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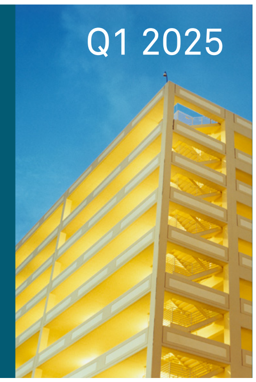
Top market structure trends to watch in 2025



2025 will be shaped by the increased importance of workflow automation and AI, unpredictable U.S. regulations, the growing influence of ETFs, and TradFi's renewed love of DeFi

The year ahead is arguably the most unpredictable since the start of the pandemic. Geopolitics are complicated. U.S. regulatory policy is uncertain. And although it seems like U.S. equity markets can't stop going up and interest rates have nowhere to go but down, we know neither is a sure thing.

Thankfully, a few trends remain omnipresent. The electronification of trading. The focus on workflow automation. Increasingly transparent markets. And of course, artifical intelligence and machine learning (AI/ML). While we didn't explicitly include it in our list, AI/ML's influence will be felt in nearly all of the trends we'll be watching in 2025. It is and will continue to be a huge catalyst for innovation in financial markets in the years ahead. With that in mind, here's what our team will be watching in 2025:

1 The influence of the ETF market gets even bigger

ETFs have become the market's smart phone—they can do almost anything. More equity and corporate bond investments moving into ETFs from mutual funds each year is a given. And institutional use of those same ETFs as cash management/liquidity/hedging tools is also par for the course.

But asset managers and owners have now discovered that ETFs are an incredible distribution tool for almost everything: private credit, Bitcoin, Ether, CLOs, money markets, munis, U.S. Treasury bills—the list keeps getting longer. There is certainly some spaghetti-flinging going on, and a few solutions are in search of a problem. But if a manager has assets that need investors (e.g., private credit), then a nicely constructed ETF in a model portfolio provides access to a whole new pool of capital with less effort than traditional methods.

Most retail investors don't need more "alts" in their investment accounts, and institutional investors already have access to them. But improving access to (and liquidity for) the full spectrum of investable assets is a net positive for institutional and (qualified) retail investors alike.

2 “Smarter and fast enough” generates alpha

To be a top-tier market maker, you still need to be faster than everyone else. Microwave, shortwave or satellite connectivity is required to move market data and orders around the world at (nearly) the speed of light. If you are the fastest and first to market, your trading logic doesn’t need to be unique to make money. But the number of such firms has dwindled dramatically over the past five years, as data and trading links bump up against the laws of physics.

For everyone else, the focus is now on being smarter and just fast enough. Smarter, of course, is subjective. Practically speaking, combining the most creative people with as much compute power you can get your hands on is where principal trading firms and hedge funds are now finding their alpha. Speed still matters, and the bar keeps getting higher. But running a successful quantitative strategy is now about unearthing unique correlations and market anomalies via predictive AI operated by a hyperscaler and capturing the profits before anyone else has a chance to figure out what it is you’ve done.

3 Matching buyers and sellers gets more efficient (and complicated)

Major equity markets, U.S. Treasuries, FX, and, increasingly, investment-grade corporate bonds (among others) are traded electronically. While our research suggests that e-trading will continue to grow, the pace of change will slow to varying degrees as each market reaches maturity. Maturity doesn’t suggest a lack of progress, however. The past and present tell us that the future will be filled with continued e-trading innovation. And while innovation won’t always grow e-trading volume, it will make trading more automated, efficient and productive for investors and traders.

New equity alternative trading systems (ATSs) have shown that even one of the most electronic markets in the world has new tricks up its sleeve. U.S. Treasury markets have declared victory trading on-the-runs electronically and have moved onto more complex challenges. And e-trading growth in corporate bonds has not come from more RFQ volume but from all-to-all protocols, portfolio trading and modern auctions. The result is more-liquid markets.

Technology doesn’t create liquidity, but it does unearth liquidity that would have otherwise remained inaccessible. The core of these solutions is often incredibly complex, but thanks to EMSs, user-interface designers and algorithms, traders can be left with only the magic and remain blissfully unaware of the complexity that makes it so.

4 Upstart pressure on incumbents is relentless

Startup disruption of incumbent businesses is as old as business itself, and such attempts are ever present in capital markets. In our Top Market Structure Trends to Watch in 2022, we pointed to pandemic-era startups coming out of stealth mode, ready to provide solutions to a transformed world. For those that made it through the tough market cycle in 2022, the fruits of those labors are increasingly evident.

ATSs are eroding on-exchange market share, nonbank market makers are picking up market share (and clients) from big banks, and capital markets fintech firms are doing both of those and more. These agile newcomers are leveraging cutting-edge technology, innovative business models and a customer-centric approach without the hangover of legacy technology and operational complexity.

But remember—incumbents are incumbents for a reason. Their size and experience often keep them ahead even when they can't be quite as nimble. And of course, they can and often do buy these innovative upstarts. The big winners? Clients who see better prices and products regardless of who comes out on top.

5 U.S. regulations become even more unpredictable

The only certainties are death and taxes—well, maybe just death. While many believe they know what's to come for capital markets under the new Trump administration, few really do. There are several assumptions we agree with: Many of the proposed but unpassed rules at the SEC will die or be reworked; Treasury and repo clearing will fall into that latter category, with at least a delayed implementation timeline; crypto markets will see a lighter regulatory touch and gain regulatory clarity; and many pending cases against the SEC will be dropped or won by the plaintiff.

The Republican victory is not the only regulatory change that will affect the securities industry. The U.S. Supreme Court's Chevron decision, which reduced the amount of deference courts show to administrative agencies, could trigger a new wave of challenges to the SEC, CFTC and other financial-regulator rulemaking in areas ranging from ESG to digital assets to the future of event contracts. The increased scrutiny by courts on SEC actions could lead to further challenges, especially to some of the more recent SEC rules.

6 Derivatives markets trading and innovation stays hot

Demand for derivative products seems insatiable. Traditional futures contracts tracking interest rates and equity markets saw record volumes in 2024. Event contracts became official in the U.S. and saw volumes explode leading into the election. Bitcoin and ETH futures volume grew, and equity options have gone mainstream with the 0DTE contracts driving volumes even higher. There is only more to come.

Institutional traders and investors will always drive most market volume, but the full-scale entry of retail into the futures market is notable. More crypto-related ETFs will bring an increase in crypto-ETF options volume. Credit futures have tried for more than a decade to find their footing, but there are signs that the market is finally ready for these smartly crafted instruments. And fresh competition for the U.S. interest-rate futures complex can only be beneficial for end users, regardless of the outcome. All of this will unfold against a backdrop of less regulatory red tape that could speed up new product approvals.

This supply-and-demand dynamic is driving investments in the market's infrastructure. Post-trade processing technology—often overlooked for more ROI-generating front-office tools—is getting the attention it's long deserved, ensuring the market's growth isn't hampered by inefficiencies and unnecessary operational risk. Expect quicker onboarding, more efficient position transfers and renewed focus on margin optimization.

7 Market data supply and demand remains insatiable

Our research shows that market participants once again expect to spend more on market data in the year ahead. Just like your grocery bill, inflation plays a part—but that's not the real story. Whether moving into a new country, a new asset class or a new investment strategy, the first step is always gaining access to new data. While supply doesn't need to grow to keep up with demand (you can sell the same data feed as many times as you want), the data available for purchase continues to expand (e.g., alt data, crypto data), as traders and investors work progressively harder to find an edge in both existing and new markets.

The data itself is only the first step in that journey. New delivery mechanisms (e.g., cloud for real-time market data), better analytics (AI anyone?) and tools to make that data actionable on the trading desk are all areas of critical investment that support the demand for more market data. None of these are one-size-fits-all. While speed matters to some for trading, historical data could matter more to others for testing strategies. This is why breadth of market and delivery mechanisms is critical for any market data business today.

The business of market data is not recession-proof. A down market could mean fewer customers in the short term as capital pools shrink and underperforming strategies are shut down. But ultimately, institutional trading and investing can't happen without market data, meaning the long-term spending chart will only go up and to the right.

8 Required repo clearing drives innovation, competition

The SEC mandate to clear U.S. Treasury repo trades is a regulation that should stick, despite the change in leadership in Washington. We and our study participants believe it will be a net positive for the market, even though development costs for market participants and short-term complexities must be ironed out. The repo market is one of the most critical of all financial markets, so injecting some standards and additional risk management processes into the market just makes sense.

The mandate will also bring innovation. Clearing and more standard product terms make e-trading easier, which will result in more volume through the incumbents and, perhaps, new entrants smelling opportunity. Trading mechanisms, in turn, will likely get smarter, taking cues from innovation used to electronify other parts of the fixed-income market.

These same market standards and trading mechanisms could also open the market to new repo buyers and sellers. An easier process to generate returns for those with cash on hand or to borrow cash for those with strategies to deploy it should inject more liquidity into the market overall.

9 The TradFi-DeFi love affair grows

Trading crypto via the blockchain and bonds via ETFs is a given, but now the script has been flipped: We can trade crypto via ETFs (and futures and options) and bonds via Ethereum. DeFi firms see opportunities in TradFi assets, but perhaps more interesting, TradFi firms are introducing access to TradFi assets via DeFi mechanisms.

Admittedly, this all seems a bit duplicative on the surface. Why trade Bitcoin via ETF when the point of Bitcoin was that you could trade it directly outside of the financial system? And not too dissimilarly, money market funds are easily accessible to anyone with a brokerage account. So why all the cross pollination?

Lots of traditional investors want access to crypto markets but would rather not fuss with opening a new account—holding it in their existing taxable or non-taxable account is easier. The same is true for native DeFi investors (yes, they exist). Putting your on-chain stablecoins (i.e., cash) into a vehicle backed by a huge asset manager holding U.S. government debt not only generates yield, but also keeps that money safely stored in the digital ecosystem.

Whether or not all of finance moves toward DeFi in the decade ahead or these two worlds ultimately coexist with more seamless linkages is too hard to predict. But the TradFi–DeFi love affair has certainly only just begun.

10 Investing in operations and compliance tech grows

Operations and compliance professionals have long been told to do more with less. Post-trade spending has resembled a game of whack-a-mole rather than a long-term strategic investment. Why spend money on a new settlement system when you can spend it developing a new execution algorithm that will generate obvious returns in Year 1?

We get it—spending money to make money is important. But making money can't happen if the foundation is weak. Those that look closely at operations and compliance infrastructures understand the goal is not just cost reduction, but scale, risk reduction and enabling strategic goals. That's why mainframes are giving way to the cloud, exception alerts to AI monitoring and margin management spreadsheets to portfolio management systems that help optimize collateral.

Industry initiatives such as T+1 and the coming Treasury clearing mandate have forced change and improvement to existing technologies and processes. The investments have not only accelerated the pace of processing, but also increased the value that the back office provides to the front office. Better post-trade data means portfolio managers have a more accurate and more real-time view of risk, while smart compliance checks keep capital moving with a greater assurance of no regulatory surprises.

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