Insights
Currency & Cash

August 2024

Currency Market Commentary

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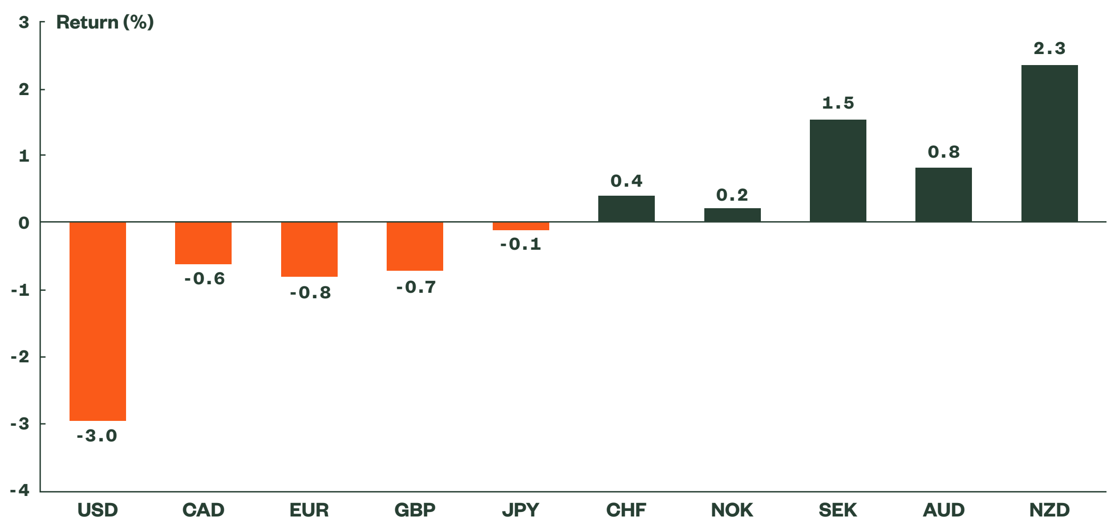
Summary of Views

The start of August brought a reminder that recession risks and markets are still susceptible to sudden market panics. The gradual pullback in equity markets, which began in mid-July, coupled with the unwinding of the currency carry trade, reached a crescendo on 5 August following the Bank of Japan's rate hike, weaker US manufacturing Purchasing Managers' Index (PMI), and poor US payroll data. Equities tumbled, and the VIX index — a measure of implied equity volatility — soared over 40 points in a single day, reaching levels not seen since the height of the pandemic scare in March 2020. The Swiss franc and Japanese yen surged over 2% and 4%, respectively, by 5 August. Higher-beta, higher-yield currencies, such as the Norwegian krone, Australian dollar, and British pound, experienced significant declines. The US dollar also weakened, though not as sharply; it was sold off as investors unwound positions in high-yielding currencies, but this decline was partly offset by its typical safe-haven appeal during periods of volatility. Recession risk became a dominant topic of discussion, and investors began pricing in the possibility of an emergency intra-meeting rate cut from the Federal Reserve (Fed).

The sky was falling — then it was not. Positive US ISM data on 5 August helped stop the rout, followed later in the month by better initial jobless claims, NFIB small business sentiment, and retail sales. The US economy is softening but not falling off a cliff — yet. Risk sentiment reversed, reviving the higher-beta currencies that had suffered at the start the month, and bringing the S&P 500 back within 1% of its all-time high by month's end. The one exception was the US dollar, which continued to trend steadily lower; the safe-haven bid waned on improved risk sentiment, while selling on lower expected US yields continued in response to weak Consumer Price Index (CPI) and Fed chair Powell's clear call for a September rate cut during a speech on 23 August.

Figure 1
August 2024 Currency Return vs. G10 Average



Source: Bloomberg and State Street Global Advisors, as of 31 August 2024. **Past performance is not a reliable indicator of future performance.**

Figure 2
August 2024 Directional Outlook

	Tactical Outlook	Strategic Outlook
USD	↑	↓
CAD	↓	—
EUR	—	↓
GBP	—	—
JPY	↑	↑
CHF	↑	↓
NOK	↓	↑
SEK	—	↑
AUD	↓	—
NZD	↓	—

Note: All individual currency views in the table above are relative to the G-10 average.
Source: State Street Global Advisors, as of 31 August 2024.

While markets recovered nicely from the early August panic, we believe the month marked an important shift. With the Fed set to join most other G10 central banks in easing policy — and US data continuing to soften, albeit gradually — we are entering a negative US dollar phase. The key driver now is growth, which has become increasingly important — perhaps the most important — factor in currency movements. Growth sets the context and determines the impact of lower global yields on currencies.

If central banks are easing into a recession or an uncomfortable soft landing, the US dollar likely resurges against most higher-beta currencies, underperforms the yen (and perhaps the franc), and remains roughly flat — with some downside risk — against the euro. If we achieve a truly soft-or no-landing growth scenario, the US dollar trends steadily lower against all major currencies, with higher-beta currencies — Norwegian krone, Australian dollar and New Zealand dollar, and, to a lesser extent, British pound and Swedish krona — leading the way higher. The euro, Canadian dollar and Japanese yen could do well against the US dollar, but are likely to underperform those higher-beta currencies. The Swiss franc may outperform, as it becomes a more attractive funding currency for carry trades.

Under the two scenarios — hard landing versus soft — the outcomes differ significantly. Thus, August proved to be a watershed month that brought growth to the forefront; it is now the key. Our base case is for an uncomfortable soft landing: we achieve a soft landing, but employment and consumption slow enough to create some recession anxiety. In that context, the bias should be to sell US dollar on rallies, with an eye toward an eventual breakdown through the bottom of its two-year range. The yen is likely the best all-weather trade, as it wins in a soft landing and wins big in a hard landing. Higher-beta, commodity-sensitive currencies are likely the most attractive in a soft landing but are not terribly appealing after their recent bounce. Those risk-sensitive currencies could be hard-hit by additional volatility shocks, which become more likely as we approach the US election and adjust to investors' apparent new sensitivity to pricing recession risk based on any disappointing data.

Review and Outlook by Currency

US Dollar (USD)

The US dollar fell 3.0% in August relative to the G10 average, making it the worst performer in the group. The short-lived market panic during the first week of the month triggered US dollar selling as investors unwound positions in high-yielding currencies. This was partly offset by its typical safe-haven bid in response to the volatility shock, but not enough to prevent losses. Through the remainder of the month, better ISM services data, jobless claims, NFIB small business sentiment, and retail sales suggested tha,t while the US economy and labor market are weaker, they are not falling off a cliff. That less frightening soft-landing sentiment — combined with softer-than-expected CPI and Fed Chair Powell's call for a September rate cut — kept the dollar on its back foot for the entire month. There was no real period in which the dollar bounced; it only fell at a faster or slower rate throughout.

We have long held the view that the US dollar is likely to fall at least 10–15% over the coming years as US yields and growth revert to the G10 average, and the US grapples with high fiscal and current account deficits. For investors with a two-year or longer horizon, we have strongly recommended short US dollar positions — to look past the highly uncertain transition period of the last 12–18 months. The transition from a bull market to a bear market is drawing close, and we believe it is now time for tactical investors to be biased towards selling rallies rather than buying dips. In other words, we see the end of cyclical US exceptionalism clearly on the horizon and approaching fast.

That said, a dollar bear market, starting now or even within the next six months, is far from certain. Such a development would require an obvious soft landing for the economy alongside a steady normalization of US interest rates. Recession — or even fear of recession — is likely to give the dollar temporary support, as will any anxiety regarding the upcoming US election. US rates are likely to remain relatively high compared to the G10 average, US equities continue to outperform, and the US retains its position as a relative safe haven due to its reserve currency status.

This makes it difficult to buy more cyclically sensitive currencies against the dollar at this point, as they are sensitive to recession risk, equity volatility, and the recent downtrend in commodity prices. It may be wiser to wait for larger selloffs to buy the Norwegian krone, Australian dollar, New Zealand dollar or Canadian dollar. The yen appears to be the safer long bet at the moment; it likely performs moderately well in a soft landing and wins big in a hard landing or recession. The British pound is sensitive to equity volatility and recession risk, but the more gradual expected pace of rate cuts and more consistent growth data likely keep it relatively well supported against the dollar for now.

The biggest risk to all these views is a reacceleration of US growth and inflation — a resurgence of cyclical US exceptionalism — that pushes US yields, equities, and the dollar higher on a sustained basis, even against the yen, and perhaps especially so. However, we currently believe that this reacceleration scenario is highly unlikely.

Canadian Dollar (CAD)

The Canadian dollar lost 0.6% against the G10 average during August but enjoyed a 2.4% gain against the US dollar. It was a relatively uneventful month for the Canadian dollar despite the major volatility spike on 5 August and the subsequent recovery. During the panic, the Canadian dollar fell only 1.1% against the G10, as was not hit by the large liquidation of carry positions.

While it is a high-yielding currency, investors were already short due to the weak economic growth outlook and steady Bank of Canada (BoC) rate cuts. Domestic data were mixed and broadly consistent with soft labor markets, sub-potential growth, and ongoing disinflation. Net job creation was weaker than expected, though the unemployment rate remained stable and wage growth was slightly better. Core inflation was a tick lower than expected at 2.4%, while the latest retail sales reading came in at –0.3% as expected. Despite the sluggish macroeconomic picture, the Canadian dollar managed to recover about half its loss as equity markets rebounded, and interest rate differentials with the US shifted in its favor after the weak US CPI report and the Fed's signal of a September rate cut. The period of steady Canadian dollar-negative interest rate divergence appears to be over.

We maintain a modestly negative tactical view on the Canadian dollar due to weakness in commodity prices, softer relative equity performance, and lower yields. On a more positive note, other central banks — particularly the Fed — are also easing policy. Because the BoC cut earlier and at a faster pace than most other central banks, it is likely to see the benefits of those cuts sooner. This is reflected in improved growth expectations for 2025. While additional currency weakness is probable, it will likely be limited, as the market has already priced in a fair amount of pessimism.

Euro (EUR)

The euro gained 2.2% against the US dollar for the month but was the second-worst-performing currency versus the G10 average, down 0.8%. The month began on a positive note, as the euro was largely spared from the market panic and rout in high-yield currencies, despite weaker manufacturing PMI and a higher-than-expected unemployment rate. Through mid-month, the euro oscillated sideways until weaker-than-expected August manufacturing PMI in France and Germany, a soft ZEW expectations survey, and the general resurgence in risk sentiment pushed the euro lower — most notably relative to the resurgent higher-beta currencies such as the Australian and New Zealand dollars. It also lagged behind the British pound during this period, as better UK growth data fueled expectations that the Bank of England (BoE) would cut rates more slowly than the European Central Bank. Ultimately, the poor economic outlook combined with positive global risk sentiment steadily pushed the euro lower throughout the final week of the month.

We maintain a neutral-to-slightly-negative tactical view on the euro, although we expect it to outperform the more commodity- and risk-sensitive currencies — namely, the Australian, New Zealand, and Canadian dollar, and Norwegian krone. This view is driven by weaker relative growth surprises, lagging European Union (EU) equity performance, and an increasingly negative signal from our short-term value model. The short-term value score indicates that the recent rebound in the euro is excessive relative to weaker growth and poor local equity market performance, despite a small improvement in relative yield differentials. Longer-term issues — such as high debt levels and low potential growth — continue to cast a shadow, one that has grown darker as French and German politics has become more fractured and less likely to drive the necessary EU-wide reforms. Moreover, our long-run fair value model suggests that the euro is expensive versus most of the G10 currencies, except the US dollar and the Swiss franc.

British Pound (GBP)

The British pound lost 0.7% against the G10 average in August. It was the hardest hit in the G10 during the early-month equity volatility event and carry trade unwind, likely due to a combination of the BoE's rate cut at the start of the month and the fact that the pound had entered August as the best-performing currency year-to-date. A sizable long position that accumulated over the course of the year, which was quickly unwound. As risk sentiment recovered after 5 August, the pound also began to rebound. However, despite falling the most during the panic, it did not recover the most.

Growth data was decent, with better-than-expected employment gains, retail sales, and both services and composite PMIs. But core CPI, headline CPI, and wage growth all surprised to the downside, creating a drag for the currency. Even BoE Governor Bailey's cautious — almost hawkish — tone in his speech at the Jackson Hole conference failed to help the pound outpace the other higher-beta currencies. It is hard to pinpoint a specific cause for the pound's lackluster recovery, other than to observe that it remains the best-performing G10 currency year-to-date by a wide margin. It was likely just not as oversold or under-owned as the other higher-beta currencies, such as the G10-leading New Zealand dollar.

Our models maintain a neutral tactical view on the pound relative to the G10 average. The strength over the course of the year appears to fully price in the resilient growth data and high relative expected yields. As of the month's end, the market is pricing the UK to have the highest policy rates in the G10 by mid-2025. Decent expected growth and relatively attractive yields suggest the pound should remain well supported. However, most of the good news is already priced in — absolute growth levels are lackluster, and the potential for limited fiscal support in the upcoming autumn budget suggests there is little room for additional appreciation.

Our long-term valuation model has a more positive outlook on the pound. It appears particularly cheap against the US dollar and the Swiss franc. Still, it is important to temper upside expectations, as low productivity growth and sticky inflation are pushing fair value lower. The fair value to the US dollar has fallen from 1.55 to 1.40 since May 2022. Breakeven inflation expectations and recent trends in productivity differentials suggest that fair value will trend down to at least the upper 1.30s over the next few years, although, from current levels in the low 1.30s, the pound is still moderately cheap, even if fair value trends down as expected.

Japanese Yen (JPY)

After a huge 6.4% gain in July, the yen added another 4.5% by 5 August before falling back to finish the month down 0.1% relative to the G10 average. The start of the month was dramatic, to say the least. In the first three days, the Nikkei 225 index dropped over 20%, while the yen rocketed higher as carry trades collapsed, with the US dollar (–6%), Norwegian krone (–9%), and Mexican peso (–13%) all falling against the yen. The yen's appreciation was dramatic, though not mysterious. The steady depreciation of the yen over the past few months, even as global yields trended lower, was far more mysterious. The unwind of yen depreciation in July and early August, although a bit disorderly, pushed the yen back toward fundamentals. However, the final leg of the yen's rally on 5 August proved short-lived, as US economic data stabilized and equity markets rebounded sharply, erasing the entire early August gain. This leaves the yen still relatively cheaper compared to carry and monetary policy expectations.

Going forward, we see further upside in the yen, with 140 against the US dollar in sight by year-end and 130–135 by the end of 2025. This outlook is consistent with another 25–50 bps increase in Japanese policy rates and 200 bps in cuts from the Fed — even in a soft-landing scenario. If recession risks intensify, the yen could easily trade well down into the 120s against the dollar, with even greater gains against higher-beta, commodity-sensitive currencies.

Altogether, this makes the yen one of the most attractive currencies in the G10, if not the most attractive, particularly against the US dollar and Swiss franc. The yen is likely to outperform both the US dollar and Swiss franc in either a soft or hard landing, though its gains against the franc are expected to be more limited in a hard-landing scenario. On the flip side, in the event of a global reacceleration in growth and inflation — with monetary easing cycles cut short or even partly reversed — the yen may still outperform the franc, though it would likely lose ground against the US dollar and most other G10 currencies.

Swiss Franc (CHF)

The franc gained 0.4% against the G10 average in August. As a low-yielding currency used to fund long positions in higher-yielding currencies — essentially a carry trade funder — it enjoyed a strong 2.7% bounce by 5 August during the carry unwind. Though it did not gain as much as the even lower-yielding yen, the 2.7% rise was still a solid win. From there, like the yen, the franc gave up all its gains as recession fears waned and equity markets recovered. A sharp downside surprise in both services and manufacturing PMI on 5 August further pressured the franc, pushing it lower through the mid-month. However, other data was relatively stable, providing a more supportive environment later in August. Switzerland posted a 0.5% QoQ increase in sports event — adjusted Q2 gross domestic product (GDP) — slightly above the 0.4% expected — while employment and core CPI remained relatively stable. This, along with weaker EU sentiment indicators, likely helped the franc trend slightly higher toward the end of the month, finishing with a small gain.

Our models maintain a positive tactical bias on the franc relative to the G10 average, thanks to resilient growth data and its relative safety in the face of a fragile global macro environment and falling commodity prices. However, we caution that this positive bias is likely temporary, as our medium- to long-term view is decidedly negative. The franc remains the most expensive G10 currency per our estimates of long-run fair value, has the second-lowest yields in the G10, and core inflation, while unchanged in August, is the lowest in the G10. Additionally, the real trade-weighted franc is at the upper end of its 30-year range, and the Swiss National Bank is cutting rates — we expect another cut in September — and is open to intervention to prevent excessive franc strength. We believe the franc is transitioning towards a prolonged reversion to our estimate of its long-term fair value. Near-term strength is likely to be temporary, supported only by the increased political and market risk premium being priced into more risk-sensitive currencies.

Norwegian Krone (NOK)

The krone gained 0.2% against the G10 average for the month after recovering from a sharp 1.8% drawdown between 31 July and 5 August. Most of the krone's price action was driven by global macro volatility — the early-month carry unwind and equity plunge, followed by a steady recovery of both. Domestically, data continue to indicate a much slower pace of monetary easing than in most G10 countries. Core inflation slightly surprised to the downside — 3.3% versus 3.4% YoY– though it remains too high relative to target. Manufacturing PMI, retails sales, and industrial production all improved modestly. With slow but resilient growth and stubbornly above-target inflation, the Norges Bank held rates steady at 4.5%, with a patient outlook. This helped the krone recover from its initial selloff, though weak oil prices likely prevented it from matching the stronger recoveries seen in the Australian and New Zealand dollars.

Our tactical model signals remain negative. Although our growth indicators are positive, they are not enough to offset the drag from weak commodity prices, poor local equity performance, and the relatively less hawkish Norges Bank policy outlook following the recent downside in CPI. The krone is looking increasingly cheap; however, it is likely to remain volatile as political risk rises, commodity markets struggle, and investors seem quicker to price hard-landing risks with any negative growth surprises. In the long term, the outlook is more convincingly positive — the krone is historically cheap relative to our estimates of fair value and is supported by steady long-run potential growth.

Swedish Krona (SEK)

The krona gained 1.5% versus the G10 average in August on surprisingly resilient price action. Sweden has struggled with weak consumption, two consecutive quarters of negative GDP growth, core inflation almost back to the 2% target, and a correspondingly dovish Riksbank monetary policy outlook. It is not a low yielder with policy rates at 3.5%; however, it does have the third-lowest yield in the G10. As a result, the krona enjoyed a bump during the early August carry trade unwind. As higher-yielding currencies and equity markets recovered, the krona remained largely stable before reaching an intramonth high in the days following an upside surprise in the 14 August core inflation release — 2.2% YoY compared to 2.1% expected.

Another dovish 0.25% rate cut from the Riksbank on 20 August, along with a surprise uptick in unemployment on 23 August, halted the rally and caused a modest retracement into month-end. Nonetheless, the krona managed to hold most of its gains for August.

Our tactical krona signal shifted to neutral as an improving economic outlook offsets weak equity markets, lower yields, and signs that it is overbought after the August rally. Retail sales and services PMI have recovered somewhat; this suggests possible stabilization and nascent recovery. However, the economy remains near recession — with inflation effectively at target. We believe this will keep the Riksbank on the path toward three additional rate cuts this year, which should weigh on the krona. Risks for investors to price in a greater chance of a global recession — and heightened equity market volatility — should also tend to weigh on the currency. Thus, we stress that risks to our current neutral model signal are to the downside. We expect the krona to continue struggling over the coming months.

In the long term, the picture is more constructive: the currency is very cheap to long-run fair value and cyclically depressed — yet, at this point, we struggle to see a catalyst that could provide a sustained rally.

Australian Dollar (AUD)

The Australian dollar reversed a 1.8% drawdown to open the month, finishing August with a 0.8% gain versus the G10 average. The initial drawdown — driven by the carry unwind and initial recovery — was a function of global macro risk, not Australian-specific factors. However, the recovery from the 5 August low was helped by local factors. On 6 August, the Reserve Bank of Australia (RBA) held rates steady at 4.35% and delivered a hawkish message that rates would have to remain sufficiently restrictive until more sustainable progress on inflation was observed. A big positive surprise in employment — 58,200 new jobs versus 20,000 expected on 14 August — underpinned a further recovery in the currency. From there, the dollar moved sideways until it pushed to a new high to close the month, following higher-than-expected July inflation — 3.5% YoY versus 3.4% expected, and 3.8% YoY for core inflation.

Our tactical models remain negative on the Australian dollar due to the strong downtrend in commodity prices, soft local equity market performance, and the fragile global macro and geopolitical environment. The recent softening of Chinese economic data and the pickup in equity market volatility — which we believe will become more likely over coming months — are also important headwinds. On the bright side, there are positive factors that should limit Australian dollar losses. Most importantly, it is at historically cheap levels. RBA policy is likely to remain tighter for longer, with US rates expected to fall to or below Australian policy rates over the next six months. The economy is sluggish, but growth remains positive, as a decent fiscal spending backdrop should provide support to domestic demand. Thus, while we are negative on the currency, we do not expect substantial downside.

In the long term, the Australian dollar outlook is mixed. It is cheap relative to the US dollar, British pound, euro, and Swiss franc — and has room to appreciate — but it is expensive against the yen and Scandinavian currencies.

New Zealand Dollar (NZD)

The New Zealand dollar gained 2.3% versus the G10 average in August, despite the carry unwind and a dovish rate cut from the Reserve Bank of New Zealand (RBNZ). Weak growth, softer labor markets, disinflation, and concerns over Chinese growth had weighed on the dollar in recent months. It entered August as the highest-yielding — but far from the most popular — G10 currency, which helped limit the impact of the carry unwind through 5 August. The New Zealand dollar barely fell 1% compared to a 1.5–2.0% drop for the Australian dollar and Norwegian krone.

The New Zealand dollar also had a muted initial recovery but managed to return to flat by 7 August, thanks in part to a better-than-expected Q2 unemployment rate — 4.6% versus 4.7% expected — though that was hardly a win, as Q1 unemployment rate was 4.3%. The currency dipped back slightly into negative territory following a surprise rate cut and dovish outlook from the RBNZ on 13 August. However, instead of trending lower, the currency reversed course and trended higher through the remainder of the month.

The ongoing strong global equity market rally provided a good tailwind for the New Zealand dollar rally. Additionally, it seems the RBNZ rate cut was taken as good news — a necessary policy easing to prevent a fall toward recession. A pickup in business confidence, credit card spending, and decent home sales data also helped support the rally.

Our tactical model remains negative on the dollar. The benefit of New Zealand's high yields is fully offset by ongoing challenges to growth and the weak external balance — the current account is −6.8% of GDP — and weaker commodity prices. Now that the RBNZ has cut rates and taken a dovish outlook, the yield support should also wane. In addition, recent softness in Chinese growth, higher equity market volatility, and rising geopolitical risk are all persistent headwinds for the dollar. We agree with the market's apparent reaction that rate cuts are necessary and good, but the benefits will take time to materialize. The New Zealand dollar outlook remains challenging in the near term.

In the long term, our outlook for New Zealand dollar is mixed. Our estimates of long-run fair value suggest that it is cheap versus the US dollar and Swiss franc, with ample room to appreciate, but it is expensive against the yen and the Scandinavian currencies.

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* Pensions & Investments Research Center, as of December 31, 2023.
† This figure is presented as of June 30, 2024 and includes ETF AUM of $1,393.92 billion USD of which approximately $69.35 billion USD is in gold assets with respect to SPDR products for which State Street Global Advisors Funds Distributors, LLC (SSGA FD) acts solely as the marketing agent. SSGA FD and State Street Global Advisors are affiliated. Please note all AUM is unaudited.

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ID2351350-4948703.25.1.GBL.RTL 0924
Exp. Date: 09/30/2025