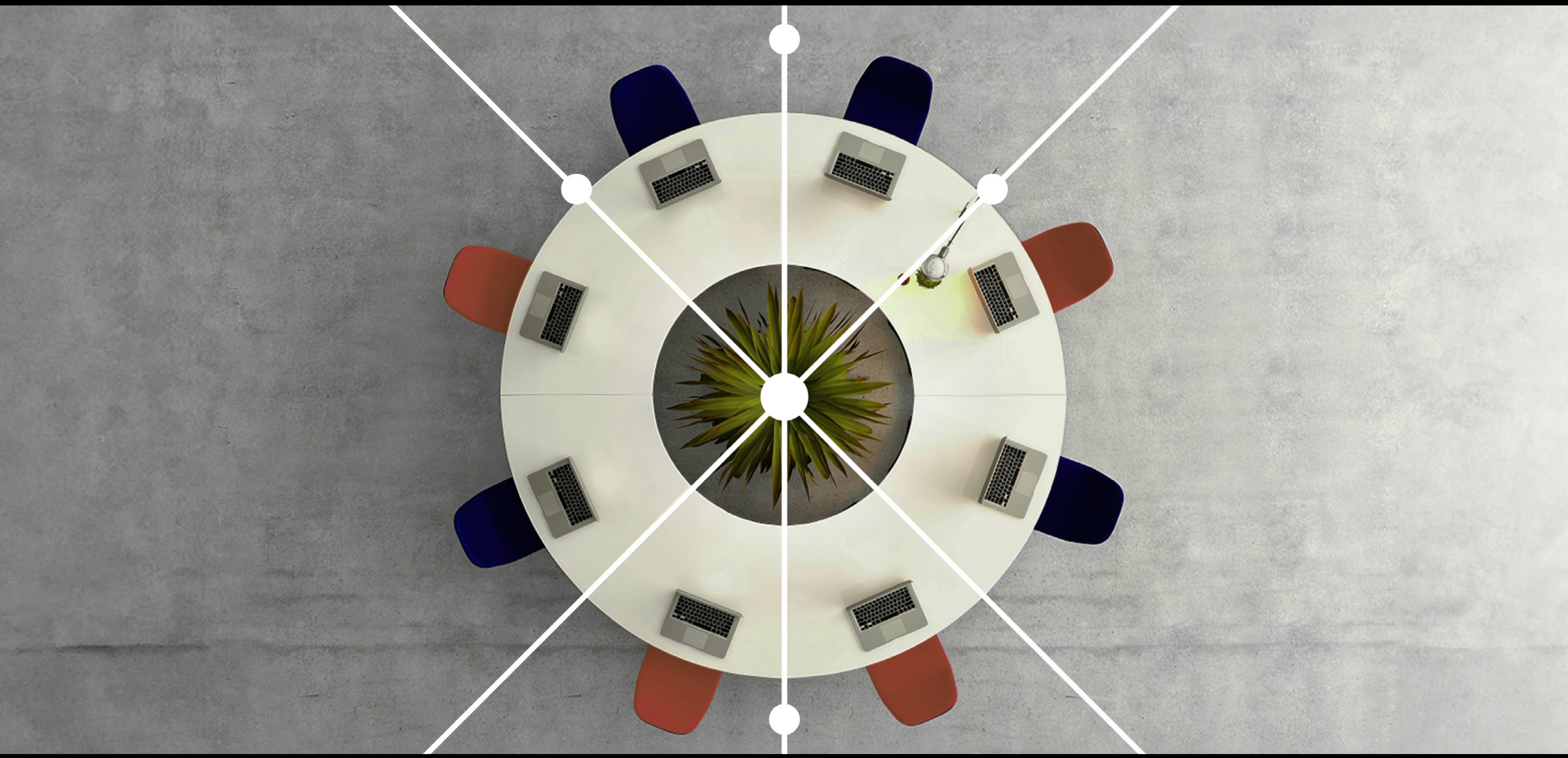

Capital Markets: Issuance rebound hinges on pace of rate cuts

See the Big Picture: Themes Shaping 2025

A look ahead to the trends and opportunities expected to drive the capital markets narrative through 2025 and beyond.

Seek & Prosper™

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Investors hope for growth as Fed easing kicks off

Capital markets issuance has begun to recover in 2024, and the start of looser monetary policy has sparked optimism for a further increase in activity in 2025.

Issuance has surged across debt capital markets, where investor appetite for US bonds has boomed and demand for riskier emerging market securities has been robust despite rates staying higher for most of 2024. Equity issuance has improved but remains modest in the US and Europe reflecting tight monetary policy and the lingering effects of earlier uncertainty and volatility surrounding elections. President-elect Donald Trump's recent victory has boosted equity markets and quelled some of that volatility.

Meanwhile, India's IPO market has been particularly strong, more than doubling its 2023 volume so far this year, and IPO issuance in Japanese and Middle Eastern markets has been sizable.

The pace of capital markets' recovery is tied to central bank rate reductions. Trajectories of stocks, bond yields and the US dollar largely depend on how quickly and by how much monetary policy is eased. Investors consider rate cuts a key driver for equity capital market returns while worries about global economic growth persist.

The Take

Corporate debt issuance bounced back at full speed in 2024 as investors looked to lock in prevailing rates at or near the top of the cycle. Equity issuance recovered more gradually as higher-for-longer rates and the election supercycle led to some offerings being pushed back to 2025. Stronger macro fundamentals and central bank rate cuts would help unlock pent-up IPO pipelines and boost capital markets activity in 2025.

Debt issuance surges on healthy investor demand

Persistent strength in the US labor market, coinciding with cooling inflation, created growing investor demand for bonds in 2024. This opened the doors for a surge in US corporate bond issuance, which climbed to $1.56 trillion in the first three quarters of the year versus $1.16 trillion in the same period of 2023. Issuance of US investment-grade bonds broke records in January, when monthly volumes hit $195 billion, and in September, when they hit $170 billion.

Improved credit sentiment from strong economic tailwinds helped offset the impact of 10-year US government bond yields. Yields temporarily turned lower on the brief volatility spike in early August, which set the stage for the Fed's 50-basis-point rate cut in September. Those yields then tightened again quickly after the rate cut, increasing 79 basis points from the lowest point of the year Sept. 16 to close at 4.42% the day after the US elections. The jump was driven by a higher-than-expected September US non-farm payroll report coupled with heightened expectations of fiscal and trade policies that could exacerbate long-term inflation.

US investment-grade cash credit spreads tightened by 17 basis points and high-yield spreads improved by 62 basis points year to date through Nov. 6. Heightened expectations of lower rates shifted more capital into the fixed-income markets through the end of the third quarter.

In 2024, corporates issued longer maturity debt, on average, compared to the prior year across all rating categories while also benefiting from lower average coupons, despite the longer terms, S&P Global Market Intelligence data shows. The lower borrowing costs were most pronounced at the high-yield end of the credit curve, with an increase of more than 70% in US high-yield issuance this year to $260 billion through the third quarter readily absorbed by the market.

Investor demand for riskier debt has proven resilient, with net portfolio inflows to emerging market securities. Traditionally, investment in riskier fixed-income assets is stronger when interest rates are cyclically low as investors accept greater risk to obtain acceptable returns.

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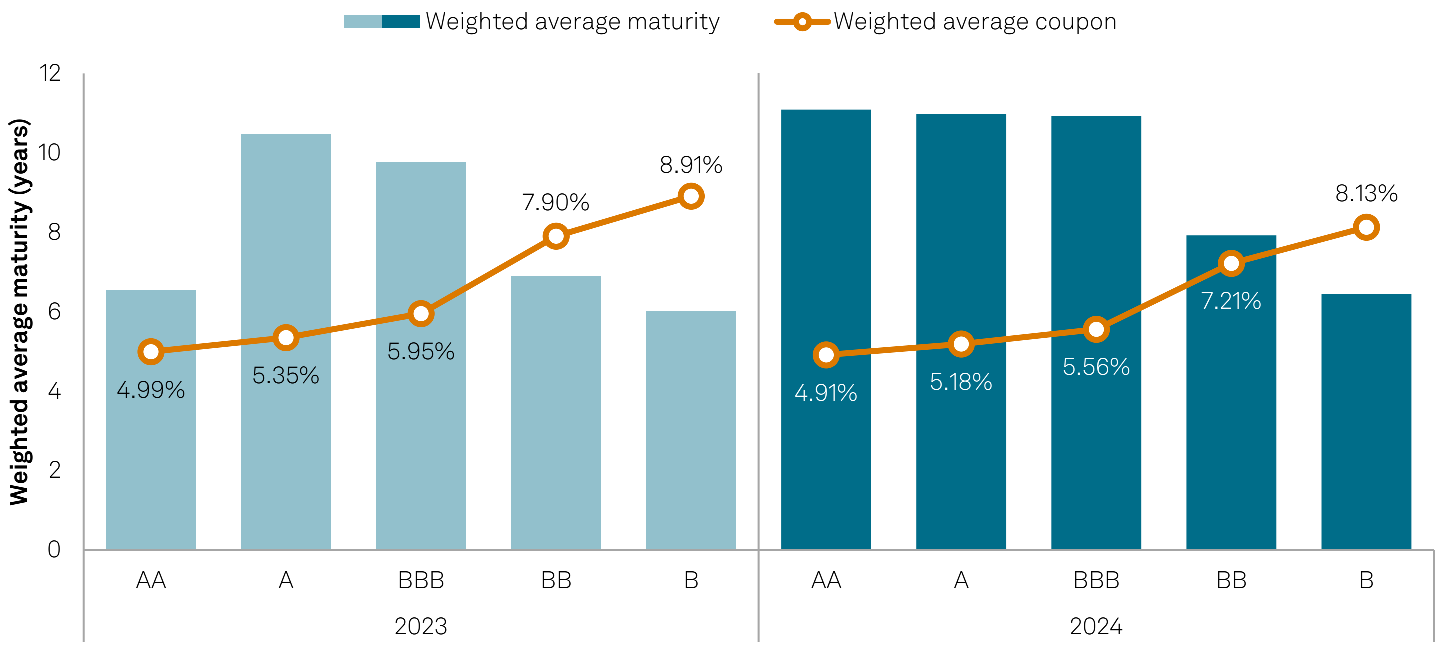
Hybrid debt is still widely sought after, proving that Credit Suisse's March 2023 default on $17 billion of Additional Tier 1 notes did not cause lasting damage. In the first week of September, six European banks raised a record €7 billion-plus of perpetual debt.

US corporate bond weighted average maturity and coupon issuance



Data as of Nov. 8, 2024.
Source: S&P Global Market Intelligence.

Stocks rise as IPO activity stumbles

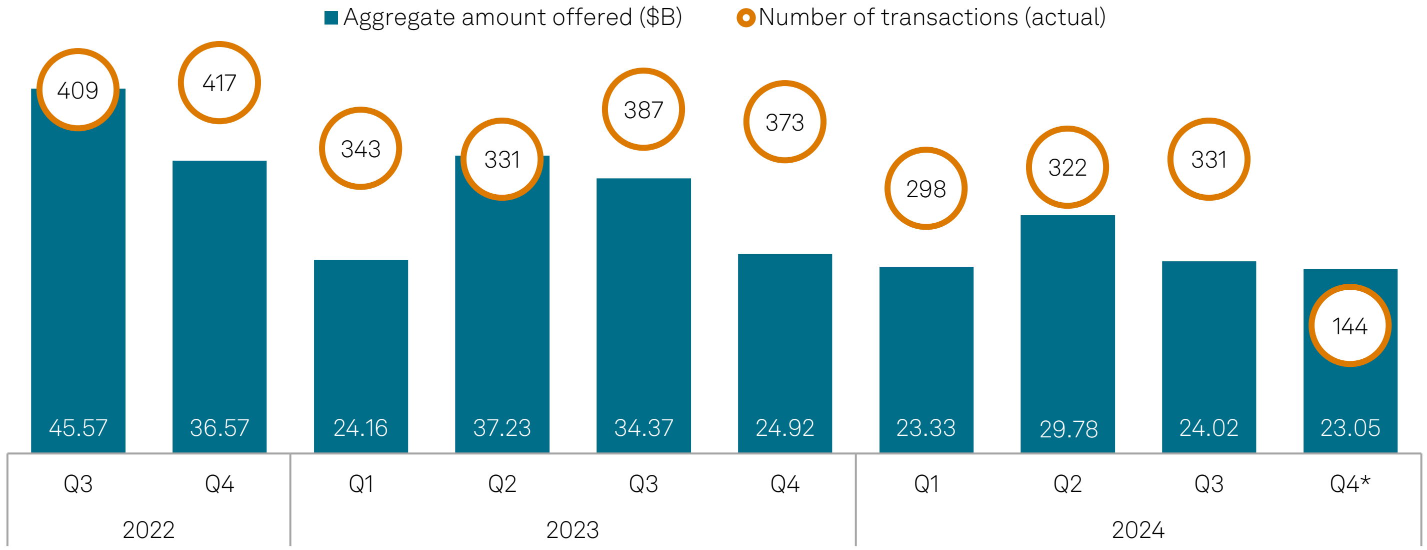
The S&P 500 closed at new highs 43 times during the first nine months of 2024. In the same period, global equity issuance totaled $241.98 billion, or roughly 5% more than in the first three quarters of 2023, Market Intelligence data shows. The US accounted for 771, or 28%, of the 2,746 equity issuance transactions recorded globally between January and September 2024.

Global IPO activity has seemingly stalled, with just 951 transactions through the first three quarters of 2024. That is 110 fewer offerings than in the same period of 2023 and 330 fewer than in the first nine months of 2022. The amount offered in IPOs through the first three quarters of 2024 fell to $77.14 billion from $95.76 billion over the same time span in 2023 and $144.72 billion in the 2022 period.

The IPO market slowdown extended in 2024 for a variety of reasons including still-high interest rates, episodes of market volatility, a fall-off in debuts of new special purpose acquisition companies, and geopolitical uncertainties surrounding a year of global elections.

The US has been a bright spot for IPOs this year with 96 transactions and $26.28 billion offered through the first three quarters of 2024, compared to 75 transactions with $13.73 billion offered in the prior-year period. This is still well behind the recent peak in US activity when there were 234 transactions and an aggregate $66.69 billion offered in the fourth quarter of 2021 alone.

Global IPO activity since Q3 2022



Data compiled Nov. 5, 2024.
* Quarter to date through Oct. 31, 2024.
Analysis includes global initial public offerings completed between July 1, 2022, and Oct. 31, 2024.
Excludes private placements.
Aggregate amount offered includes overallotments.
Source: S&P Global Market Intelligence.

Fed embarks on long-awaited rate cuts

Two-and-a-half years after launching one of the most aggressive interest rate hiking cycles in its history, the Federal Reserve reduced interest rates in September and November, beginning the process of easing US monetary policy.

How much Fed officials will ultimately cut and how long it may take have become the biggest open questions for financial markets, with the direction of the stock market, bond yields and the US dollar all tied to the future path of rates.

Based on the latest economic data, Fed officials have little motive to cut rates with urgency. Inflation is steadily dipping to within striking distance of the central bank's goal of 2%, the labor market appears to show no signs of cooling, real gross domestic product continues to grow annually, and equities are rising to all-time highs even as federal funds rates remain elevated. Consumers have also adjusted to relatively high rates, with sentiment and spending holding steady despite frequent recession projections.

Against this background, the ongoing easing cycle seems likely to happen in dribs and drabs, with smaller, 25-basis-point cuts. The Fed could opt against any reductions at all at some future meetings.

While the hiking cycle was initially aimed at cooling inflation growth to 2%, that battle is expected to be over early next year, if not before the end of 2024. As the Fed shifts to easing, its focus has turned from rising prices to weakness in the labor market. Fed Chairman Jerome Powell has indicated cuts will likely accelerate if unemployment begins to surge and the jobs picture starts to wobble.

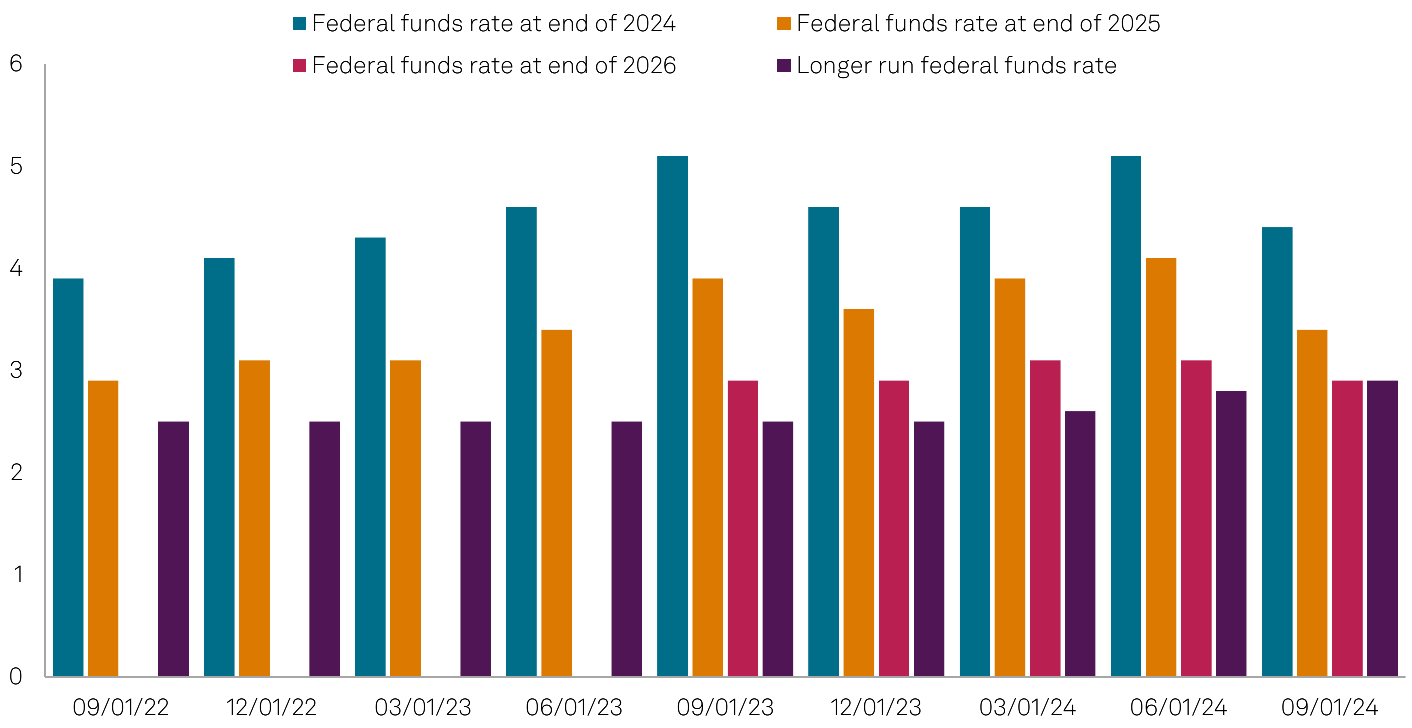
So far, there have been few signs of any weakness. The unemployment rate has averaged just 4% through the first nine months of this year. There were 1.8 million jobs added through the first nine months of 2024, an average of 200,000 per month.

The US has not seen monthly job losses since December 2020. Nearly 16.6 million jobs have been added since that time.

Fed Chairman Jerome Powell has indicated cuts will likely accelerate if unemployment begins to surge and the jobs picture starts to wobble.

Labor market resilience may compel Fed officials to pare back their expectations for rate cuts. In the latest quarterly Fed summary of economic projections, released in September, the median view among Fed officials was for the federal funds rate to be at 4.4% at the end of 2024 and 3.4% at the end of 2025. Back in June, Fed officials projected 5.1% at the end of 2024 and 4.1% at the end of 2025. Nearly all of the futures market is now betting that the funds rate will be below 4.0% by the end of next year.

Fed officials' interest rate projections have lowered (%)



Data accessed Oct. 9, 2024.
Forecast represents the median views of participants in the Federal Open Market Committee.
Fed began 2026 forecast in September 2023.
Source: Federal Reserve Summary of Economic Projections.

What is on the horizon?

Despite stocks surging to record highs through much of the first three quarters of 2024, global equity issuance and IPO activity has begun to lag last year's pace, a sign of a potential slowdown into 2025. Yet investor sentiment improved markedly following the US presidential election, with risk appetite and expectations for higher equity market returns reaching their highest levels in three years.

This shift is largely based on rising optimism about US economic growth and its positive impact on stock markets.

Investors surveyed in S&P Global's Investment Manager Index November 2024 Edition identified the US macroeconomic environment as the second-biggest driver of equity returns, expecting the world's largest economy to get a boost from pro-growth policies under the new Trump administration. This marks a notable change in sentiment from the three months before the election when US economic growth was considered a drag on equities.

Rate cuts were named as the biggest driver of stock market returns for the fourth consecutive month, with the share of investors more optimistic about the positive impact of central bank policy remaining elevated at 45%, after peaking at 58% in October.

The outcome of the US election has also reduced investor concerns about the political environment, with the perceived drag on equities related to that dropping to the lowest level since June 2021, the survey showed.

Trump's proposed policy agenda with new import tariffs and tax cuts could stoke inflation and increase the US deficit, which could potentially impact Treasury yields. The yield on the 10-year US Treasury bond, which has been on the rise since mid-September, spiked in the days after the election. Market observers note, however, that the actual policy agenda may differ from campaign promises.

The US economy has held up well during the first three quarters of 2024 and investors' outlook has brightened further since the Nov. 5 election. If the Fed cuts rates at a good pace and economic conditions stay solid in 2025, issuance, especially across equity markets, should accelerate.

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Sector spotlight

AI boom drives debt issuance, fuels equity investor angst over potential bubble

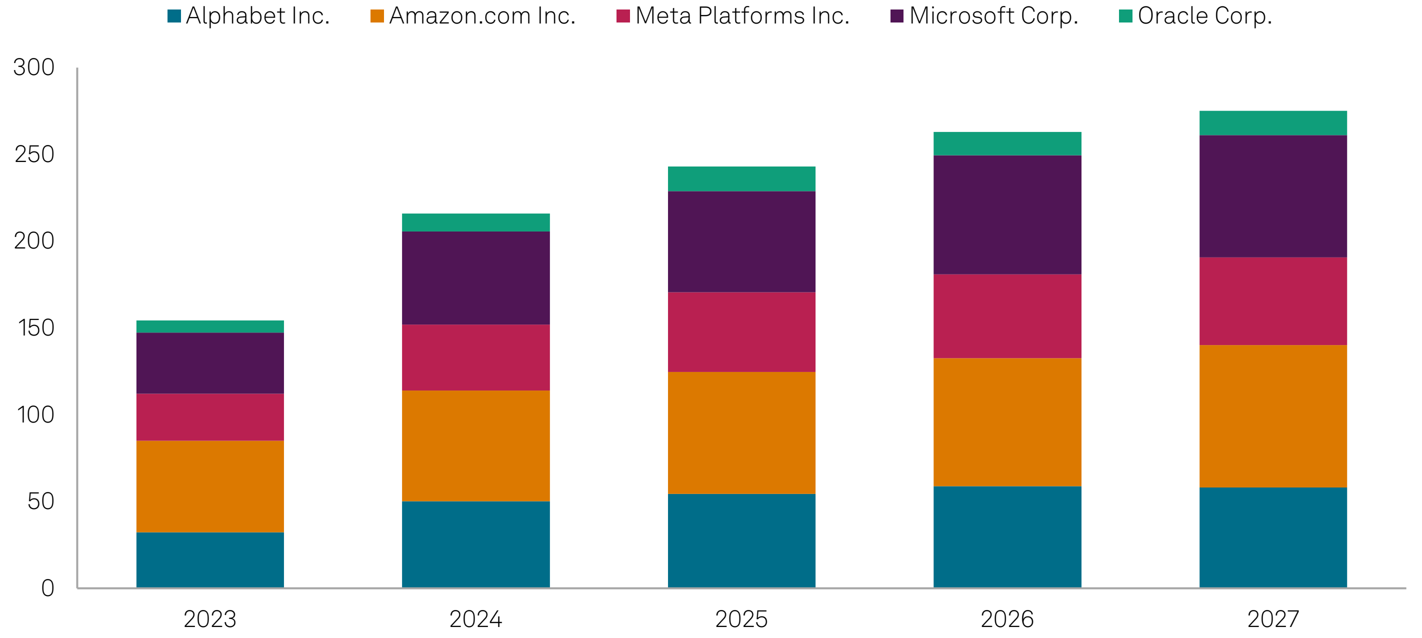
The rise of generative AI has begun a capital expenditure cycle reminiscent of the internet boom in the 2000s, driven by the five hyperscalers — Microsoft, Meta Platforms, Amazon, Alphabet and Oracle — which are projected to allocate nearly $1.0 trillion in capex between 2024 and 2027, Market Intelligence data shows. While a portion of this funding will derive from hyperscalers' robust cash flows, a growing reliance on capital markets is anticipated to support these investments.

The AI ecosystem, including AI chips, cloud services and GenAI applications, is expected to raise about $200 billion in debt this year, a notable increase from 2023. Rate cuts may further catalyze AI-related debt issuance in the US.

Meta Platforms raised more than $10 billion in debt in 2024 through the issuance of its largest-ever bond sale — and the biggest in the AI ecosystem this year — to boost investments in AI-related initiatives. Coreweave, a privately held AI cloud infrastructure provider, secured $7.5 billion in debt to expand its capabilities amid booming demand. And Super Micro Computer is leveraging both debt and equity to finance its acquisition of Nvidia GPU chips that it uses to build servers for its customers.

A key aspect to watch in 2025 and beyond is the return on investment of these AI capex initiatives. For now, return on investment is taking a back seat.

Big Tech's capex projected to surge ($B)



Data compiled Sept. 18, 2024.
Data for 2023 is reported, while 2024 and later are estimates.
Source: S&P Global Market Intelligence.

Meanwhile, equity investor sentiment has turned more bearish toward technology stocks. Short interest has surged, and inflows have declined across major tech exchange-traded funds (ETFs) since early September. Fears of a potential economic slowdown or recession are driving investors to pull back from sectors perceived to have higher operational costs.

The Direxion Daily Technology Bear 3X Shares (TECS), an ETF designed for traders with bearish outlooks, experienced a dramatic increase in short interest in early September with percentage of market capitalization on loan skyrocketing from 3.4% to 13.9% between Sept. 2 and Sept. 9. Short interest in this stock remained volatile throughout October before increasing once again to just under 14% toward the end of the month.

Net inflows in the Invesco QQQ Trust, which tracks the Nasdaq 100 Index, dropped to $7.5 billion in the second quarter of 2024 from $9.6 billion in the first quarter, while inflows in the VanEck Vectors Semiconductor ETF plummeted to $891 million from $3.07 billion in the same period.

Profit-taking amid concerns of overvaluation is another factor driving the decline in inflows. Following significant rallies in tech stocks, particularly those related to AI and cloud computing, traders are locking in gains, leading to increased short positions as they anticipate a market correction.

The rise of artificial intelligence has led to extreme valuations for AI-related companies, raising concerns of a speculative bubble. While the long-term potential of AI is acknowledged, many investors are adopting a cautious stance, further reflected in the increased short interest in tech stocks with significant AI exposure.

Exposure to the AI and technology, media and telecommunications (TMT) sectors could still pay off for investors. The US equity market has seen its highest dividend initiation momentum in years, led primarily by large-cap TMT companies. Meta's first ever dividend, announced in early 2024, to confirm the success of its long-dated AI bets, and prompted Alphabet, its closest competitor, to follow suit.

Notably, this return to dividends occurs in an AI-driven, higher-capex environment. S&P 500 TMT companies' capex is expected to rise 23.5% in 2025 from the previous 12 months.

TMT dividends are not risk-free as considerable investments are required to stay competitive. Intel, historically a dividend-paying company, recently suspended payouts to preserve cash to fund capex needs and catch up to rivals.

In 2025, dividends at large-cap TMT companies are expected to grow as investor interest in dividend stocks continues to rise on the back of expected rate cuts.

Global dividends 2025 outlook

After a year of solid bank dividends growth and a rise in dividend initiations, global regular dividends are projected to grow 5.6% year over year to $2.34 trillion in 2025[1] from an estimated $2.2 trillion in 2024, according to data from S&P Global Market Intelligence Dividend Forecasting. Dividend payments from the banking, energy and automotive sectors are forecast to slow, but this will be offset by stronger payouts from the semiconductor and software sectors.

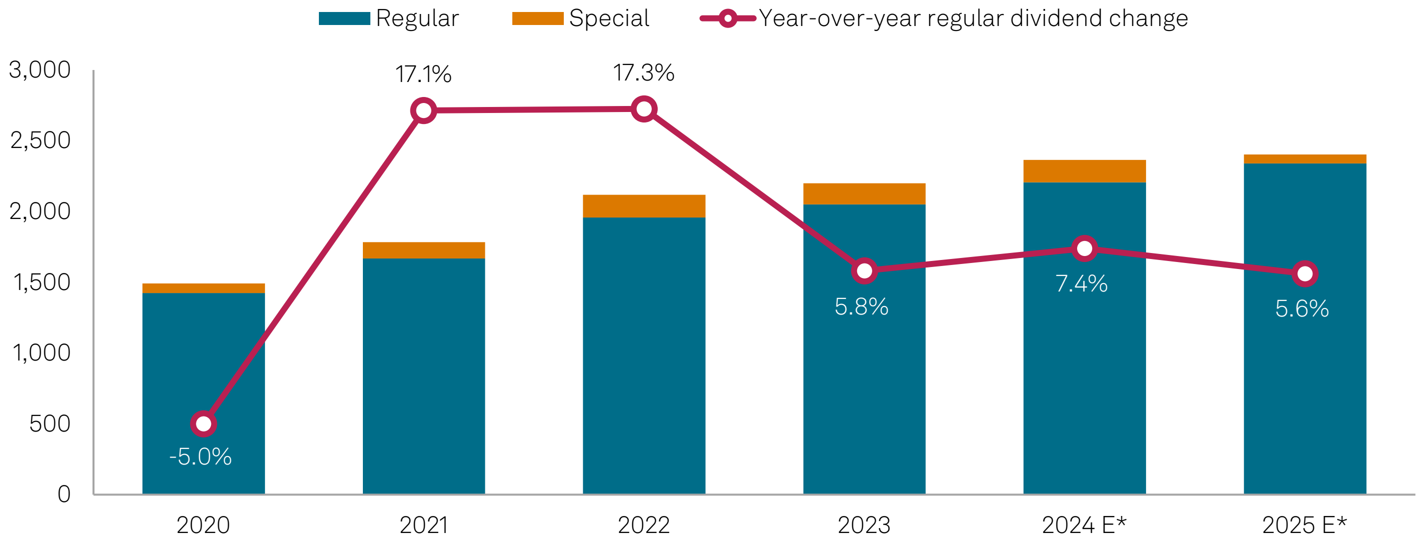
North America is the largest market, with a share of 38% of global dividends. Within the region, we expect US dividends to grow 7.1% in 2025 from 2024. Banks, energy, financial services and pharmaceuticals are leading the way with payouts, but media and entertainment distributions rose to $20 billion in 2024 from $8 billion in 2023, followed by software and services. These two sectors are expected to see the fastest year-over-year dividend growth in 2025, with 21% for media and entertainment and 10% for software and services.

Dividends for the healthcare equipment and services industry are projected to grow 9.0% in 2025.

European dividends are expected to rise 6.1% to $513 billion in 2024, driven by the banking and insurance sectors. Growth is expected to slow in 2025 with dividends projected to be 3.1% above the 2024 level, reaching $529 billion.

The ongoing struggle in the automotive sector is expected to reduce payouts. That trend will be partially offset by higher distributions in the pharma sector, where Novo Nordisk stands out with a 41% expected increase in 2024 dividends due to strong revenue growth from popular weight-loss drugs such as Ozempic and Wegovy. The outlook for the banking sector is mixed with Deutsche Bank, BBVA, Banco de Sabadell and Banca Monte dei Paschi di Siena expected to increase payouts, while CaixaBank and ING Groep are seen cutting dividends.

Global aggregated dividends (US$B)



Data compiled Sept. 24, 2024.
E = estimate.
Global aggregated dividends account for the dividends covered by S&P Global analysts.
Source: S&P Global Market Intelligence.

Dividends of developed markets in Asia-Pacific[2] are expected to amount to $371.1 billion in 2024, 7.0% higher than a year ago. An easing supply chain, pent-up demand and the transition to electric vehicles drove growth of 28.6% year over year in automotive payouts. Steady growth of 6.3% year over year to $394.3 billion is forecast for Asia-Pacific in 2025, mainly led by the automotive and capital goods sectors[3]. In developing Asia-Pacific[4], robust payments from banking and semiconductor companies are expected to boost the region's dividends to $342.1 billion in 2025, 8.0% above the prior-year level. The estimated year-over-year growth rate for the region in 2024 is 8.7%.

[1] Regular dividends (i.e. excluding specials) considered only onward (unless specified otherwise).
[2] Australia, Japan, Hong Kong special administrative region, New Zealand, South Korea and Singapore.
[3] Specifically, companies including Toyota Motors, Hyundai Motors, China Mobile, Sumitomo Mitsui Financial and Mitsubishi UFJ Financial as well as Aerospace & Defense payer Singapore Technologies are anticipated to be key contributors.
[4] Mainland China, Taiwan, India, Indonesia, Thailand, Malaysia, the Philippines and Pakistan.

Further reading

Fed set for cut with jobs cooling, inflation sticking, bond market guessing

Fed's pivot to lower rates could spur more bond restructuring

Equity issuance proceeds increase in Q3; IPO performance ticks up

Securities finance 2024 Q3 review

GenAI funding on track to set new record in 2024

2024 dividend trends

Navigating european dividends: Trends, risks, and opportunities

Dividend initiation fever – S&P 500 nonpayers

Dividend initiation fever – S&P 500 dividend holdouts

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