Market Chronicles

Resurgence of the Titans:

Traditional Asset Managers Reclaim Market Influence in 2024

Jeffrey O'Connor
Head of Market Structure and Liquidity Strategy
joconnor@liquidnet.com

In a memorable scene from the 1980 smash hit "Star Wars: Episode V – The Empire Strikes Back," Darth Vader demands results, not excuses, from Admiral Piett. This sentiment perfectly encapsulates the current state of the equity marketplace. For years, traditional asset managers have seen their strength and presence wane in favor of passive indexing, high-frequency trading, non-bank market making, quants, and even the enigmatic Roaring Kitty. Yet, despite overall market volumes and volatility not signaling a full return of institutional portfolio managers and traders, their presence is creating the healthiest market backdrop in the last five years. This shift suggests a reassertion of the fundamental manager, providing a much-welcomed signal for those tracking trading conditions—cue Vader's theme.

Improved Trading Conditions in 2024

The trading conditions improved significantly over 2023 for traditional institutional trading, marked by low correlations and low volatility. Yet, this did not translate into continuous institutional liquidity, with macro uncertainties keeping conventional money managers sitting on higher levels of cash. This trend reversed in 2024, with consistent and stable institutional involvement across various metrics. The price action of the market, with major indexes hitting all-time highs, aligns with the low volatility backdrop. The normalization and growing health of institutional trading have been expected, but the level of participation has been the biggest surprise of 2024 so far. While overall market volumes haven't exploded, the composition of those volumes tilting back to institutional creates a more favorable backdrop for traditional money managers.

Navigating Macro Volatility

The macro volatility is set to continue, with equity performance keeping retail players engaged and the re-emergence of social media-driven meme plays. The current bear case revolves around narrow breadth, market concentration, and the acceleration of valuations, particularly in AI-themed names. In contrast, the bull case points to improved macro surprise momentum, positive earnings, buybacks, passive inflows, recent disinflation data, and a tightening job market. Additionally, July's seasonal tailwinds historically make it one of the best-performing months of the year for the S&P 500 and Nasdaq. Buckle up, because the market might just be taking us on another rollercoaster ride!

Impact of Institutional Volume

Continuous traditional institutional volume can significantly impact market conditions, with the U.S. Top 500 Top of Book striving to return to pre-COVID levels and better two-sided liquidity in E-mini depth. The right atmosphere to pick winners and losers is created by high-but-steady interest rates, with fundamental factors like earnings growth and balance sheet strength driving equity returns. The healthier market allows more reliable trading patterns, with a recent Bloomberg article highlighting the strong start of fast money strategies in 2024. Despite concerns about a hedge fund crowded trade in time series momentum, the VIX and MOVE indices hovering at low levels offer stability. Even hedge funds are enjoying their second-best start since 2000 – who knew they had it in them?

Low Correlations and Market Risk

Low correlations suggest lessening macro risk, a better backdrop for single stocks, and growing overall risk. This environment can foreshadow market pressure, as seen in past correlational valleys matching market selloffs. The high percentage of volume generated by retail sources is evident, but other sources like retail wholesalers, ATSs, and capital commitment also contribute significantly. Liquidnet's unique perspective from running both an agency block ATS and a traditional broker/dealer service shows high institutional activity in block seeking and appetite through algos, with sell-side flows running 20% better than yearly averages. It's like everyone decided to show up to the party at once – and they're bringing snacks!

The Effects of Low Volatility

When volatility is low and market health improves, dark trading picks up, average trade sizes increase, and spreads drop. The best FINRA TRF reported volumes since early 2021 indicate rising institutional appetite for dark/blocks. While social media-driven meme stocks contribute to market volumes, this has largely been contained to an institutionally insignificant market corner, making it more manageable for institutional traders seeking liquidity.

Regulatory Changes and the SEC

The rollout of T+1, despite initial concerns, has been successful, reducing counterparty credit risk and improving industry affirmation rates. However, the Market Structure Overhaul proposals from the SEC remain a point of contention, with the current administration's high volume of proposals creating an "onslaught" of regulatory changes. The upcoming presidential election adds to the uncertainty, with potential shifts in SEC leadership and regulatory priorities.

In summary, the resurgence of traditional asset managers in 2024 marks a significant shift in the equity marketplace, providing a healthier market backdrop and improved trading conditions. The evolving market structure and regulatory environment will continue to shape the landscape, with institutional strength playing a crucial role in driving market dynamics. As Darth Vader would demand, the institutional presence in 2024 is not about excuses; it's about results. The force is strong with these traditional managers, and their influence is reshaping the market in profound ways.

Questions? For more information, please contact your Liquidnet Coverage.

US
+1 646 674 2274
eqs-us@liquidnet.com

Canada
+1 416 594 2481
eqs-canada@liquidnet.com

Liquidnet