Forecasts
**Market Outlooks**

**Q4 2024**

# Market Forecasts
## Q4 2024

**Simona Mocuta**
Chief Economist,
Global Macro and Research
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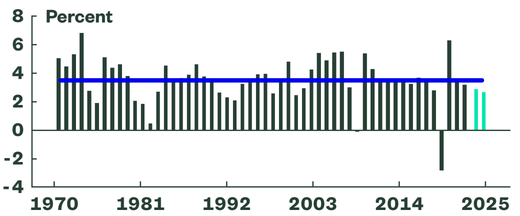
Figure 1
**Global Growth Forecasts Steady, Modest Slowdown Ahead**

- World, Real GDP Growth (WEO)
- World, Real World GDP, State Street Global Advisors Forecast
- Long Term Average Growth (3.5%)

### Global Economic Outlook




Source: International Monetary Fund, Macrobond, State Street Global Advisors, as at September 22, 2024. The above forecast is an estimate based on certain assumptions and analysis made by the State Street Global Advisors Economics Team. There is no guarantee that the estimates will be achieved.

- Global growth forecasts are largely unchanged from last quarter, with the pace of economic expansion in 2024 slowing moderately in 2025. Easing inflation, resilient consumers, and a broadening of central bank rate cuts underpin our expectations for a soft landing.
- The geopolitical landscape remains tense amid ongoing conflict in Ukraine and the Middle East and as the United States goes to the polls in early November in an election that could materially change policy direction.

**Simona Mocuta**
Chief Economist,
Global Macro and Research
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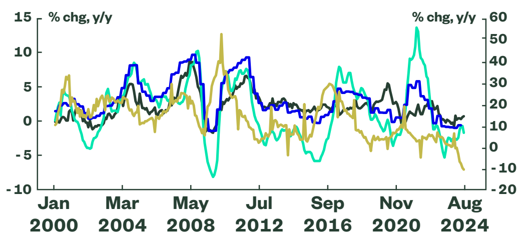
Figure 2
**Disinflation Taking Hold**

- CPI
- PPI
- GDP Deflator (LHS)
- M1, Demand Deposits (Corporate), CNY (RHS)

### Emerging Markets Outlook




Sources: Macrobond, SSGA Economics, National Bureau of Standards, People's Bank of China. Data as of September 24, 2024.

- Chinese authorities are seeking to counter deepening deflationary pressures with more stimulus.
- Monetary easing by the US Federal Reserve relieves some emerging markets risks, but US elections could bring about others, particularly on trade.

**Jerry Holly**
Senior Portfolio Manager,
Investment Solutions Group
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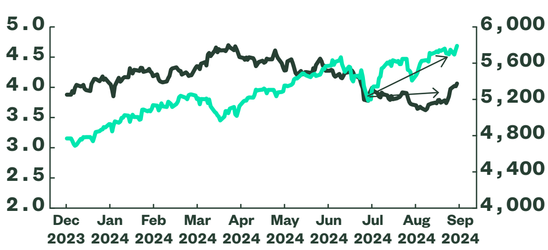
Figure 3
**S&P 500 vs US 10-Year Treasury Yield**

- US Benchmark Bond — 10 Year — Yield % (Left)
- S&P 500 — Index Price Level (Right)

### Global Capital Markets




Source: State Street Global Advisors, FactSet as of October 9, 2024. Past performance is not a reliable indicator of future performance.

- Equity markets still appear to be in reasonably good health, but we are growing more cautious due to less supportive sentiment readings and concerning divergences related to forward earnings expectations.
- Bond markets appear to be closer to embracing a soft-landing economic scenario and high yield bonds look relatively attractive given low default rates and muted expected returns for equities, despite historically tight spreads.

# Global Economic Outlook

**Simona Mocuta**
Chief Economist, Global Macro and Research

Heading into the final months of 2024, and with the US Federal Reserve joining many other central banks in the easing cycle, we have left our global growth forecasts virtually unchanged compared to last quarter. A soft landing remains our baseline forecast for 2025.

For more than a year, we've been discussing two main global macro trends: slowdown and disinflation. We argued that as those took visible hold, the next chapter in the global macro narrative would involve broad and substantial rate cuts. This was to be an exercise of calibrating policy rates lower in light of improving inflation dynamics, rather than any sort of panic-driven rush to cut rates to prevent a recession.

Several months ago, the US appeared to temporarily depart from the broad trend of disinflation and rate cuts, but as we wrote in our previous quarterly update "*US inflationary pressures are increasingly narrow and, given normalizing labor market and anchored inflation expectations, the disinflation process is set to resume.*" We also forecast that "*the Fed joins the easing cycle later in the year and quickens it in 2025. The 'different speeds, same direction' mantra we applied to global disinflation in 2023 applies to global policy easing in 2024–25.*" It is good to see those views validated by recent developments as the US Federal Reserve kickstarted its own easing cycle with a 50 basis point rate cut in September.

For the second quarter in a row, our global forecasts are almost unchanged. This may seem at odds with considerable market volatility — particularly in early August — but that simply speaks to lack of conviction on timing given contradictory data than on the direction of travel per se... The rise in oil prices in recent weeks alleviated some of the strong disinflationary pressures emanating from that space this year and recent stimulus measures in China will push in the same direction. However, the broad disinflation trend globally continues for a while further.

Elections remain a key source of uncertainty. With the US heading to the polls in early November, we should have a better sense of policy direction by the time of our next quarterly update.

## United States: Catching Up

What a difference a quarter makes! In the aftermath of the Fed's June meeting and summary of economic projections (SEP) indicating a single rate cut in 2024, we worried "*that the Fed stays too high for too long, and in the process, endangers the soft landing.*" This was because we believed the economy "*to be less robust than the Fed thinks it is*" and projected a lower growth forecast and a higher unemployment rate for end-2024. We argued that "*based on incoming data, we'd certainly welcome 100 bps worth of cuts, mindful as we are that policy works with long lags.*"

Those 100 bps worth of cuts may have seemed like wishful thinking in June, but the Fed's September meeting changed all that. In a close call that involved the first dissent from a Fed Governor since 2005, the Federal Open Market Committee (FOMC) kickstarted the easing cycle with a bang (i.e., a 50 bps cut) and indicated in the updated SEP that an additional 50 bps worth of cuts through year-end would follow. We welcome the outcome even though the Fed's communication leading to this point left a lot to be desired.

At the September meeting, the message from the FOMC consequently was that the "Committee has gained greater confidence that inflation is moving sustainably toward 2 percent, and judges that the risks to achieving its employment and inflation goals are roughly in balance." The resulting action was a 50 bps rate cut with 11 votes in favor and one against. Governor Bowman would have preferred a 25 bps reduction. We had long said the Fed should initiate the cutting cycle at either the June or July meeting to allow for a gradual descent and control over the message — that these first cuts are a calibration exercise facilitated by lower inflation rather than a correction forced by a lagging economy. That is exactly how Fed Chair Jerome Powell has positioned and explained the move. At this stage, there is no point dwelling on the alternative paths of getting to where we are. We also do not believe that the somewhat stronger data flow since the September cut warrant a pause in November. There is little to be gained from any sort of stop and go approach to policy so we continue to look for 25 bp cuts in both November and December. A good moment to pause may come in the first quarter. As this stage, we see the Fed kipping January to take time to reassess incoming data.

## Economy in Good Stead

The economy remains in a good place and now that the Fed seems more attentive to downside risks, we retain our soft landing forecast. Oddly, we now have a slightly lower unemployment rate for end-2024 than the Fed's updated 4.4%, although our growth projection remains weaker. We do see a more pronounced slowing of the economy in 2025, but we have lower conviction in that view given the more "activist" Fed. Risks to our 2025 growth forecast of 1.5% are balanced. On the upside, material rate cuts could drive a resurgence in housing activity and allow homeowners to unlock massive home equity, hence fueling ongoing consumption. Downside risks stem primarily from slowing labor demand, corporate refinancing needs, diminished lift from lingering fiscal stimulus, and fiscal and trade policy uncertainty. We hope to get more clarity on policy direction following the elections.

As of now, we expect 50 bps in additional cuts by the end of this year and an additional 125 bps in 2025. This would take the federal funds rate to 3.00-3.25% by December 2025. The risks are skewed to the Fed doing more — especially in the near term — on the basis of the expressed intention to front-load the rate adjustments.

## Eurozone: Germany Weighs on Region's Progress

For the eurozone, our 2024 growth forecasts have barely changed since last December. From 0.9% back then, we moved to 0.8% in March, then back to 0.9% in June and we are now at 0.8% again. This is because the story has not changed. The region is gently emerging from the shock of the Ukraine war, but the pace of improvement is slowed by dismal performance in the region's largest economy.

The German economy contracted 0.1%, quarter-on-quarter (q/q) in Q2, which left real GDP unchanged from a year earlier. However, the details behind that headline were far more downbeat. In particular, consumer spending contracted 0.2% q/q, the first decline since early 2023. And despite a powerful disinflationary benefit, real household consumption is flat relative the same quarter a year ago. Equally troublesome, if not more so, was the 2.2% q/q plunge in fixed investment, which is now 3.7% lower than in Q2 2023. The only support came from government spending, which rose 1.0% q/q, and 2.8% y/y. The domestic demand dynamics are weak — consumers are reluctant to spend despite a considerable savings cushion — and export performance is curtailed by Germany's energy cost-induced competitiveness loss. There is also little in the way of near-term demand catalysts, so it is at least positive that sharply lower inflation has opened the door for more European Central Bank (ECB) rate cuts.

Indeed, easing inflation has allowed the ECB to cut the benchmark deposit rate by 25 basis points in June and September. In our view, cuts at both remaining meetings of the year are warranted now that the Fed has begun easing. However, it remains to be seen whether the ECB is ready to move again in October or wait until December to do so. Inflation has come down significantly — with provisional data indicating a drop to 1.8% y/y in September — but this will likely tick back up at the end of the year due to base effects. Most importantly, wage inflation has moderated notably and will likely improve further from here.

Arguably, the eurozone labor market is tighter than in the US, but policy works with long lags in the region and it seems advisable for the ECB to also front-load the rate cuts in light of soft growth. Whether we get one or two more cuts this year, however, is less important than the fact that 4–5 additional cuts are likely in store for 2025. The material decline in borrowing costs should help revive investment spending and lift GDP growth to 1.2% in 2025.

## United Kingdom: Growth Continues, Albeit Slowly

The year started strongly for the UK economy, with GDP in the first half growing well above market expectations and leading us to revise up our forecasts. We upgraded our 2024 growth forecast by two tenths to 1.0%, while maintaining a 1.5% growth estimate for 2025. Lower inflation, monetary policy easing, and rising real wages should continue to support the economy. Meanwhile, fiscal constraints, long-term productivity issues, and a softening labor market might act as headwinds to growth.

Following a strong expansion of 0.7% q/q in Q1, GDP in Q2 then grew robustly by 0.6% q/q, supported by increases in gross capital formation, government consumption, and household spending. However, the strong Q1 momentum faded slightly in Q2. Despite the recovery in purchasing power, household consumption remained weak, reflecting a weakening jobs market and the impact of higher interest rates. Household spending growth in Q2 was only 0.2% q/q, down from 0.4% in the previous quarter, while the household saving rate had jumped to an almost three-year high of 11.3% in Q1. Meanwhile, retail sales returned to growth in July after several months of declines and continued growing strongly in August, suggesting an upturn in the retail sector in Q3. However, the sharp drop in the GFK consumer confidence index in September, led by a marked deterioration around the outlook on personal finances for the next 12 months, prospects for the general economy, and the major purchases index, underlines the risk that budget finances could constrain consumer spending in coming months. Business investment remains weak, falling by 0.1% q/q during the second quarter and staying 1.1% lower compared to the same period a year ago. Net trade was also a drag on economic growth in Q2 after contributing significantly to growth in the prior three months. As a result, our growth expectation for the second half of the year is comparatively more modest.

### Inflation Edging Towards Target

Headline CPI inflation stayed at 2.2% in August, in line with market expectations and two-tenths below Bank of England (BoE) estimates. Importantly, services inflation seemingly moved in the wrong direction during the month as it rose by four-tenths to 5.6% y/y. However, just like other recent downside and upside surprises in UK's inflation, the increase in August services inflation was largely noise over substance. The main contributors to the upward pressures on services inflation included furniture and household equipment inflation, recreation/culture inflation, and a sharp rise in airfares inflation, which are largely subject to base effects. Excluding volatile items, the picture is looking brighter. The latest UK purchasing managers index (PMI) readings also suggest further easing in inflation, particularly in the services sector. Hence, compared to our June forecast, we have revised our 2024 inflation forecast just slightly by 0.1 percentage points from 2.5% to 2.6% and maintain our 2025 forecast unchanged at 1.7%.

The labor market is still tight by historical standards but there is ongoing easing. The unemployment rate stands at 4.1%, down from its April high of 4.4%, but labor demand has cooled. Headline vacancies in the three months to August declined 4.7% from the prior three months. Wage pressures also eased: growth in regular pay (ex-bonuses) dipped three tenths to 5.1% y/y, and growth in average total pay (including bonuses) for the three months to June fell from 4.6% to 4.0%.

Having kickstarted the monetary policy easing cycle at the start of August, the BoE left its policy rate unchanged at 5.0% in September, in line with our expectations, and reaffirmed that it is not in a rush to cut interest rates. Its statement that "*in the absence of material developments, a gradual approach to removing policy restraint remains appropriate*" effectively suggests quarterly rate cuts of 25 bps is plausible. The next rate cut is very likely to arrive in November. However, we doubt that the BoE's easing cycle will diverge that much from that of the Fed. Given that the stickiness in services inflation was mostly down to volatile categories and labor market easing is continuing, we expect the BoE will soon move its focus away from inflation to growth. That said, we continue to look for rate cuts in November and December this year and expect the benchmark interest rate to be lowered to 3.5% by June 2025.

## Japan: Upbeat Outlook, But Eyes on the BoJ

Our upbeat outlook on Japan remains intact, but it will be tested by the Bank of Japan (BoJ) and markets. We expect inflation to remain at or above 2% while the economy continues to grow on the back of reviving consumption. Wage growth is highly likely to stay strong in 2025 and the BoJ will continue to pro-actively guide markets on their policy. We expect the policy rate to reach our neutral terminal forecast of 1% by the end of 2026, but we now see a lesser chance of a December 2024 hike — although the potential for a hike at the meeting is surely live.

The Bank of Japan (BoJ) held their policy unchanged at its September meeting as universally expected at its September meeting, but the guidance was more hawkish than we expected. At the post-meeting press conference, BoJ Governor Ueda said that the Bank 'will keep raising rates' if the economy evolves as expected. This is a very difficult maneuver for the BoJ — to keep hiking when the Fed is expected to keep cutting. The governor emphasized that the Bank wants to take time to assess how overseas uncertainties are affecting Japan. We expect it to achieve the needed confidence on inflation and growth by the end of the year.

Furthermore, demand-driven inflation is gradually rising, so we expect consumption recovery to underpin inflation as well as economic growth. The yen will be extremely critical to the outlook. We believe it helps to have a yen that is weaker than its fair value, and we expect any rapid moves to be countered in adverse cases. The BoJ will watch currency movements carefully and likely hike only after achieving the requisite confidence on intact price pressures despite a stronger yen. The flow of money in the carry-trade will also be watched carefully; we expect domestic institutions to increase their Japanese government bond (JGB) holdings through 2025, allowing the Bank to continue running down their massive quantitative easing (QE) program.

## Economy Retains Momentum

The upbeat growth outcome in Q2 reassured us that the economy retains the hard-built momentum in the post-Covid period. We factor structurally improving consumption and potential improvements in global aggregate demand in 2025 into our forecasts. We expect household consumption to keep expanding above the historic average of 1.5% y/y in 2025, as we expect better shunto outcomes to become entrenched in Japan. Exports will be critically important for growth, and we expect improvement, as signaled by a resilient future output index despite a clear deterioration in other manufacturing PMIs. The PMI data reported an increase in input buying for the first time since July 2022. Overall, we forecast GDP growth of 0.1% y/y this year and 1.5% in 2025.

Our outlook on inflation is unchanged in the sense that CPI will average 2.5% in 2024 and 2.0% next year. Input price inflation in the PMI data rose to a 16-month high as the disinflation of goods prices may have run its course. Given high demand and wage growth, services prices may also pick up by December. We have reasonable conviction that inflation has changed structurally, although Japan is yet to officially recognize that the 2% price target has been achieved. It will be critical how the next administration in Japan approaches this long-time target.

# Emerging Markets Outlook

**Simona Mocuta**
Chief Economist, Global Macro and Policy Research

Near the end of the third quarter, China surprised markets with a range of stimulus measures aimed at supporting the economy and stock market.

## Emerging Markets: Spotlight on China

In late September, the People's Bank of China (PBOC) announced a slew of stimulus measures to support its economy and equity market. The focus on the equity market was new and has the potential to drive a short-term rebound in Chinese stocks. However, the actions simply target the "P" (price) component in the price-to-earnings (P/E) debate, while doing little for "E" (earnings). Unless the earnings part of the equation changes on a sustainable basis, and unless more investor-friendly policies are adopted, a sustained repricing of Chinese equities will remain difficult to achieve.

### Summary of Policy Actions

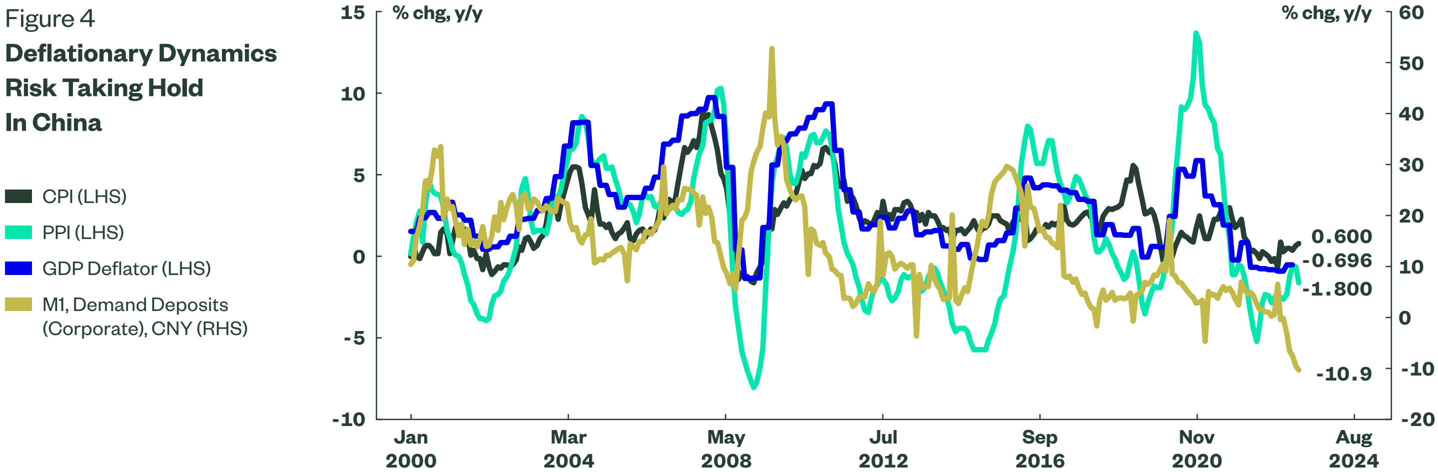
Below are the key actions taken by the People's Bank of China (PBOC) in September:

- 20 bps cut in 7-day reverse repurchase rate to 1.5%
- 30 bps cut in medium term loan facility rate (MLR) to 2.0%
- 50 bps cut to reserve requirement ratio (RRR); further 25–50 bps cuts possible later this year. Reductions will not apply to small banks
- 50 bps cut (on average) to rates on existing mortgages
- Cut in downpayment requirement on second homes from 25% to 15%
- Increase in funding support ratio for housing relending program from 60% to 100%
- RMB800 billion (about $110 billion) preferential lending to support stock purchases and buybacks
- The possibility of a market stabilization fund was floated, but no details offered

## Stimulus Injection Triggers

This announcement comes at a time of intensifying deflationary pressures in China, a telltale sign of insufficient demand. Money supply growth had been flashing disinflationary even before the onset of Covid, but this turned outright deflationary in 2023 and dramatically so of late (Figure 4). This is not the sort of warning sign authorities anywhere can simply ignore. Action was needed, but had previously been doled out in a tentative fashion. This was because the extent of the deflationary signal was initially concealed by the global inflation surge following the Covid reopening. But growing reports of risks to the growth target and the Fed's recent dovish pivot have finally allowed the rollout of more meaningful measures without too much fear about undue currency weakening.

Figure 4
**Deflationary Dynamics Risk Taking Hold In China**




Source: Macrobond, State Street Global Advisors Economics, National Bureau of Standards (NBS), People's Bank of China. Data as of September 24, 2024.

## Assessing the Policy Package

Will this approach work? The answer depends on how one defines the goal. We believe there will be a marginal lift to growth, possibly a visible (if short-lived) lift to market performance, but no change in the underlying trajectory on either front.

We believe strongly that China is no longer a 5.0% growth economy. There is simply no denying the gravitational pull of China's worsening demographics. Incidentally, China recently approved plans to raise the retirement age for the first time since 1978, which we view as a bigger positive for long-term growth than this week's package. There is also no denying — even putting geopolitics aside — that the world is not growing fast enough to support the export-oriented growth pattern that China has relied on in the past. The sooner Chinese authorities recognize this reality, the better: There is little value in propping up an artificially-elevated growth target.

Given this, will the aforementioned measures boost growth? Only incrementally so in our view — for the same reason that prior stimulus packages have had little effect. This is not a problem of insufficient liquidity; after all, Chinese households have one of the highest savings rates in the world. It is a problem of insufficient demand and in turn a problem of confidence. It had long been accepted as fact that housing demand in China was as much a function of investment demand as a function of genuine shelter demand. Nothing squashes investment demand faster and more thoroughly, in our view, than repeated negative returns on that investment. The Chinese government aims to convince people to get back into the housing market and seems surprised by their muted response. It should not be. So, the latest round of measures will likely speed up the process of digesting the supply overhang but drive little to create genuinely new demand. There is even a risk that, having seen better terms with each new intervention, would-be buyers instead wait for even sweeter deals down the line. The reduction in the mortgage rate for outstanding mortgages is significant, but the savings are as likely to be tucked away as they are to be spent.

## Potential for More Meaningful Impact on Equities

Measures aimed at the equity market represent a new element and could prove more visibly helpful. Chinese policymakers are currently willing to offer up public funds to help finance stock purchases. If one doesn't want to "fight the Fed," one also probably doesn't want to "fight the PBoC."

That being said, this liquidity injection can lift the "P" (price) in the P/E discussion, but does nothing to sustainably increase the "E" (earnings). Unless this dynamic changes on a sustainable basis, it will be difficult for China's equity market to close the underperformance gap to global peers.

## The Bottom Line

The stimulative growth effect of the September 24 stimulus measures is modest. Their range, however, betrays a renewed sense of urgency in addressing the challenges. This suggests more may be in store, perhaps in the form of substantial fiscal stimulus. But not all fiscal stimulus is created equal: "what?" and "how?" matters just as much as "how much?".

Ultimately, the Chinese government must recognize that it is difficult to deepen domestic capital markets while also curtailing the growth of certain sectors, aggressively investigating private sector leaders, and capping the scope of achievable returns. China may have a massive domestic capital pool, but even the largest countries benefit from foreign capital and the innovation and creative forces that usually accompany it. That capital, however, demands certain protections and guarantees, presently not fully in place in China. This is not to say that there is no compelling value in select Chinese stocks; there most certainly is. Harvesting that value effectively requires active management at this juncture. For the near term, the rising tide of stimulus may lift all Chinese equity boats, but beyond that, a more discerning approach is needed. Gold may be the unintentional winner in this current environment.

# Global Capital Markets Outlook

**Jerry Holly**
Senior Portfolio Manager
Investment Solutions Group

Equity markets still appear to be in reasonably good health, but we are growing more cautious due to less supportive sentiment readings and concerning divergences related to forward earnings expectations. Bond markets appear to be closer to embracing a soft-landing economic scenario and high yield bonds look relatively attractive given low default rates and muted expected returns for equities, despite historically tight spreads.

## Range Bound with an Upward Bias

In the not-too-distant past I was having a conversation with a colleague about the state of capital markets, in the United States and abroad. Having just returned from a vacation where WiFi access was wanting and financial publications in short supply, I asked for his assessment of stocks. "*Range bound with an upward bias*" was his reply. Plenty of risks could weigh on the market and inject interim volatility, but the trend was still ok and best to stick with it. This was a distinctly technical viewpoint — technical in the Chartered Market Technician (CMT) meaning of the term, or "chartist" as it is sometimes called. But in addition to anchoring around the principles of technical market analysis over the fundamental evaluation of a company or market, it also represents a manner of investing that can be classified as divergent.

In the research, a divergent strategy "is based on the premise that past patterns in security prices can reliably predict future price patterns."[1] This is in contrast to a convergent strategy which is "based on the notion that every security has an intrinsic value."[2]

While we incorporate both convergent and divergent investment ideas into our portfolio management process, if push comes to shove I'd say it leans convergent. In the last edition of Market Forecasts, we discussed how market sentiment was still quite good, but that we might see tougher sledding in the future due to difficult backward-looking comparisons. This would be one example where we straddle both divergent concepts (market sentiment) as well as convergent manifestations (comparison or reversion to an equilibrium level).

But where we see some important developments across markets lie not necessarily in a technical definition of convergence and divergence, but rather in their layman's use. Has the convergence of money manager opinion around a soft landing led to outsized forward-looking risks? What's going on with the divergence between implied volatility around the US election (relatively low) compared with betting markets related to the composition of the US government? Why have we seen such stark divergence between the level of projected earnings growth (still strong) versus a weakening in the earnings data when evaluated as a diffusion index? And did the divergence of bond yields (lower) during the third quarter set the stage for their convergence (upward) in the fourth? We'll assess these and other questions as we outline our current positioning and asset allocation views through year end. In the meantime — "range bound with an upward bias" is not a terrible way to characterize our current thinking with a small equity overweight as we head into the end of the year.

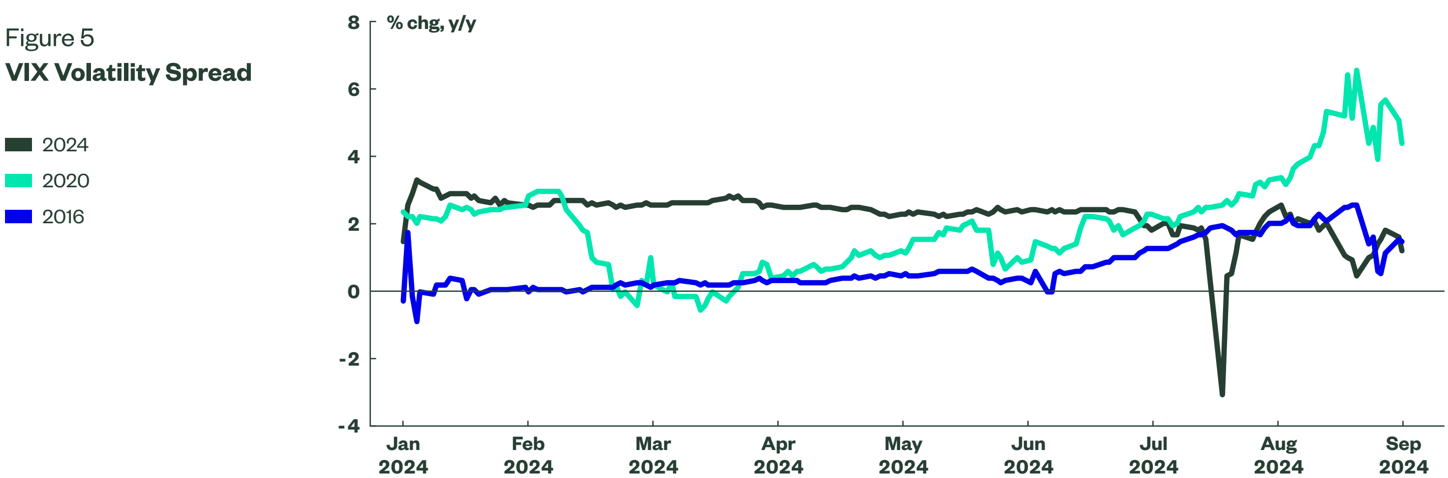
## Risk Sentiment Still on the Weaker Side

At a recent conference we were asked about what appeared to be pervasive confidence in a soft landing scenario from the money manager community. And while the unanimity on this point from the three investment managers on stage might easily be dismissed as anecdotal, broader surveys suggest there is some truth to this idea.[3]

However, just as the confidence in this scenario is rising (perhaps peaking) we are also seeing our indicators of market sentiment continue to gradually erode. To the extent that a soft landing serves as a baseline, however uncomfortable it may feel at times, what is it that is causing our evaluation of market sentiment to turn more suspect?

There are many that would point to the upcoming election in the United States as a potential catalyst for volatility in the markets. And there are good reasons to brace for changes to policies surrounding taxation, fiscal policy, tariffs and otherwise. Betting data from Polymarket puts the odds of a unified government in the US at roughly 50% — with better odds for a Republican sweep than a Democratic blue wave. That seems somewhat high given the relatively consistent and benign pricing of the VIX curve so far this year (see Figure 5).[4] But nonetheless, implied volatilities in both equity markets and currency markets are not as supportive of markets as they were earlier in the year — even if they're hovering around levels that are not overly worrisome. Whether the drivers relate to elections, economics or geopolitical risk, this aspect of market sentiment is tilting a touch negative in our view.

Figure 5
**VIX Volatility Spread**




Source: Bloomberg Finance L.P. as of September 17, 2024. Past performance is not a reliable indicator of future performance.

Other trends related to investor sentiment that cloud the outlook for us include performance differentials between some of the more defensive and offensive parts of the market. Again, this suite of indicators (sentiment spreads) is not suggesting that draconian de-risking is needed, but at the margin, the strength of precious metals over industrial metals and the stabilization in sectors such as consumer staples versus consumer discretionary are beginning to suggest some changes in market internals. And although these dynamics are in part offset by a still strong underlying equity trend, the overall tone of market risk sentiment is just not as strong as it had been over the past 12–18 months.

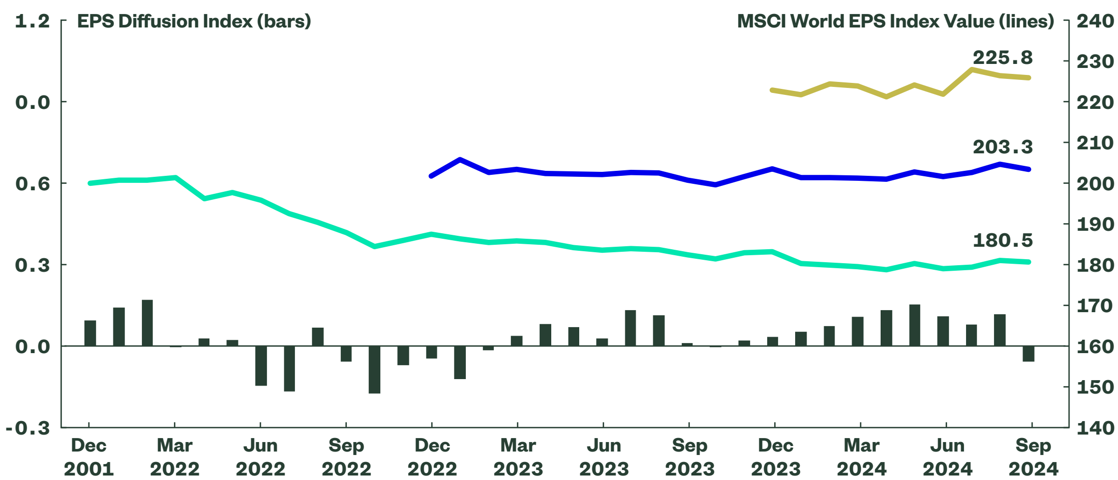
## Equities: Earnings Divergence

Our equity research (outside of risk regimes) also corroborates the idea that prospects for the market are not as compelling as they were in the recent past. And in this respect, much of our equity modeling is giving us similar signals when compared against our last quarterly update. Valuations in aggregate remain above average and weigh on our equity outlook. Certain internal market dynamics such as relatively low stock-level dispersion also dent our forecasts. But we also continue to see strength in terms of balance sheet quality and momentum in the market. Where we have seen a bit more of a damaging turn has been in our evaluation of earnings and sales sentiment — as measured by analyst earnings revisions. And this highlights a tension across equity markets. Because we continue to see strong overall expectations for earnings growth for US and global markets in 2025 and 2026. But the degradation that we've witnessed in our proprietary earnings and sales diffusion indices gives us pause.

Figure 6 illustrates this tension as it shows consensus earnings expectations for the MSCI World Index for the current calendar year as well as 2025 and 2026 (represented by blue, red, and green lines respectively). These estimates have been relatively stable in 2024 and, at the moment, suggest that earnings will grow by more than 12% in 2025 and by another 11% in 2026. However, our earnings diffusion index has not displayed the same degree of resilience.[5] After peaking at 0.15 in May 2024, this measure of earnings health has, for the most part, been steadily falling. And in the most recent reading it turned outright negative. As can be seen from the history, it's possible for earnings sentiment to pick back up and reaccelerate — but we'll be waiting for more confirmation in the data before adding too much equity risk to our portfolios.

Figure 6
**MSCI World Earnings Expectations vs. Earnings Revision Diffusion Index**

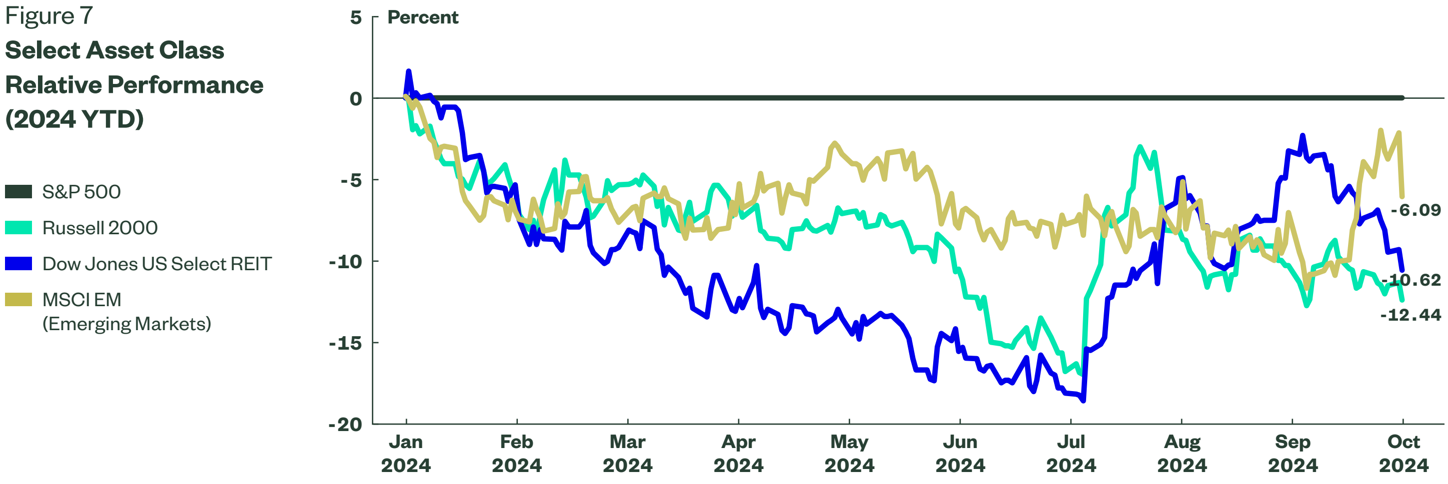
MSCI World EPS Diffusion Index (LHS)
MSCI World Index — EPS 2024
MSCI World Index — EPS 2025
MSCI World Index — EPS 2026




Source: State Street Global Advisors Investment Solutions Group, FactSet, MSCI as of September 30, 2024.
Past performance is not a reliable indicator of future performance.

In the meantime, we have found sufficient confirmation to invest more heavily in what have been some of the previously unloved pockets of global equity markets. And there has been no shortage of questions related to when (or if) US large cap exceptionalism will abate. From our vantage point, US large cap continues to behave well and warrants an overweight allocation in our portfolios. But Figure 7 highlights a few other equity markets that have delivered glimpses of hope at different points in 2024. We believe that some of them have staying power.

Figure 7
**Select Asset Class Relative Performance (2024 YTD)**




Source: State Street Global Advisors, Factset as of October 8, 2024. Past performance is not a reliable indicator of future performance. Index returns are unmanaged and do not reflect the deduction of any fees or expenses. Index returns reflect all items of income, gain and loss and the reinvestment of dividends and other income as applicable.

Foremost among those allocations that we favor is emerging market equities. As can be seen in the chart, emerging markets looked to be turning a corner in the spring as China showcased new equity market reforms at the same time that US markets were struggling with naggingly persistent inflation and fears that policy rates would remain high. But that relative strength receded until the more recent, and more forceful, policy announcements out of China pertaining to both market and fiscal support. For our part, we aren't hanging our hat on future blockbuster policy catalysts out of China or elsewhere. But for the emerging markets complex as a whole, our equity research points to favorable conditions with solid momentum, an improved macro environment with less currency pressure and higher commodity prices, and healthy balance sheets which may sustain future earnings growth — even if aggregate ROE (return on equity) levels leave something to be desired.

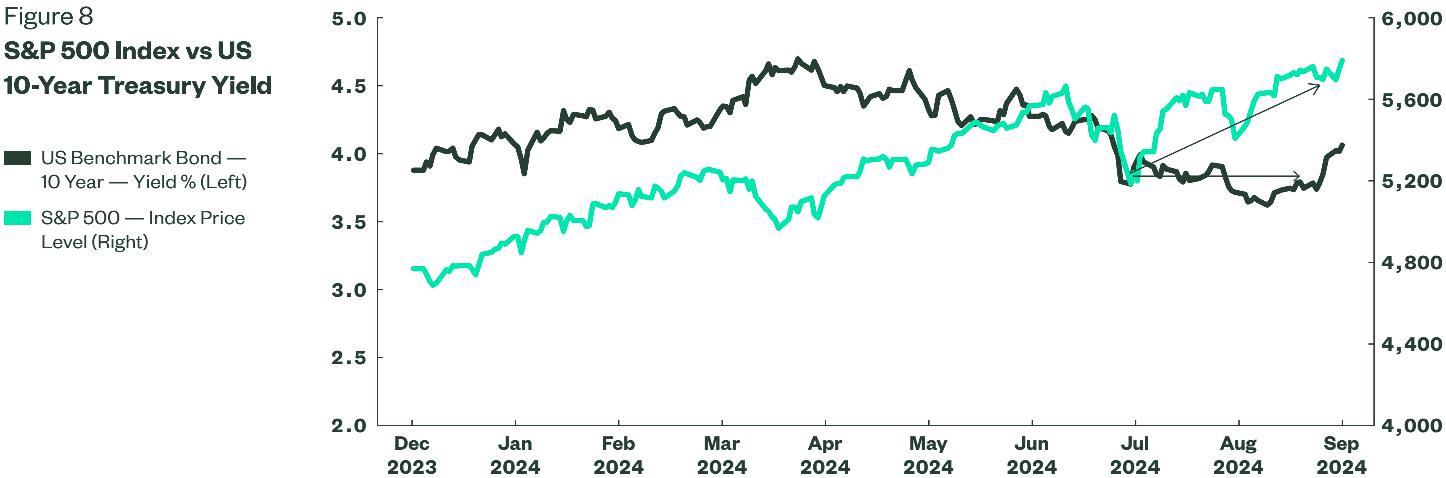
Small cap US equity is another underdog that we see as having better prospects moving forward. Similar to emerging markets, small caps exhibited significant strength earlier in 2024 but it has not yet proven to be durable. The June US CPI report served as the initial turning point for a phenomenal rally in small cap companies as investors envisaged an environment of stable growth, low inflation and easing monetary policy conditions. But those hopes were dashed by the early August spike in volatility and the enthusiasm for small caps has yet to return. In our asset allocation, we don't necessarily give small caps an advantage versus large caps just yet — but they look competitive. And with improving earnings sentiment and support from all of our value factors, that is enough to make small caps look attractive versus most other equity assets and warrant a small overweight allocation.

In REITs, our relatively constructive stance of persistently unloved assets starts to diverge. In this case, we continue to see headwinds across a variety of fronts. As can be seen in Figure 7, the June CPI report and ensuing dip in interest rates also helped to propel REITs to strong relative performance versus the S&P 500. But with rates backing up, notwithstanding a 50 basis point rate cut from the Federal Reserve, REITs appear to have lost their footing once again. And with our bond modeling pointing to somewhat sticky interest rates and our equity models capturing weak commercial real estate activity, we remain underweight REITs for the foreseeable future.

## Bond Prices Converge to Soft Landing

In equity investing it is understandable that market participants can put bad news in the rearview mirror and quickly re-orient around more optimistic views of the future. After all, to the extent those rosier growth projections come to fruition, they will benefit from the concomitant capital appreciation or dividends that are delivered. For investors that are mainly trying to get their money back, it's equally rational to adopt a more skeptical view of the world. In rates markets, this divergent pattern of behavior appears to have been in full force following the early August volatility shock. Figure 8 shows how both stock markets and interest rates plummeted in an environment where the Bank of Japan raised interest rates, US jobs growth disappointed, carry trades unwound, and the VIX surged to 65 on an intra-day basis. But it only took equity markets a few short trading days to mount an impressive comeback, whereas bond markets clung to a more somber outlook until only recently.

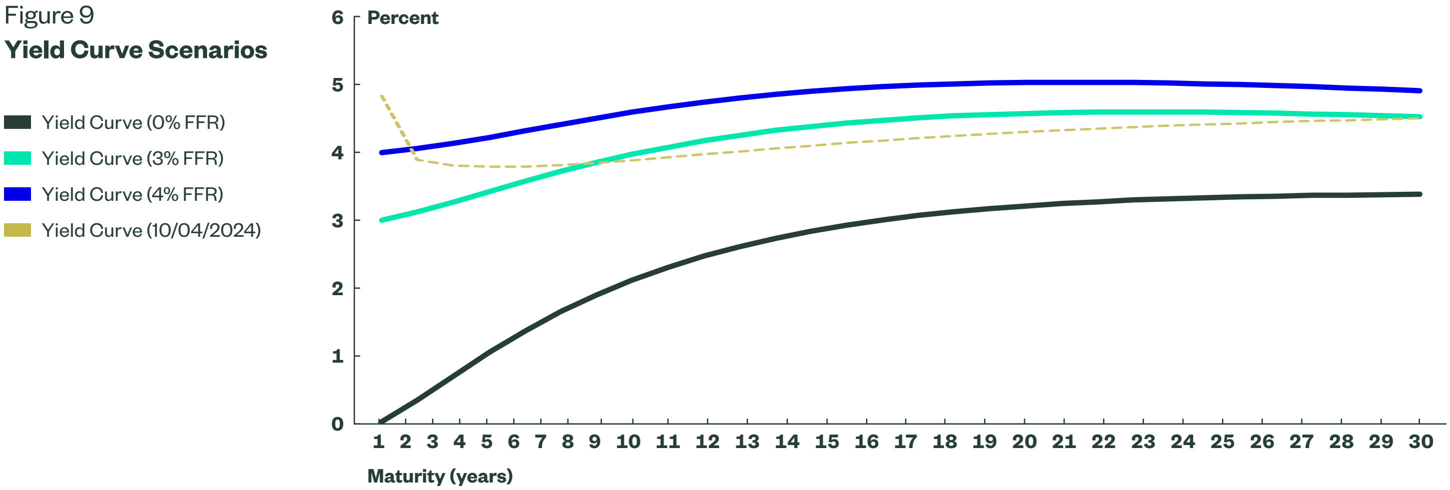
Figure 8
**S&P 500 Index vs US 10-Year Treasury Yield**




Source: State Street Global Advisors, Factset as of October 9, 2024. Past performance is not a reliable indicator of future performance. Index returns are unmanaged and do not reflect the deduction of any fees or expenses.

That apparent disconnect contributed to our view that interest rates might see some upward pressure, notwithstanding the global monetary policy easing cycle that is well underway. And we continue to hold an underweight to duration in our multi-asset portfolios — both because we see better opportunities in equities (though the advantage is dwindling) and because our research continues to point to modestly higher interest rates. But the recent back-up in interest rates makes that calculus a bit more challenging. To frame the evaluation using longer-term historical data we can look to Figure 9, which provides a visual of the current yield curve and a few hypothetical curves based on different landing points for the federal funds rate.[6] The "0% FFR" scenario represents a recession environment where the Federal Reserve is forced to take policy rates back to the zero lower bound. This is not our expectation, but it does show that there is plenty of room for intermediate and long-term rates to fall. The "3% FFR" scenario corresponds to roughly where the latest Summary of Economic Projections (SEP) places the fed funds rate by 2026. And the interesting point here is that, based on historical average term premia, intermediate and (most) long-term yields might still settle higher, even after the sell-off that occurred following the September jobs report. And if policy rates were to settle in some sort of higher-for-longer regime, then more upward pressure on interest rates would naturally result. The 3%-ish scenario still seems to make the most sense to us, but interest rates can and will deviate from these simple extrapolations. But for the time being, we may also characterize the outlook for interest rates as "range bound with an upward bias."

Figure 9
**Yield Curve Scenarios**




Source: State Street Global Advisors Investment Solutions Group, US Federal Reserve as of October 4, 2024.

In credit markets, high yield bonds are showing up in a bit of a sweet spot from a cross-asset perspective. With interest rates having moved off peak levels and default rates low (and trending lower) spreads don't necessarily need to tighten to generate ample return. To be sure, high yield spreads are historically tight at less than 300 basis points. But they do have a little bit of wiggle room when compared to spreads in the investment grade market, which are just about at the tightest levels seen in the past 20 years. And to the extent that equities look more or less range bound at the moment, the monthly carry from high yield alone is helping to propel it up the ranks in our short-term market comparisons.

## No Upward Bias in Commodities

Across commodity markets, our view has been consistent in 2024 with a favorable outlook for gold and a less optimistic view of broader commodities. Recently, there has been some geopolitical risk premiums priced into global oil markets which have boosted broader commodities, but we don't see this as a compelling rationale to move from our underweight position. Our modeling is continuing to suggest a negative trend and increasing hurdles from contango. Meanwhile, estimates of spare capacity suggest there is ample room to expand production if Iranian oil infrastructure were impacted by the ongoing war in the Middle East. And even though economic growth appears to be trending towards a soft landing, the manufacturing sector remains a weak spot, which likely weighs on other commodity sectors such as industrial metals.

Gold, on the other hand, continues to look like a solid investment through year end. Strong performance has persisted which supports our multi-faceted trend analysis of the precious metal. Gold prices also appear to have recoupled with key fundamentals as falling yields and a softer dollar have afforded favorable conditions for it to advance. And if we needed any more conviction in an asset that is sometimes looked at as a diversifier to political risk, well US elections are coming up quickly.

## Converging Closer to Neutral

In the realm of active multi-asset investing, it can be easy to get caught up in big macro and political calls as a mechanism to try to add value. And there is a place for those headline-grabbing predictions and provocative political prognostications. But there is also a time and place to assess how and where the prices of seemingly unrelated asset classes might be diverging from one another, or from a baseline view about the economy and markets. In this respect, bond markets seem to be in the process of adjusting to a reasonably healthy economic environment. The concern for equities is that they've embraced too much of that optimism already. But with a simple 60/40 balanced fund already delivering a return of almost 15% in 2024, it would not be a bad outcome were markets to remain range-bound with an upward bias from here on out. Holding risk a bit closer to benchmark is the short-term plan.

Sources: Bloomberg, FactSet, J.P. Morgan, Barclays, MSCI, Morgan Stanley and The Economist as of September 30, 2024.

## Endnotes

1 Rosenberg, Mark, James Tomeu and Sam Chung. "Hedge Fund-of-Funds Asset Allocation Using a Convergent and Divergent Strategy Approach." *Journal of Alternative Investment*, Summer 2004.

2 Ibid.

3 Bank of America Global Fund Manager Survey as of September 2024 finds that 79% of survey respondents anticipate a soft landing economic scenario over the next 12 months.

4 Note that the sharp downturn in the blue line occurred as a result of near-term volatility spiking in early August amidst the BoJ rate hike, weak US payroll report and carry trade unwind. This caused the Sept/Oct volatility spread to invert, but was unrelated to the election.

5 The diffusion index takes the number of analyst EPS upgrades in a given month, subtracts the number of EPS downgrades and then divides by the total number of earnings revisions for the period. If all analyst revisions were upgrades then the diffusion index would sit at "1" whereas if all revisions were downgrades it would register as "-1."

6 The yield curves represented in the chart use the zero-coupon Treasury curves supplied by the Federal Reserve to estimate average term premia that prevail for different levels of the federal funds rate (https://federalreserve.gov/data/nominal-yield-curve.htm).

## State Street Global Advisors Forecasts as of September 30, 2024

| | 2024 (%) | 2025 (%) |
|---|---|---|
| **Real GDP Growth** | | |
| Global | 2.9 | 2.7 |
| US | 2.2 | 1.4 |
| Australia | 1.4 | 2.6 |
| Canada | 0.9 | 1.4 |
| Eurozone | 0.9 | 1.3 |
| France | 1.0 | 1.2 |
| Germany | 0.5 | 1.1 |
| Italy | 0.9 | 1.2 |
| UK | 0.8 | 1.5 |
| Japan | 0.5 | 1.2 |
| Brazil | 1.2 | 2.4 |
| China | 4.7 | 4.2 |
| India | 7.0 | 6.5 |
| Mexico | 2.0 | 1.9 |
| South Africa | 0.7 | 1.4 |
| South Korea | 2.3 | 2.1 |
| Taiwan | 3.5 | 2.5 |
| **Inflation** | | |
| Developed Economies | 3.0 | 2.3 |
| US | 3.0 | 2.3 |
| Australia | 3.2 | 2.8 |
| Canada | 2.6 | 2.2 |
| Eurozone | 2.4 | 1.9 |
| France | 2.5 | 1.7 |
| Germany | 2.0 | 1.7 |
| Italy | 1.3 | 1.6 |
| UK | 2.5 | 1.7 |
| Japan | 2.4 | 2.0 |
| China | 0.4 | 1.5 |

| | September 30, 2024 (%) | September 30, 2025 (%) |
|---|---|---|
| **Central Bank Rates** | | |
| US (upper bound) | 5.50 | 4.00 |
| Australia | 4.35 | 3.60 |
| Canada | 4.75 | 3.50 |
| Euro | 4.25 | 3.25 |
| UK | 5.25 | 3.75 |
| Japan | 0.10 | 0.75 |
| Brazil | 10.50 | 7.75 |
| China | 2.50 | 2.30 |
| India | 6.50 | 5.75 |
| Mexico | 11.00 | 8.25 |
| South Africa | 8.25 | 7.50 |
| South Korea | 3.50 | 2.75 |
| **10-Year Bond Yields** | | |
| US | 4.37 | 3.84 |
| Australia | 4.31 | 4.07 |
| Canada | 3.50 | 2.96 |
| Germany | 2.47 | 2.10 |
| UK | 4.15 | 3.54 |
| Japan | 1.06 | 1.45 |
| **Exchange Rates** | | |
| Australian Dollar (A$/$) | 0.67 | 0.71 |
| British Pound (£/$) | 1.26 | 1.31 |
| Canadian Dollar ($/C$) | 1.37 | 1.30 |
| Euro (€/$) | 1.07 | 1.11 |
| Japanese Yen ($/¥) | 160.86 | 133.78 |
| Swiss Franc ($/SFr) | 0.90 | 0.95 |
| Chinese Yuan ($/¥ ) | 7.27 | 7.00 |

| **One-Year Return Forecasts** | USD (%) | EUR (%) | GBP (%) | JPY (%) | AUD (%) | CAD (%) |
|---|---|---|---|---|---|---|
| S&P 500 | 7.1 | 3.4 | 3.3 | -10.9 | 0.7 | 1.7 |
| Russell 2000 | 7.4 | 3.7 | 3.6 | -10.7 | 1.0 | 2.0 |
| MSCI EAFE | 6.8 | 3.1 | 3.1 | -11.2 | 0.5 | 1.5 |
| MSCI EM | 8.1 | 4.4 | 4.3 | -10.1 | 1.7 | 2.7 |
| Barclays Capital Aggregate Bond Index | 4.6 | 1.0 | 0.9 | -13.0 | -1.6 | -0.6 |
| Citigroup World Government Bond Index | 2.5 | -1.0 | -1.1 | -14.8 | -3.6 | -2.6 |
| Goldman Sachs Commodities Index | 1.1 | -2.4 | -2.4 | -15.9 | -4.9 | -4.0 |
| Dow Jones US Select REIT Index | 5.3 | 1.7 | 1.6 | -12.4 | -0.9 | 0.0 |

State Street Global Advisors Forecasts, as of September 30, 2024 .
The above estimates based on certain assumptions and analysis made by State Street Global Advisors. There is no guarantee that the estimates will be achieved.

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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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