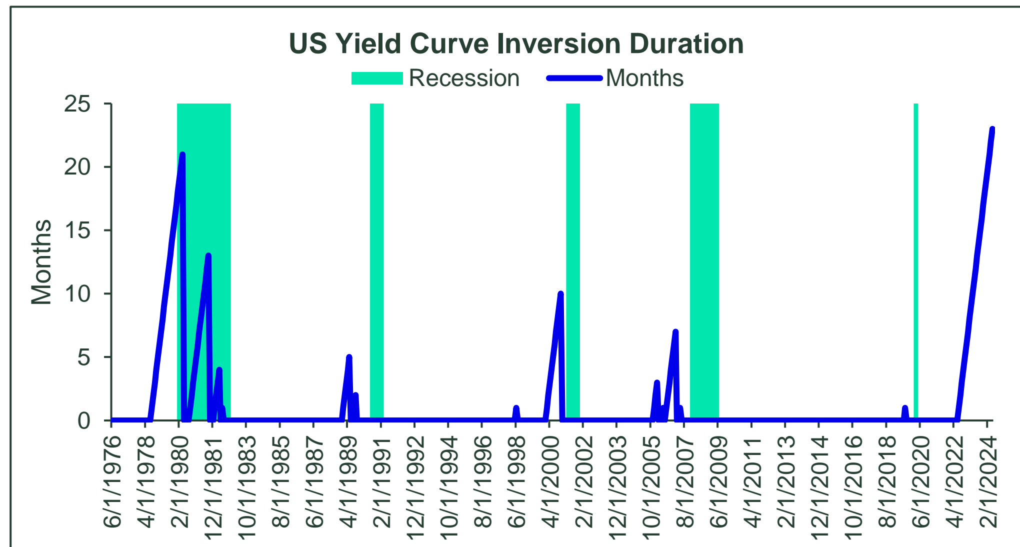
June 27, 2024
Commentary

Weekly Market Update

Insight of the Week

The Length of the US Yield Curve Inversion

The yield curve usually slopes upwards as investors expect more compensation for the cumulative risks over the long term. For example, the 10-year note typically yields more than a 2-year note, but currently this is not the case. Today the yield curve remains inverted as the hawkish Fed continues to fight inflation. But historically, the Fed has kept rates restrictive for too long, which frequently led to recession.



Sources: Bloomberg. Monthly data as of 5/31/2024. Recession periods as per NBER records. Yield curve is considered as inverted when yield on 2 year US Treasury is greater than 10 year US Treasury yield.

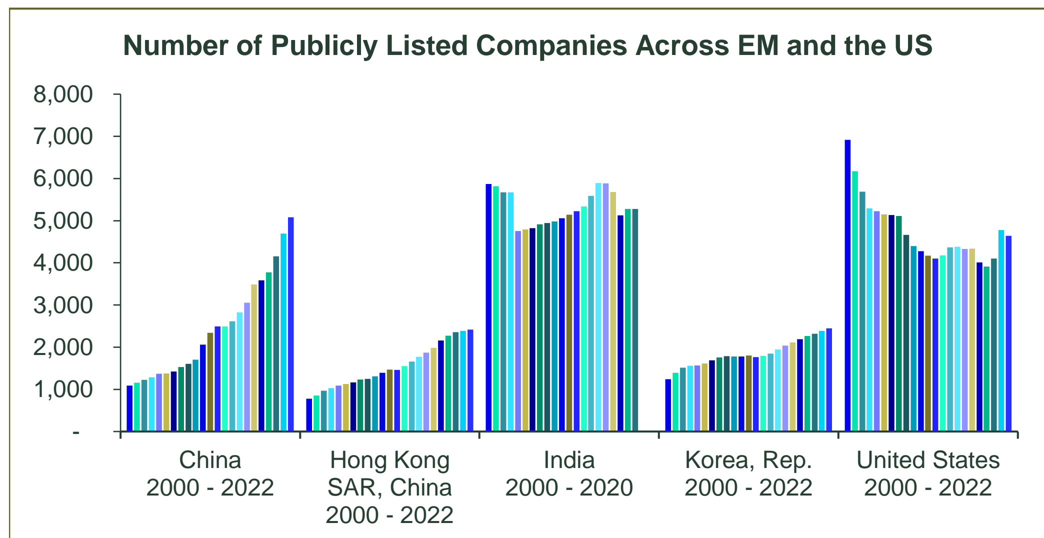
The above plot shows the amount of time, in months, that the US yield curve has remained inverted in past instances over the past 50 years. The Fed's recent aggressive rate hikes started in March of 2022 and the curve initially inverted a few months later in July of 2022. Fast forward 23 months to today, and the curve still remains inverted. This is the longest period over the past 50 years, surpassing the 21 month period back in 1978-1979. Additionally, an inverted yield curve has typically led to recession since 1976. Yet, despite the current lengthy inversion, a recession has not yet materialized and the U.S. economy continues to surprise to the upside. Will this time be different? We explore this topic a bit more in this week's Fixed Income section.

Source: State Street Global Advisors, Bloomberg.

Equities

Is There a Decrease in Public Investing in the US?

The number of firms traded in the US has been shrinking for more than 20 years. Meanwhile, the number of publicly listed companies in China has doubled over the past decade, reaching 5000+ companies, exceeding that of the U.S. In India, another emerging economy, over 5,000 companies have been trading on the BSE and NSE since 2018, with this trend continuing to rise. These metrics align with the number of IPOs (Initial Public Offerings) seen in 2023, where China and India led in terms of volume, followed up by the United States.

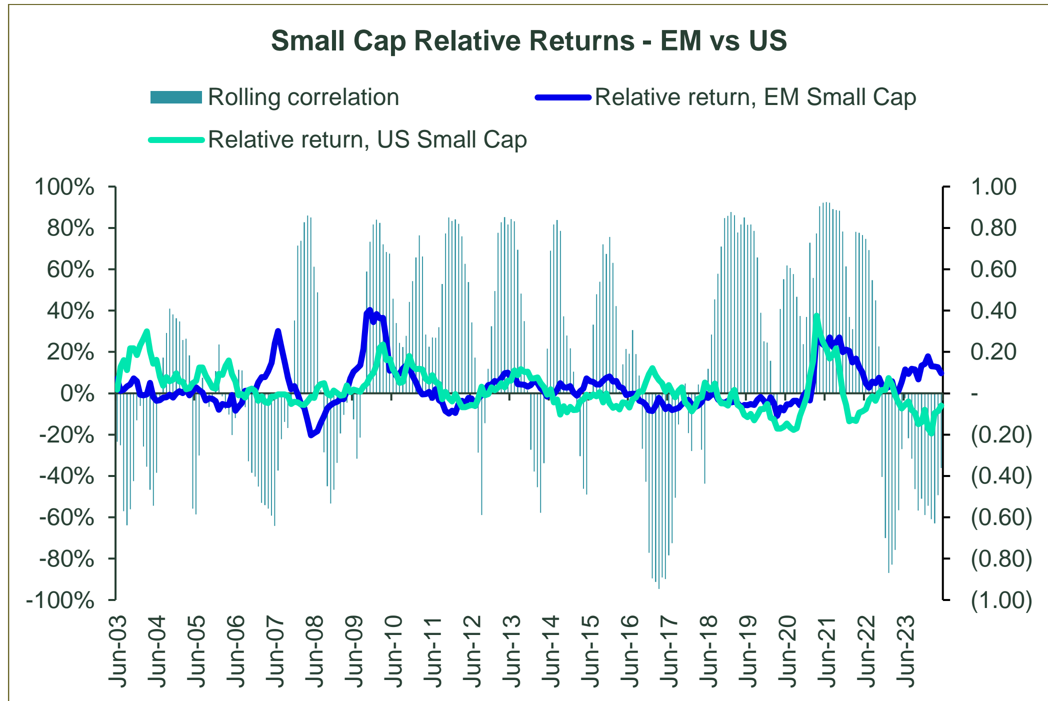


Source: FRED, WorldBank. Data used for India is until 2020 due to significant discrepancy between several data sources for 2021 and 2022 and possible double-counting of companies listed on both BSE and NSE.

Though some developing economies hold more publicly listed companies than the United States, proceeds from newly listed firms have been declining, highlighting that new participants are mostly small- and mid-capitalization companies. For example, in 2023 India set a record with 220 IPOs (+48% YoY) on the BSE and NSE, although the proceeds were nearly the same as the year prior at $7.9 billion (vs $7.8 billion in 2022). In China, a key policy objective has been strengthening the domestic financial market including newly launched smaller businesses, leading to the establishment of trading boards for start-ups at the two major bourses.

While small caps are entering public markets in emerging economies more actively, those in the US are facing obstacles – it's not just that companies are leaving US public markets; many are opting to stay private. Mega-cap companies are experiencing lofty valuations, and small-caps are struggling with 'higher for longer' interest rates.

The more developed PE market in the US has driven down recent returns for its small cap companies – the trend over the past few years. The private equity market in the US has been consistently growing since 2014, with over $350 billion in deals each year becoming an attractive option for companies to grow and expand their operations. In 1Q24, divestments by buyout firms were minimal, contributing only $13.7 billion to U.S. IPOs – now private equity firms need to hold onto assets longer to even surpass the amount of capital they invested.



Source: FactSet, State Street Global Advisors. Relative return is calculated as Small Cap index return minus the market return (i.e., Relative return, EM Small Cap = MSCI EM Small Cap return – MSCI EM return). Correlation is calculated as 12 months rolling correlation between MSCI EM Small Cap relative returns and MSCI US Small Cap index relative returns.

Relative returns of small caps in developing economies have been outperforming those in the US recently capturing the specific effect of the discrepancy between emerging and developed economies. The market has recently favored those businesses that open up to investors at their earlier stages.

Source: SSGA, FactSet, FRED, WorldBank.

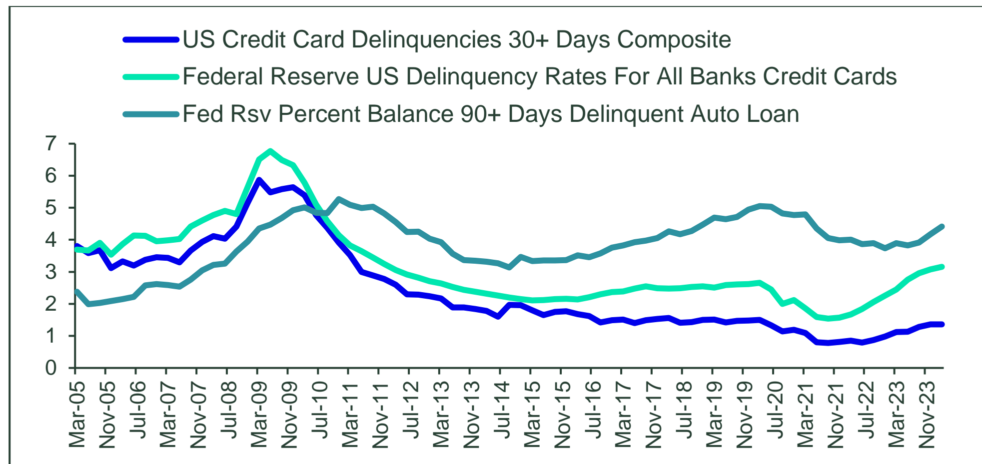
Fixed Income

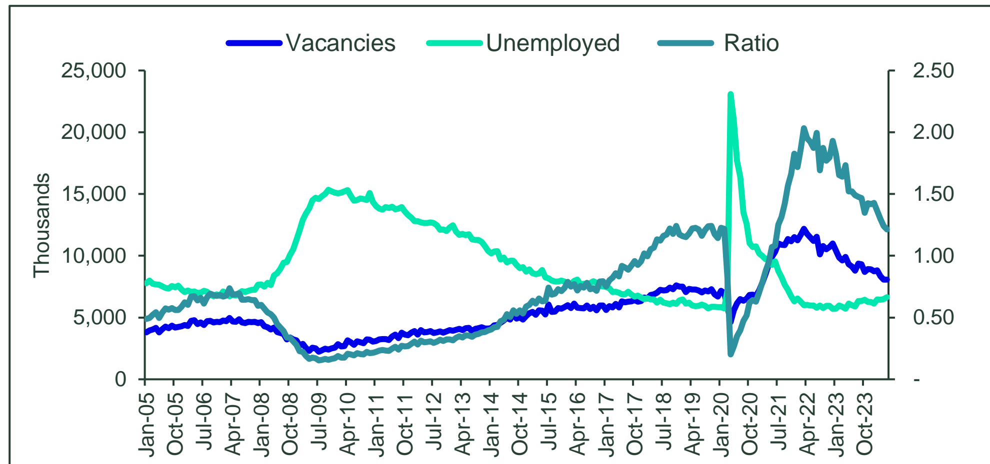
A Federal Reserve Policy Mistake?

It has been a quiet week leading up to the end of the second quarter of 2024, a welcome break from the chaos of the last six months. We began 2024 with markets pricing in between five to seven rate cuts amid expectations of easing inflation and a stable labor market; the perfect scenario for a soft landing. As of June, we have experienced relatively sticky inflation, continued (but softening) strength in the labor market and a re-pricing of rate cuts to one 25 bps cut in 2024 (at SSGA our base case remains two cuts in 2024).

Interest rates have remained highly restrictive (fed funds rate between the 5.25% and 5.50% range) as the Federal Reserve tries to gain confidence that inflation is in fact heading towards it’s 2% target rate. So is the Fed making a policy mistake? Possibly.

We are beginning to see the strength of the consumer dwindle. Excess cash that had accumulated during the pandemic has been spent down, credit card debt and default rates have increased. Clearly excess cash and wage growth have not been able to keep up with the prolonged higher borrowing costs in the system.





Source: Bloomberg. Data as of 5/31/2024.

Job creation has also decreased, in March of 2022 there were two job openings for every one unemployed worker looking to get hired, currently that ratio is down to 1.2, as companies are pull back on their hiring plans. Quit rates are also decreasing as workers are less confident that they will be able to get rehired - the labor market is entering an inflection point. Once companies start laying off workers, the layoff waves will happen fast and across sectors, leading to a sharp increase in the unemployment rate and an economic slowdown. At that point, the Federal Reserve would not be able to initiate rate cuts fast enough to avoid a recession.

Continuing to hold rates higher could lead to a break in the system (as we saw during the SVB crisis in March 2023), the depth and breadth of which cannot be accurately predicted. Fronting loading a few rate cuts, even as inflation continues to come down could prevent risks to the soft landing narrative.

Source: State Street Global Advisors, Bloomberg.

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.

ssga.com

State Street Global Advisors Global Entities

Marketing Communication

The information provided does not constitute investment advice and it should not be relied on as such. It should not be considered a solicitation to buy or an offer to sell a security. It does not take into account any investor's particular investment objectives, strategies, tax status or investment horizon. You should consult your tax and financial advisor.

The information contained in this communication is not a research recommendation or 'investment research' and is classified as a 'Marketing Communication' in accordance with the applicable regional regulation. This means that this marketing communication (a) has not been prepared in accordance with legal requirements designed to promote the independence of investment research (b) is not subject to any prohibition on dealing ahead of the dissemination of investment research.

This communication is directed at professional clients (this includes eligible counterparties as defined by the "appropriate EU regulator") who are deemed both knowledgeable and experienced in matters relating to investments. The products and services to which this communication relates are only available to such persons and persons of any other description (including retail clients) should not rely on this communication.

The views expressed in this material are the views of Christopher Carpentier, Zanub Raza, Dane Smith, Maria Nikitanova and Saketh Reddy Moyilla Sai Shiva through the period ended June 27, 2024 and are subject to change based on market and other conditions. This document contains certain statements that may be deemed forward-looking statements. Please note that any such statements are not guarantees of any future performance and actual results or developments may differ materially from those projected.

Investing involves risk including the risk of loss of principal.

The whole or any part of this work may not be reproduced, copied or transmitted or any of its contents disclosed to third parties without SSGA's express written consent.

All information is from SSGA unless otherwise noted and has been obtained from sources believed to be reliable, but its accuracy is not guaranteed. There is no representation or warranty as to the current accuracy, reliability or completeness of, nor liability for, decisions based on such information and it should not be relied on as such.

Equity securities may fluctuate in value and can decline significantly in response to the activities of individual companies and general market and economic conditions.

Bonds generally present less short-term risk and volatility than stocks, but contain interest rate risk (as interest rates raise, bond prices usually fall); issuer default risk; issuer credit risk; liquidity risk; and inflation risk. These effects are usually pronounced for longer-term securities. Any fixed income security sold or redeemed prior to maturity may be subject to a substantial gain or loss.

Currency Risk is a form of risk that arises from the change in price of one currency against another. Whenever investors or companies have assets or business operations across national borders, they face currency risk if their positions are not hedged.

Generally, among asset classes, stocks are more volatile than bonds or short-term instruments. Government bonds and corporate bonds generally have more moderate short-term price fluctuations than stocks, but provide lower potential long-term returns. U.S. Treasury Bills maintain a stable value if held to maturity, but returns are generally only slightly above the inflation rate.

© 2024 State Street Corporation - All Rights Reserved.

AdTrax: 5064514.73.1.GBL.INST

Exp. Date: 7/31/2024