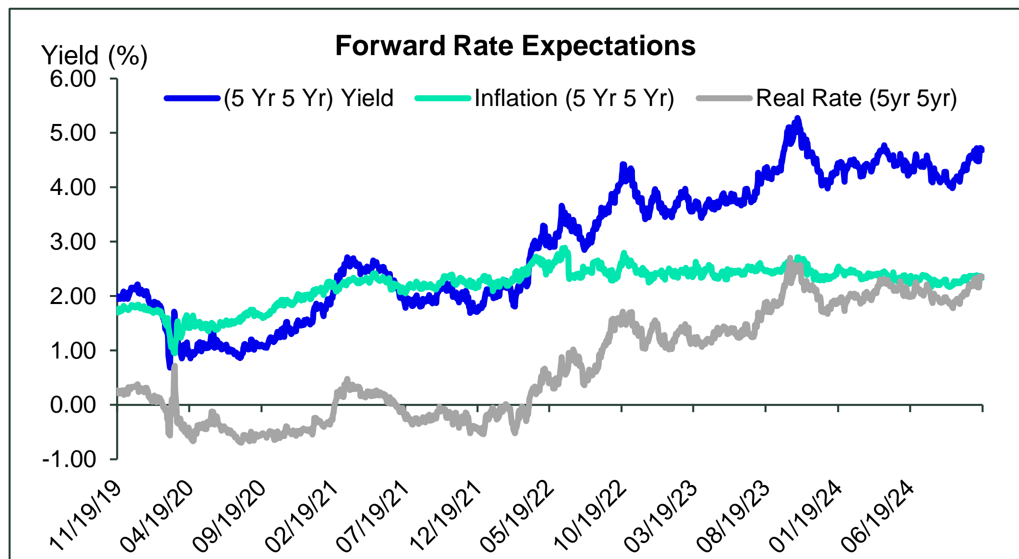
November 21, 2024
Commentary

Weekly Market Update

Insight of the Week

Lofty Real Rate Expectations

5 yr. 5 yr. forward rates are market derived yields that indicate what the market is expecting the 5 yr. yield to be, five years from now. This perspective looks to capture what the 5 year yield might be once the economy stabilizes in the coming 5 years.



Source: FactSet. Data as of 11/18/2024.

In the chart above we plot nominal forward yield expectations, along with the inflation and real yield components. Current nominal 5yr 5yr forward yields are at 4.7%. Outside of the recent inflation surge, we haven't seen 5 yr. yields reach this level since back in 2007! Further, notice that inflation expectations are relatively flat, right around the Fed's target of 2%. Despite this stable inflation outlook, nominal bond forward yield expectations are rising. This mainly comes from the rise in real rate expectations.

From an optimistic perspective, rising real rates can indicate market confidence in future economic growth. Investors may anticipate that economic fundamentals will support higher real yields. On the other hand, higher real rates may represent a larger risk premium investors demand for higher levels of government debt. Higher real rates also mean higher borrowing costs for all, a headwind to overall growth. In the end, market expectations are for something quite different than we saw before the pandemic, and what we saw throughout the 2010's.

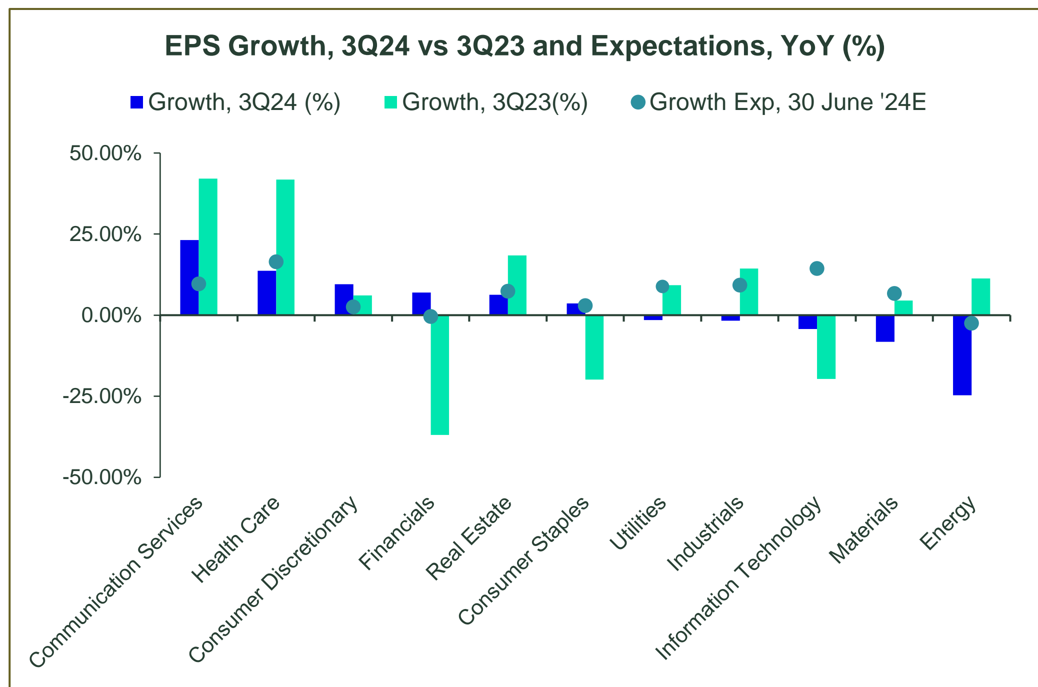
Source: FactSet. Data as of 11/18/2024.

Equities

Q3 Earnings Overview

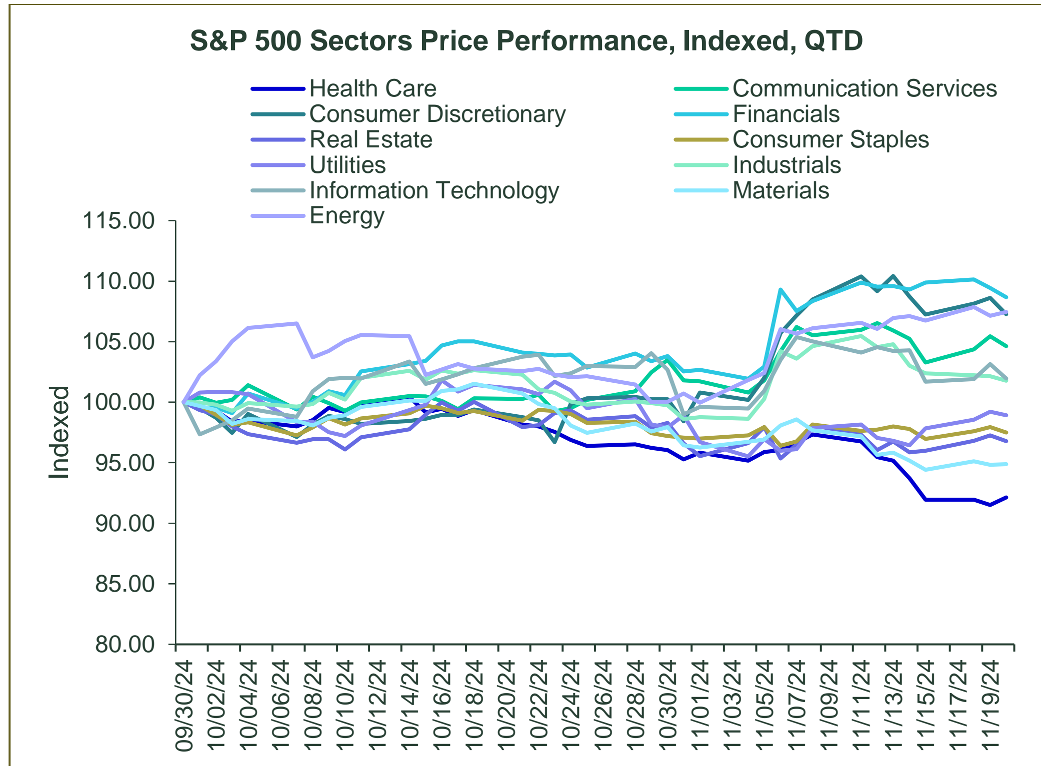
The first half of 2024 brought strong earnings from the S&P 500, with growth rates exceeding market expectations. The continuation of earnings growth is essential for further outperformance of U.S. equities.

Unfortunately, third quarter S&P 500 earnings growth has disappointed, slowing to 3.9% YoY vs the anticipated 7.4% (as of Nov 20th with 94% of index constituents reporting). Compared to the same period in 2023, earnings growth for many companies is now half of what it was a year ago (communication services, healthcare, real estate) and for others it even became negative (utilities, industrials, materials).



Source: FactSet, State Street Global Advisors. Data as of 11/20/2024.

Although the magnitude was lower, we did see positive growth for 6 out of 11 sectors. These include communication services, health care, and consumer discretionary. Interestingly, performance quarter to date has been mis-aligned with earnings growth leaders – since September, the only sector leading in both EPS and returns was consumer discretionary (+8% QTD).



Source: FactSet, State Street Global Advisors. Data as of 11/20/2024.

The top performer is financials, which is benefitting from the outlook of financial deregulation, and should be positively impacted by increasing dealmaking and loans. Moreover, a steeper yield curve is supportive of the industry as banks pay less for short-term deposits, earn more from longer term loans, and profit from higher spreads.

The energy sector is the second best-performing sector QTD despite having the lowest earnings growth this quarter. The new administration's pro-fossil fuel stance along with escalating geopolitical conflict are main factors in this recent outperformance.

Overall, while this quarters EPS growth has not been strong, future estimates are still quite optimistic – 14% and 12% YoY growth is projected for 4Q24 and 1Q25 as of November 20th. This supports our constructive view on U.S. equities into the coming year.

Source: State Street Global Advisors, FactSet. Data as of 11/20/2024.

Fixed Income

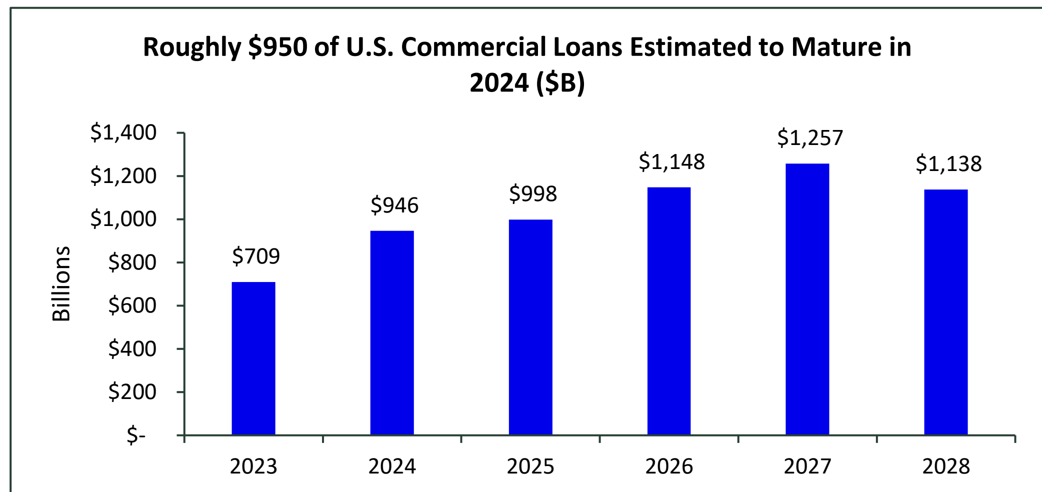
CMBS Issuance Increases as Maturity Wall Looms

The third quarter of 2024 saw deteriorating conditions within the CMBS sector, especially within office space. Despite headwinds, issuance remains strong as loans become due and refinancing activity increases.

Tight lending standards and high interest costs have led to lower property values, higher LTV ratios, and tighter debt service coverage ratios, leading to headwinds

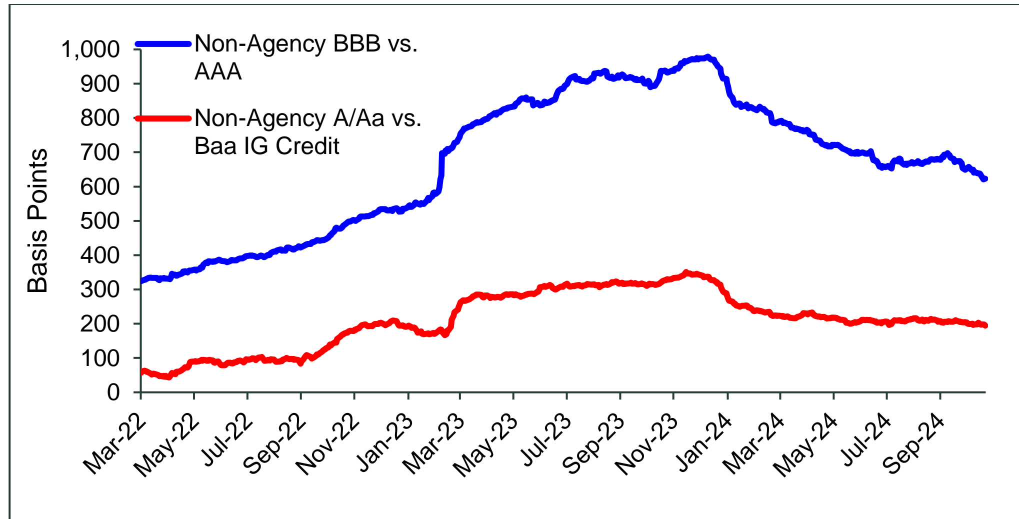
for the sector. The delinquency rate for the sector climbed to 5.98%, special finance rates (where a third party in brought in to manage and resolve loans for CMBS borrowers struggling to make loan payments) increased to 9.14% and approximately $22 billion loans were modified year to date. Within office space, delinquencies nearly doubled to 9.37% year over year and special financing rates increased by 136 basis points to 13.94% (the last time rates went above 13% was in November 2011). The office space also experienced the highest downgrade activity.

In addition to the above mentioned headwinds to the sector, borrowers are facing the reality of refinancing pressure as loans are becoming due. Based on data from S&P Global approximately $950 billion in loans are coming due in 2024 and over $1 trillion due through 2028. With loans coming due, issuance has increased as borrowers look to extend their maturity walls. Approximately 10% of loans coming due in 2024 are within the office space and the ratio is expected to decline in subsequent years. With market rate cut expectation's decreasing, we expect borrowers to remain under pressure as loans would need to be rolled over at potentially higher interest rates.



Source: S&P Global. Data as of 9/30/2024.

From an investment perspective we see value with the Non-Agency credit sub sectors, where spreads have remained high relative to Corporate credit. AA spreads are at 199 bps, A spreads are at 384 bps, and Baa spreads are at 723bps (pricing in a hard landing scenario). Given current market pricing we see value in Non-Agency Baa and Non-Agency AA/A deals, as spreads remain relatively wide, and provide an attractive entry point.



Source: Barclays. Data as of 11/20/2024.

Delinquency Rates:

Property Type	OCT 24	SEP 24	AUG 24	3 MO	6 MO	12 MO
Overall	**5.98%**	**5.70%**	**5.44%**	**5.43%**	**5.07%**	**4.63%**
Industrial	0.32%	0.32%	0.50%	0.64%	0.44%	2.56%
Lodging	6.09%	6.23%	5.91%	6.17%	5.97%	4.76%
Multifamily	3.24%	3.33%	3.30%	2.63%	1.33%	2.64%
Office	9.37%	8.36%	7.97%	8.09%	7.38%	5.75%
Retail	6.82%	7.07%	6.21%	6.14%	5.94%	6.55%

Source: Trepp, as of November 2024

Special Service Rates:

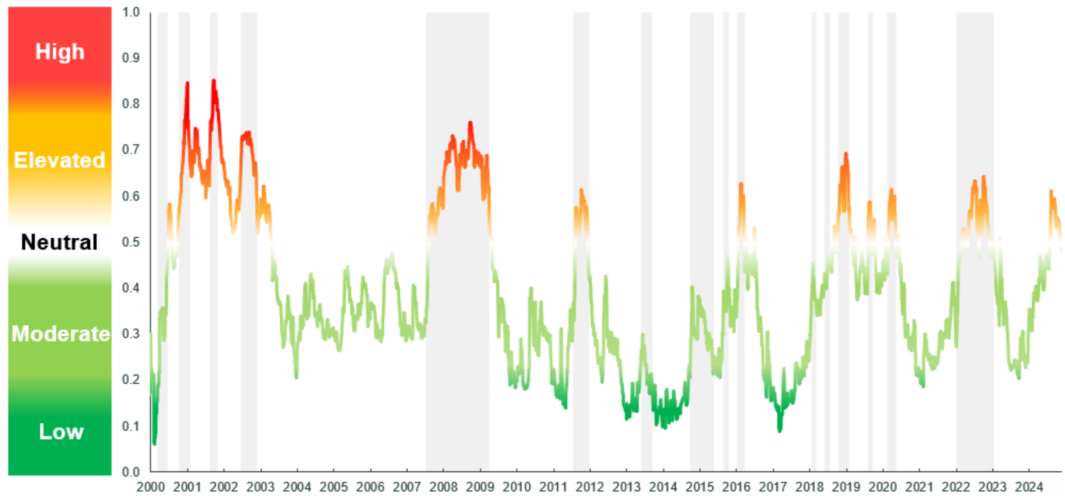
Property Type	OCT 24	SEP 24	AUG 24	3 MO	6 MO	12 MO
Overall	**9.14%**	**8.79%**	**8.46%**	**8.30%**	**8.11%**	**6.80%**
Industrial	0.39%	0.50%	0.39%	0.40%	0.41%	0.32%
Lodging	8.32%	7.84%	7.42%	7.33%	7.40%	7.03%
Multifamily	6.21%	6.07%	5.71%	5.11%	5.10%	3.14%
Office	13.94%	12.58%	11.91%	11.25%	10.84%	8.55%
Mixed-Use	8.79%	9.67%	9.59%	8.93%	8.25%	7.70%
Retail	11.37%	11.22%	10.92%	10.89%	10.85%	9.84%

Source: Trepp, as of November 2024

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 November 20, 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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