
October 31, 2024

Commentary

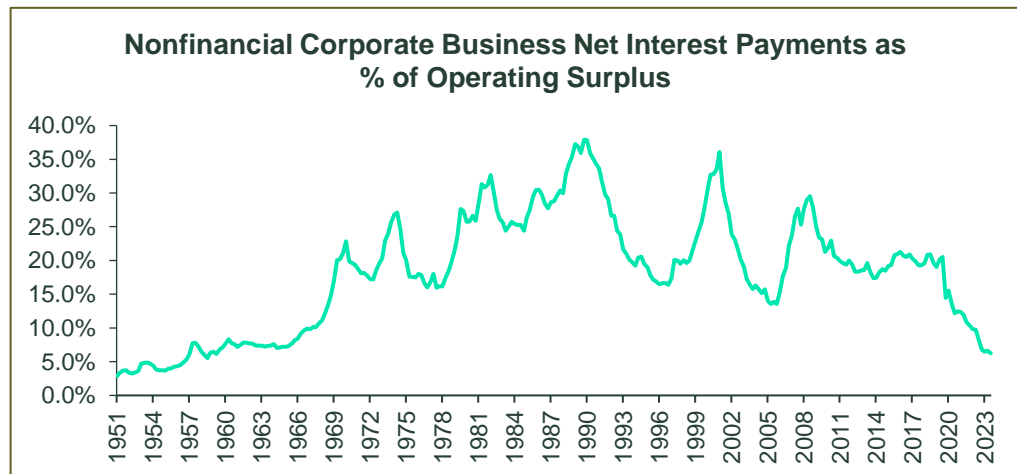
Weekly Market Update

Insight of the Week

Fed Rate Hikes Had Limited Impact on Corporate Balance Sheets

The Fed's recent rate hiking cycle didn't produce the anticipated effects on US corporate performance. Typically, one would expect that rising interest rates leads to higher debt servicing costs for businesses. However, US corporations have used the ultra-low interest rates post COVID to lock-in low interest rates for their debt. Consumers also utilized this near zero interest rate regime to lock in mortgages at favorable rates, subsequently resulting in rate hikes having limited negative impacts. Moreover COVID relief packages from the federal government made sure consumer spending rebounded quickly after the pandemic lockdowns, which kept economic growth buoyant.

Today, due to the confluence of locked-in low interest rates and robust corporate earnings, net interest payments as a percentage of operating surplus have actually declined and is at multi decade lows, as shown in the chart below. All this despite the aggressive rate hikes over the last couple of years.



Source: FRED. Quarterly data as of 4/1/2024.

This doesn't mean that there hasn't been negative effect from interest rate hikes on corporate balance sheets. Smaller companies suffered more than large companies. They rely more heavily on floating rate debt or need to refinance more frequently.

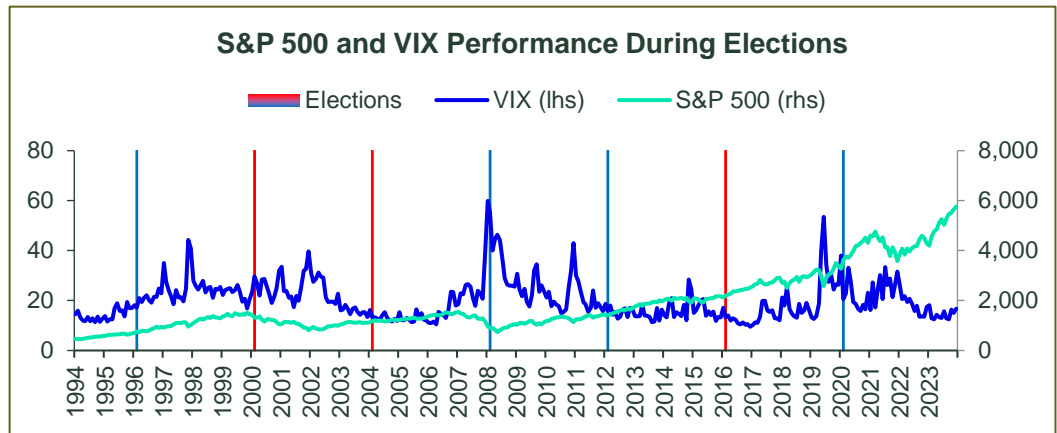
Now as the Fed begins to cut rates, smaller companies should benefit from a reduced interest rate burden. However rates across the curve have moved in different directions and the recent spike in 10 year yields suggest that the path to lower rates won't be uniform. To learn about our macroeconomic views read our latest version of [weekly economic perspectives](#).

Source: FRED, State Street Global Advisors.

Equities

Historical evidence for the future

The US Presidential Election is only a few days away and the outcome is decidedly uncertain. It'll be a close race, with the official outcome not known for days, and the probability for litigation is high. It appears the stock market is quite indifferent to who wins this election. THE CBOE VIX index has been quiet, not reacting to the potential political uncertainty, but instead strong U.S. data and earnings. The VIX moved up slightly to 19.3 as of the end of October 2024, lower than the average level of 21.4 for the past 5 years.



Source: FactSet, State Street Global Advisors. Monthly data as of 09/30/2024.

Since S&P 500 performance doesn't seem to have a strong correlation to presidential outcomes, it is the earnings growth outlook that interests investors most when trying to prognosticate the future. Interestingly, the Fed easing, which just started in September, is generally associated with an earnings decline as economic growth is hindered by higher rates.

Period Start	Period End	Cutting Cycle?	S&P 500 EPS YoY, Period Avg.
Jul '95	Jan '96	Yes	5.0%
Jan '96	Jan '01		10.1%
Jan '01	Jun '03	Yes	-13.1%
Jun '03	Sep '07		-2.8%
Sep '07	Dec '08	Yes	-12.6%
Dec '08	Aug '19		4.8%
Aug '19	Mar '20	Yes	6.2%
Mar '20	Sep '24		8.3%

Source: FactSet, State Street Global Advisors. Monthly data as of 09/30/2024. EPS growth is calculated as the average of EPS YoY growth rates for the stated period.

Though equity market declines and faltering earnings growth have characterized past easing cycles, historical data is limited to mostly hard landing scenarios. Our base case is the Fed will be able to navigate a soft landing; the latest GDP print and the Fed's renewed focus on the labor market have only solidified this view. For now, volatility remains quite muted even as election day nears, Q3 earnings growth is proving resilient, and the equity market is still on a roll. Some say history doesn't repeat itself, but often rhymes. Though this time, it may not rhyme at all.

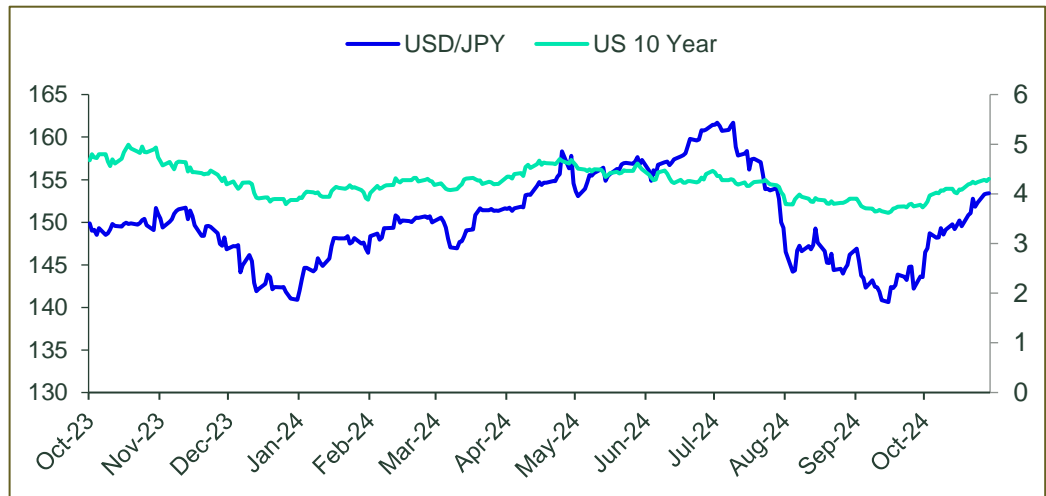
Source: FactSet, State Street Global Advisors.

Fixed Income

Election Impact on BOJ Policy

Japan has always been the “calm in the storm” or “beacon of stability” when it comes to politics and policy as the key pillars to the bullish Japan (equities) thesis. After the October 27th election, this will be a more difficult game. The likelihood of a minority government in Japan is the new and critically important factor for markets going ahead. There is increased risk of a newly elected LDP party leader Ishiba, who led the ruling party into a bigger than expected loss last Sunday. He might be forced to step down by next July giving the party a new face for the 2025 Upper House election. Japan is known for its past periods of “revolving door” politics – post war Prime Ministers lasted on average around 380 days prior to Abe in 2013.

In this period of uncertainty, we look for a potential positive externality: a larger and more populist fiscal package (at least on surface), irrespective of the coalition outcome. As expected, the BOJ held policy constant on October 31st amidst the political noise, while focusing on being data dependent. A December 2024 BOJ move is still on the table, albeit the bar is extremely high due to political uncertainty, whilst a potentially weak Yen hitting 160 handle like July this year acting as a caveat.



Source: Bloomberg as of October 30, 2024.

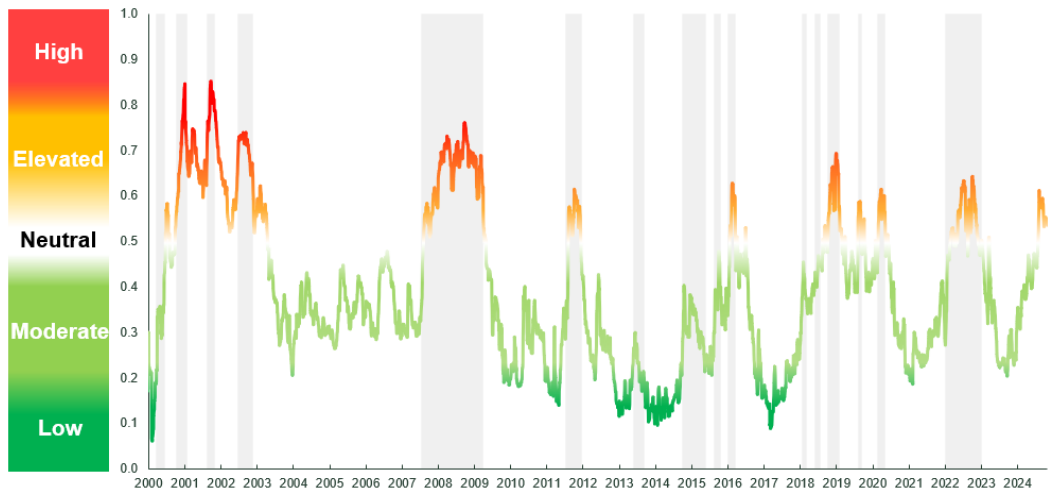
In terms of implications to Global Fixed Income and currency:

- JGB curve is expected to twist steepen – front end anchored by BOJ intact, longer end yields to edge mildly higher pricing in term premium from easier fiscal policy.
- Japanese investors who heavily invest in foreign bonds, will remain invested overseas given diversification needs (more potential capital gains from lower yield in foreign bonds vs JGBs facing potential BOJ hikes/ easier fiscal stance).
- Japanese Yen will take cue from Fed’s next move(s), rather than BOJ despite greater political uncertainty in Japan is not great for the yen in isolation.

Source: Bloomberg, State Street Global Advisors.

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 October 30, 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 September 30, 2024 and includes ETF AUM of \$1,515.67 billion USD of which approximately \$82.59 billion USD 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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Bonds generally present less short-term risk and volatility than stocks, but contain interest rate risk (as interest rates rise, 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.

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