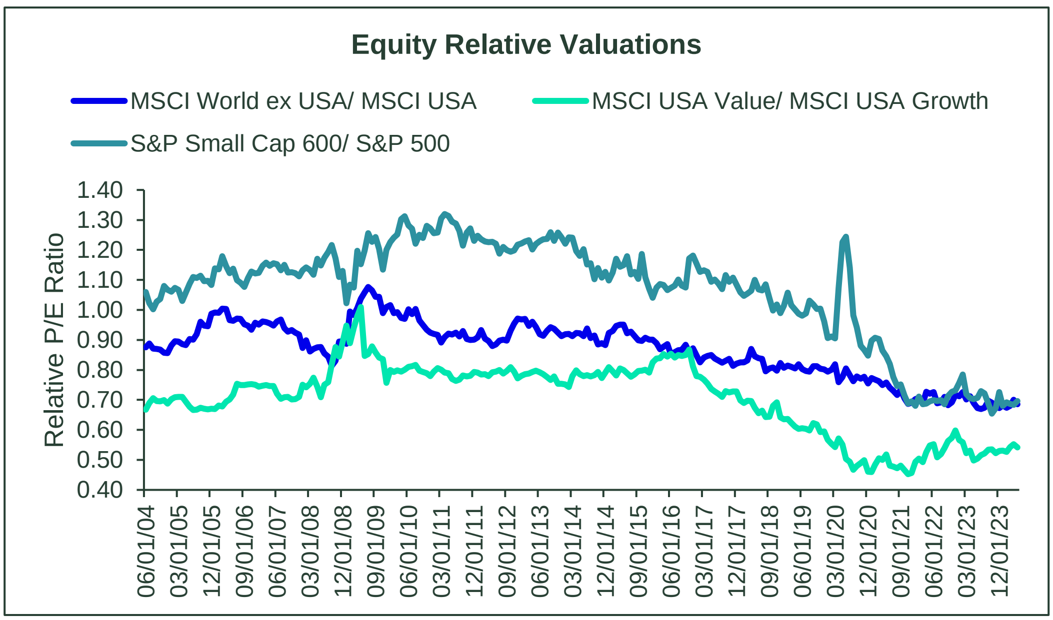
June 13, 2024
Commentary

Weekly Market Update

Insight of the Week

Equity Relative Valuations

Asset allocators partake in a perennial debate on USA vs World ex USA, small-cap vs large-cap and growth vs value investing. Understanding their dynamics is crucial for making informed investment decisions that align with market trends and economic cycles. Below, we plot the relative valuation trends for small vs large cap, World ex USA vs USA, and value vs growth over the last 20 years. Each of these plots indicates a downtrend after the 2008 GFC, reflecting waning market performance and investor sentiment.



Source: FactSet. Monthly data as of 5/31/2024.

The small cap vs. large cap plot highlights a decline in small-cap stocks relative valuation, suggesting investors preference for the stability and financial strength of large-cap companies, particularly large cap tech companies. A similar trend is observed in World ex USA vs. USA, which can be attributed to several factors, including stronger economic fundamentals in the US and higher corporate earnings growth. Moreover, geopolitical tensions and currency fluctuations have impacted international markets more adversely, contributing to their relative underperformance. The Value vs. Growth pair reveals that investors were attracted towards growth stocks given the stable and low interest rate environment.

Small caps, World ex US and value stocks have been underperforming for quite some time compared to their counterparts. There is, obviously, no way to pinpoint when this changes. What this shows though, is that despite valuation attractiveness, the market hasn't moved in their direction, illustrating that valuations alone don't move markets.

Source: State Street Global Advisors, S&P, MSCI, FactSet.

Equities

Markets Reaction to Central Bank Moves and Recent Data Prints

Recent economic data further emphasizes the possibility that the Fed will navigate a soft landing. Firstly, the latest Nonfarm Payrolls report came in higher than expected in May with payrolls rising 272k, indicating some continued resiliency in the labor market despite an uptick in jobless claims this week. The Consumer Price Index showed May CPI was flat at 0.0% month over month and the year over year number showed inflation at an annualized rate of 3.3%, both cooler than anticipated. Although progress has been made on inflation, the Fed as expected decided to hold the Federal Funds rate steady at 5.25-5.50%, diverging from the normalization we have seen from the BOC and ECB. Additionally, the latest dot plot shows the Fed expects only one rate cut this year, as they think there is still more work to be done on the inflation front.

In Canada and Europe, rates were cut on June 6th and June 12th respectively. On each of those days, respective equity markets welcomed the change in policy. The MSCI Canada index was up 0.36% and the MSCI Europe index was up 1.05%, both reacting positively to the decrease in policy rates.

The U.S. equity market reaction to the inflation print and Fed decision was somewhat tempered. Overall, the S&P 500 was up 0.85% on the 12th, not fazed by the continuation of higher rates as the market had already priced in this outcome. At market close the S&P 500 sectors that posted the best performance included Information Technology and Industrials, up 2.46% and 0.93% respectively. The worst performing sectors on the day were Consumer Staples and Energy, down -1.00% and -1.09% respectively.

Looking a bit deeper, less restrictive monetary policy, as a response to cooling inflation, would typically be positive for equities. Observing the correlation between MoM CPI prints and S&P 500 sector returns, we can see the most meaningful correlation between Energy and MoM inflation. Intuitively, the price of commodities impacts the revenue generation of energy firms. Indeed, as CPI came in lower than expected in the US, we saw Energy perform poorly as stated above.

Moving forward, we anticipate inflation to continue to moderate, and the Fed to cut rates more than the dot plot suggests. This would provide a more challenging backdrop for the Energy sector, however with a less restricted economy we could see equities more broadly continue on their run. That is, if nothing breaks in the meantime.

Source: FactSet, MSCI, S&P. Data as of 6/12/2024 in local currency unless otherwise stated.

Fixed Income

Treasury Buyback Program 2024

During the first half of 2023, the Treasury began exploring a treasury buyback program that would focus on two debt management objectives: liquidity support and cash management.

The Treasury aimed to achieve its liquidity objective by allowing markets participants (specifically primary dealers) to sell off-the-run securities and swap them with on-the-run securities. This would bolster liquidity by providing market participants with a predictable schedule to sell these off-the-run securities to the Treasury. The buybacks would be WAM neutral, i.e. they would not meaningfully change the overall profile of marketable debt outstanding.

The Treasury aimed to achieve its cash management objective by reducing volatility in Treasury cash balances and bill issuance. During periods of high cash inflows (when tax receipts are coming in), the Treasury has high cash balances in its Treasury General Account (TGA). These high cash balances would be used to buy back illiquid bonds which usually trade cheap. This would provide relief to dealer balance sheets and reduce volatility around bill issuance.

In May 2024, the Treasury announced that it would begin implementing the liquidity support program by buying back $2 billion in nominal coupon securities and $500 million in TIPS on a weekly basis (or a total of $15 billion in buybacks in the current quarter and $30 billion in buybacks per quarter for future periods).

The New York Fed began conducting treasury buybacks with primary dealers on May 29, 2024. The Treasury indicated that it would not scale the program up during episodes of market stress (unlike Quantitative Easing there will no net new liquidity created in the markets). On-the-run and near on-the-run securities as well as cheapest to deliver (CTD) and near CTD futures contracts would be excluded from buybacks. High demand securities, such as those trading in repurchase markets would also be excluded.

No cash management buybacks were planned for the current or subsequent quarters, but this could change depending on fiscal flows and overall market conditions.

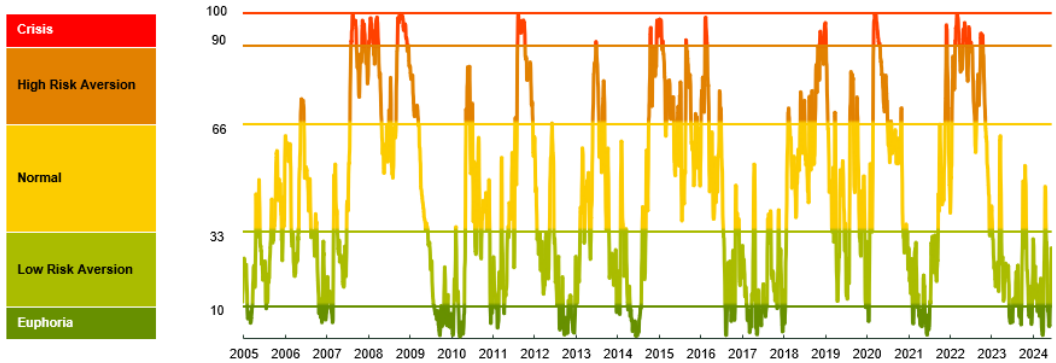
There were only two other treasury buybacks in U.S. history (1990s and 2000s). The two previously buybacks were used as a way to preserve auction sizes at a time when borrowing needs were declining. However the current buyback is intended to ease pressure in Treasury market liquidity and enhance cash management during a period when deficits and government borrowing are both increasing. Aside from easing liquidity, buybacks may also be beneficial as they may push down long-term yields and make the yield curve less inverted.

Source: State Street Global Advisors, Treasury Direct, Barclays.

Market Regime Indicator

The Market Regime Indicator (MRI) represents a proprietary multi-asset class model designed to characterize risk appetites within the capital markets.

Days in the Low Risk Regime (since June 3): 8 days



As of June 12, 2024. The data displayed is not indicative of the past or future performance of any SSGA product. The portion of results through March 31, 2011 represents a back-test of the MRI model, which means that those results were achieved by means of the retroactive application of the model which was developed with the benefit of hindsight. Data displayed beyond this date is not backtested, but is still generated by the model referenced. All data shown above does not represent the results of actual trading, and in fact, actual results could differ substantially, and there is the potential for loss as well as profit. The Market Regime Indicator (MRI) is a quantitative framework that attempts to identify the current market risk environment based on forward-looking market indicators. We believe the factors used, equity implied volatility, currency pairs implied volatility and bond spreads, are good indicators of the current risk environment as they are responsive to real-time market impacts and in theory should include all current and forward views of those markets. These factors are combined to create a single measure and used to identify one of five risk regimes: Euphoria, Low Risk, Normal, High Risk, and Crisis. A slight calculation change was made as of June 28, 2019.

About State Street Global Advisors

For four decades, State Street Global Advisors has served the world's governments, institutions and financial advisors. With a rigorous, risk-aware approach built on research, analysis and market-tested experience, we build from a breadth of index and active strategies to create cost-effective solutions. As pioneers in index, ETF, and ESG investing, we are always inventing new ways to invest. As a result, we have become the world's fourth-largest asset manager* with US $4.34 trillion† under our care.

*Pensions & Investments Research Center, as of 12/31/22.
†This figure is presented as of March 31, 2024 and includes ETF AUM of $1,360.89 billion USD of which approximately $65.87 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.