STATE STREET GLOBAL ADVISORS

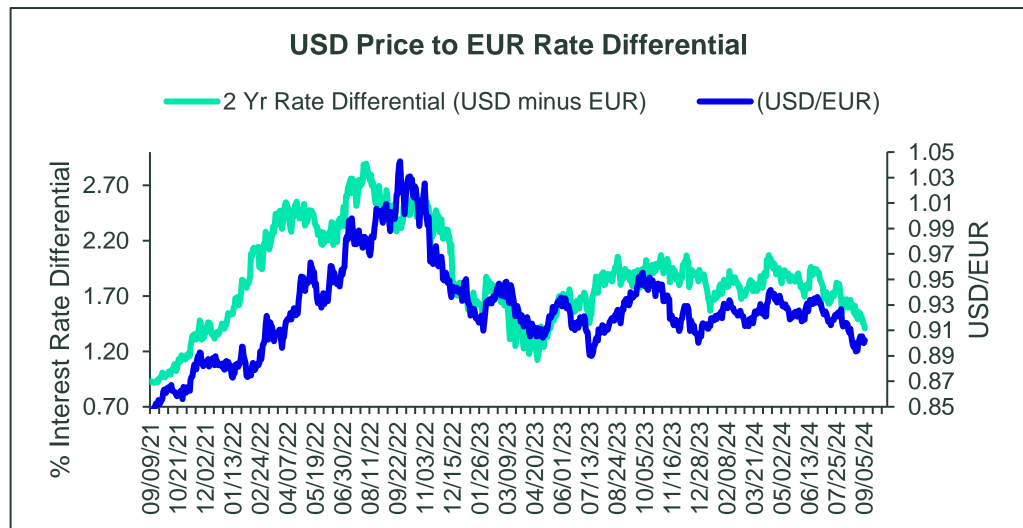
September 12, 2024
Commentary

Weekly Market Update

Insight of the Week

Interest Rate Differentials As a Driver of the US Dollar

Across capital markets, there are a whole host of influences that have a push/pull effect on asset prices. When it comes to the US Dollar, a strong recent influence has been the interest rate differential between the US and other major economies.



Source: FactSet. Data as of 9/6/2024.

Frequently, during times of economic uncertainty or global risk, the U.S. Dollar tends to be viewed as one of the “safe-haven” assets, providing downside protection. However, when focusing on more stable or recovery periods, interest rate differentials become a key determinant in how the currency moves. A higher interest rate in the US relative to Europe often incentivizes investors to move capital into USD denominated assets, boosting the US dollars value. This trend has been particularly evident over the past few years as the US has maintained higher rates than its Eurozone counterparts.

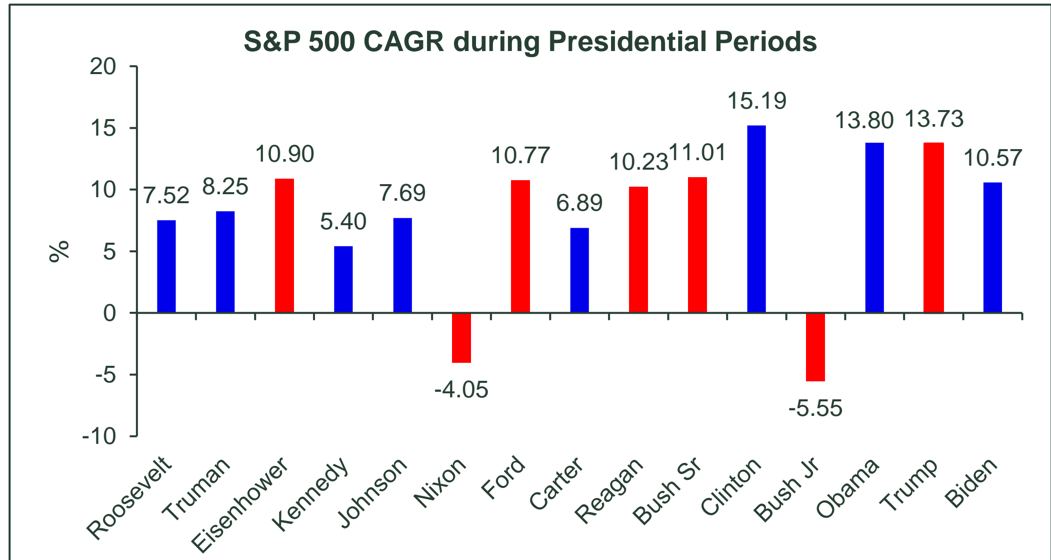
Global economic troubles may have provided some tailwind for USD strength, but the persistent rate differential effects has been dominant over the past few years. The Fed is about to embark on a rate cutting path and is contemplating a 25 or 50 bps cut at the September 18th meeting. The ECB, however, got a head start and initiated its first 25bps cut back in June. Looking forward, we believe the paths decided by central bankers will continue to be a strong influence on the USD, something that historically hasn’t always been the case.

Source: State Street Global Advisors, FactSet.

Equities

Harris vs. Trump.. Does the Outcome Matter?

The presidential debate kicks off the next few months of election season with early voting starting in just a few days in Pennsylvania. Regardless of each candidates performance, we continue to anticipate the presidential race will remain narrow. As investors contemplate the impact of the toss up on the equity market we take a look at history to see how the equity market has performed over prior presidencies.



Source: MacroBond. Data from 3/4/1933 to 9/11/2024.

The chart above is a visual representation of the compound annual growth rate (CAGR) of the S&P 500 across presidential terms. Notably, the majority of presidencies have resulted in positive growth across years in office. However, democratic presidents have shown to produce a higher average CAGR of 9.4% over the studied years compared to 6.7% during republican presidencies. The drag on S&P 500 growth under republicans stems from the terms of Nixon and Bush Jr,. where they both presided over two recessions each.

The question remains how much does the candidate matter for the equity market? The value creation inherent in innovating and growing economies such as the U.S. has allowed for equity market price appreciation across almost all presidencies. Although politicians aren't solely responsible for how the stock market behaves, their policies and fiscal endeavors certainly have an impact. As the race progresses, our policy team has seen the odds of a democratic majority in the house improving. Ultimately this will have implications, positive or negative, for the legislative program and policies of the president-elect. The proposals of the two candidates are likely to impact specific sectors of the equity market and potentially, economic growth.

The newly elected President will have the most impact on the corporate tax rate, trade, regulation, energy, and healthcare. Investors looking to create tactical positions around the election may choose to position more heavily, or lightly, into sectors most impacted.

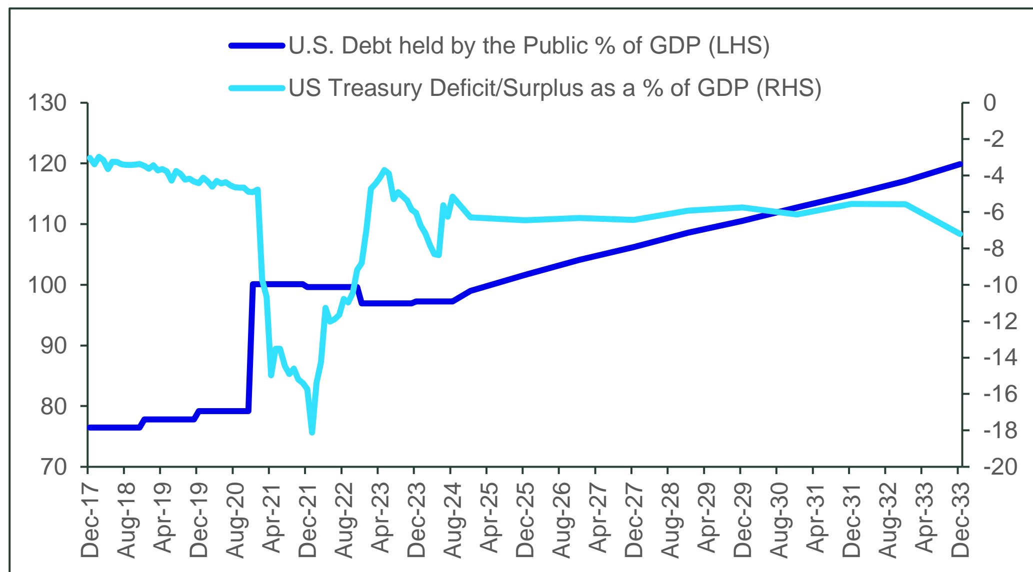
Source: MacroBond. Data from 3/4/1933 to 9/11/2024.

Fixed Income

Will U.S. Treasuries Continue to Be a Safe Haven

U.S. Treasuries are generally considered to be free of default risk. They are backed by the U.S. government and often serve as a safe haven especially during tumultuous economic environments. During the COVID 19 pandemic, the U.S. government initiated large scale debt fueled spending to stimulate the economy. The first two years (2020 and 2021) saw government spending increase by 50% driven by a combination of tax cuts and stimulus programs. Outstanding US government debt subsequently ballooned. With elections around the corner, and both candidates promising tax and spending plans, that would potentially further increase national debt, the haven status of treasuries could change.

In the paper "Government Debt in Mature Economies, Safe or Risky" presented at the Jackson Hole Symposium, authors Roberti Gomez-Cram, Howard Kung, and Hanno Lustig discuss how governments underestimate their capacity to borrow debt. If governments choose to protect taxpayers, and issue large amounts of debt unfunded by taxes, they create an environment known as a risky debt or a fiscal dominance regime. In this environment, bondholders are forced to mark down treasury valuation when government cash flows backing their claims deteriorate, and therefore, demand a higher risk premium.



Source: Bloomberg as of 9/12/2024.

According to the Congressional Budget office, the U.S. national debt is expected to increase to $56 trillion by 2034 as rising spending and interest expense outpace tax revenues. As a share of the economy, debt held by the public is expected to be 122% of GDP. Annual interest costs are expected to rise to $1.7 trillion in 2034, approximately as much as current Medicare costs.

Under a potential Trump presidency, tax cuts could result in between $3.6 trillion to $6.6 trillion added to the U.S. deficit over the next decade. Potential outcomes under the still-developing Harris plan range from a deficit reduction of $400 billion to an increase of $1.4 trillion over the same period.

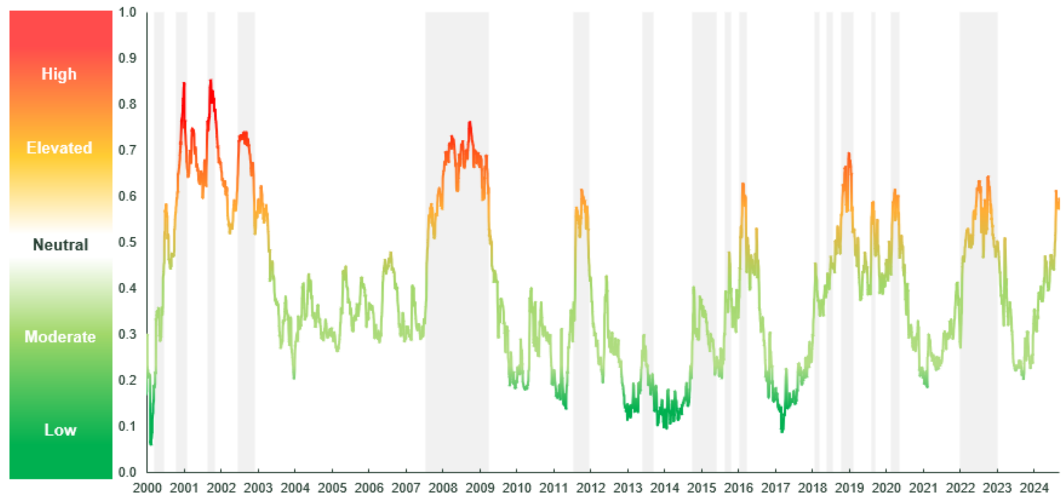
Both candidates are expected to put popular policies ahead of fiscal responsibility, like contributing to further deficit expansion. While investors so far seem unconcerned with US government credit risk, a ballooning debt problem coupled with structural headwinds (low long-term growth and productivity) could make U.S. debt less attractive to investors in the long run (affecting both the ability and cost of borrowing).

*Estimates provided by Committee for Responsible Federal Budget, University of Pennsylvania, Oxford, and Tax Foundation

Source: State Street Global Advisors, Bloomberg.

Market Regime Indicator

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



Source: State Street Global Advisors, Investment Solutions Group (ISG). As of September 11, 2024. The data displayed is not indicative of the past or future performance of any SSGA product. The above data 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 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 four risk regimes: Low Risk, Moderate, Normal, Elevated and High Risk..

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*Pensions & Investments Research Center, as of 12/31/23.
†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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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.

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