



Capital  
Markets

Global Market Outlook 2023

# Equity Capital Markets: The Year Ahead

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**Macroeconomic stability is key, but the backdrop doesn't need to be perfect for investors to regain confidence in equity markets.**

## Key Points

- Ultimately, an equity markets 'reset' is expected that will create a wider breadth of issuance from a broader spectrum of issuers across more industries.
- In terms of equity execution in the current climate, the key drivers are de-risking and providing stability of outcome.
- Investors should be ready to move quickly when IPO markets reopen, and expect the next IPO class to span a broader spectrum of industries.

## The path to equity market recovery

Rising inflation, interest rates and monetary tightening drove down equity markets globally in 2022. We entered the year with central banks trying to fight pandemic-induced inflationary pressures from 2021, only to see them magnified by Russia's invasion of Ukraine – a conflict which continues to weaponize energy and commodity markets.

As a result, 2022 has been dogged by macro volatility. It has been difficult for investors to gain a footing in any market in terms of buying new issues. And in a rising rate environment, a lot of the traditional products that usually come to the fore, like convertibles, didn't materialize either.

Looking forward, there are signs for optimism. Many of the key factors that could have driven markets into a tailspin have started to show signs of recovery. We have seen a reduction in very high inflation recently turn into a bullish signal that investors immediately got behind.

Those are the type of signs equity markets need to see to lead the recovery. If more signs like slowing inflation become consistent, investors will put money to work. It's likely the global economic backdrop will remain

challenging in the near to medium-term, but the trajectory of the recovery doesn't need to be perfect – investors just need to regain confidence in the stability of the markets.

**“Many of the key factors that could have driven markets into a tailspin have started to show signs of recovery.”**

John Kolz, Global Co-Head, Equity Capital Markets, RBC Capital Markets

Corporate earnings are expected to reset, but once we reach that adjustment period, investors should have more confidence in fundamental valuations and be able to put capital to work with more confidence.

Once they see a path to peak inflation and interest rates, investors will have more confidence in their own models, sectors and companies, which mark a return to the fundamentals of stock picking again (rather than macro-driven investment decisions).

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Going forward, it will be important to see what the ‘reset’ constituency of deals looks like across sectors, products and regions. Historically, the technology sector dominates and should continue, albeit not to the same extent. There is a tremendous backlog in other sectors like healthcare, but also in less represented industries like industrials, real estate, consumer, retail or financial institutions.

Ultimately, a wider breadth of issuance from a broader spectrum of issuers across more industries will create healthier equity markets. The focus will also move beyond revenue multiples to real cash flow and valuation dynamics that are tangible in the near term. There will be an increased depth of product as well, but a richer depth of sectors and the ability for stock pickers to have something to choose from will be a welcome change.

In terms of geopolitics, markets want stability. Conflicts and issues don’t have to be fully resolved, but the market needs a modicum of stability so that issuers and investors feel like they can put dollars to work.

Until we reach that point, cross-asset volatility will remain elevated. The ongoing conflict in Ukraine remains a “wild card,” along with other geopolitical risks like China and Taiwan. Any escalation or development of new conflicts poses unknown but significant degrees of risk to the outlook for 2023.

“Investors are returning to fundamental financial characteristics – cash flows, balance sheets, debt levels – to identify opportunities.”

Justin Grimmond, Managing Director, Head of Equity Capital Markets, Australia

### New trends in equity execution

The key drivers of equity execution in the current climate are de-risking and providing stability of outcome. A perfect example is a recent wall cross transaction that we priced with investors – a confidential process with investors for a sale of equity from a financial sponsor, who then knew exactly what the outcome was going to be before public market exposure.

A wall crossing is a traditional product that’s been used relatively rarely in equity markets over the last five years, with a recognized trade-off between investor-led pricing versus broker risk-driven pricing on follow-on offerings. We expect to see much more

of this type of execution going forward because it that does everything possible to de-risk outcomes.

In terms of other products, we also see investors indicating directly that they are willing to support existing companies to fund strategic initiatives and M&A. Companies that are executing well continue to raise primary capital for expansion of their businesses. The ones that work best have an established pattern recognition for investors – we told you we’re going to do this, we’ve done it, and now we need more capital to move forward.

Fund flows and availability of cash for new issues have been a problem for many investors who would otherwise be active participants in new issues. Portfolio managers are now very selective in how they deploy more limited cash, focusing on larger, liquid names. This makes sense given the market backdrop – it is the established, resilient, listed businesses that investors are most supportive of.

However, we do see the market beginning to move towards a healthier place for conversations around capital formation for new companies. And with the new dynamics of a higher rate environment, investors will expect an opportunity for value and a good balance in power between issuer and investor, or sponsor and investor, where a win-win occurs.

Equity will also become a more important component of company funding structures, for those listed and those coming into market, than perhaps it has been in the past. In terms of equity execution, it’s a market where debt is no longer free, so equity will become a more important component of financing.

However, private equity is arguably still in the most well-funded state it has ever been. Their use of leverage and their ability to act with leverage is down, but in general, private equity has massive dry powder on the sidelines.

“We see the market beginning to move towards a healthier place for conversations around capital formation for new companies.”

Nitin Babbar, Global Co-Head, Equity Capital Markets, RBC Capital Markets

The historical dynamic of private equity bringing transactions to the public markets is also one of the reasons to be optimistic. We see a backlog of high-quality

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companies that are owned by private equity, that are levered less than they had been historically, and that are in fitting with the balance of what public market investors want to buy.

This is welcome news for IPOs. By every possible measure, the performance of IPOs in 2022 was historically weak. After the declines and volatility in broader equity markets, a slowdown in IPO activity in 2022 was not surprising, but the extent to which activity and appetite for new listings dried up has been extreme.

Overall, there are good companies that are well-funded in the backlog waiting for the market. We expect the constituents of the next IPO class to look a little different to previous years, with a better balance of industries and sectors, although technology should still dominate IPO volumes.

Biotech IPOs have been one of the few bright spots in the US equity capital markets, which in some ways is a little unexpected. It's probably the most long-term investment, the one where you have to take the biggest leap of faith. But it proves investors are willing to bet on long-term secular growth stories that have an ability to really change the paradigm, in any given sector.

### A new playbook for 2023

Along with the return of IPOs, we expect to see the return of convertibles, not just in the market overall, but in support of IPOs.

A few years ago, it wasn't uncommon to see an IPO alongside a mandatory convertible, or an IPO alongside a convertible preferred to try to bridge the gap of the size needs and the balance for yield and growth within the investor dynamic. However, this return to a more robust IPO issuance will likely be back-end loaded and require a degree of geopolitical and macro stability. There are other signposts to look for that will signal that markets are open/receptive. IPOs and other offerings will need to provide positive, meaningful returns, with upsizes and strong levels of oversubscription on offerings across sectors. We will also look for

strong participation on new issues by both long only investors and hedge funds, along with momentum in secondary markets driven by trends of earnings, upside surprises, fund flows and research upgrades.

When the IPO market does open up, it will open very quickly. People may have to get used to a slightly different valuation paradigm, but ultimately the markets will be there for executability, if we see some of these signposts.

**“The key message for the year ahead is that issuers need to be prepared and be willing to do things differently in terms of execution.”**

Duncan Smith, Co-Head of European Equity Capital Markets & Corporate Broking, RBC Capital Markets

Another aspect to take confidence from is that if we go back over 25 years, there are not many periods with a negative secondary market performance over a multiple period of years. ECM activity always follows that secondary market performance. It always comes back in a relatively robust fashion.

There are always windows of opportunity. Even in difficult or down markets deals can get done.

The key message for the year ahead is that issuers need to be prepared and willing to do things differently in terms of execution. We've already seen IPOs utilize wall crosses and cornerstone investors. We've seen a block trade intraday on a Friday morning. Multiple at-the-market offerings and two wall cross follow-ons. That level of creativity will be the new normal in 2023.

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