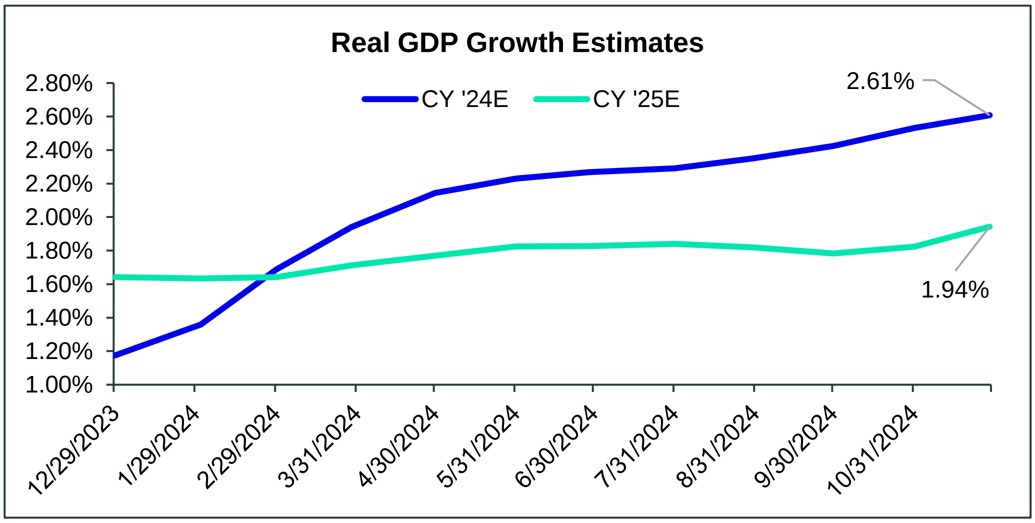
December 12, 2024
Commentary

Weekly Market Update

Insight of the Week

Realized Economic Growth Continues to Surpass Expectations

Throughout this past year, we've seen consistent upward revisions to the 2024 real GDP forecast, which has underscored the resilience of the US economy. Projections at the start of 2024 stood around 1.2%, reflecting concerns about restrictive monetary policy and global uncertainties. As the year progressed, there's been a steady upward progression to real growth estimates, which has now climbed to over 2.6%! As we look forward to next year 2025, we can see that growth is also expected to remain healthy at around historical trend levels, which is usually considered around 2%.



Source: FactSet Economic Estimates. Data as of 12/10/2024.

For 2024, most of the upward revisions have been driven by resilient consumer spending, supported by a strong labor market. Equity markets have reflected this economic strength as incoming data has provided a tailwind to the S&P 500, which is up almost 30% YTD. This impressive market performance is supported by strong corporate earnings which is expected to end the year up 9%. Encouragingly, this economic strength appears to remain solid into 2025, where we've also seen GDP growth expectations tick up more recently.

While there are certainly a fair amount of market crosswinds to think about over the coming year, we believe solid economic growth expectations will continue to be a supportive environment for equities. Please see our recently released Global Market Outlook for further insights across a variety of asset classes and themes.

Source: State Street Global Advisors, FactSet. Data as of 12/12/2024.

Equities

Risks to the U.S. View – Part 2

Last week we laid out reasons why the U.S. equity market looks appealing over the next year. The risks to this view are explored below.

The lagged nature of monetary policy uncovers fractures in the economy that weren't yet visible. To date, we have seen a regional banking crisis, the unwind of the Yen carry trade, and struggles in the commercial real estate sector. One worry we hear from investors is the sustainability of the U.S. fiscal position. Will the government be able to manage higher interest costs? If rates rise, could the budget become too stretched?

Inflation bout 2.0 puts pressure on the consumer and potentially corporate margins. A second wave of inflation such as that seen in the 1970s would pose a risk to our view. If inflation reverses from its downward trajectory and increases to a point where wages cannot keep up, we could see a hit to consumer confidence and demand. Additionally, corporate margins of companies that are unable to pass on prices to consumers, or see decreased demand when passing on prices, are likely to suffer.

Though Trump's re-election should bring the extension of tax cuts, his proposed polices on immigration and trade, are presumed to be inflationary. We are watching this area as a potential driver of inflation resurgence.

Labor market worsens and/or large data revisions skew to the downside.

The health of the consumer is dependent upon a strong labor market, and as mentioned above, healthy consumers support economic growth. At this point, the labor market remains resilient. However, if companies begin to feel more pressure from the policy rate being too high above "neutral," they could attempt to cut back on costs, namely the cost of labor. A material uptick to the unemployment rate could cause consumer demand to flatline. We continue to monitor job openings and unemployment claims (along with revisions), for any indication of labor market deterioration.

Earnings do not deliver as expected.

The S&P 500, thus far, has produced Q3 earnings growth of ~3.9%. Growth across sectors is mixed, and the Information Technology sector has -4.2% growth, a surprise to the downside. In addition to this, we have begun to see downward revisions to 2025 earnings growth across regional indices. Our favorable view on U.S. equites is predicated upon the fact that earnings growth will continue and round out. Downward revisions in the U.S. or a disappointment in earnings would create a hurdle for U.S. equities.

Geopolitical events worsen.

Of course, we would be remiss to ignore the geopolitical events occurring globally. Just recently, the U.S. supplied missiles to Ukraine which they used to conduct a strike on Russian soil. This prompted Putin to tout Russia's nuclear policy, which he updated by lowering the requirements in which Russia could use nuclear weapons. If wars were to escalate and the U.S. became more directly involved, this could create a drastically different economic backdrop. Not only could escalation create widespread turmoil, at the least it could cause a resurgence of inflation (explored above).

Not only do nuclear weapons pose a massive risk, but the increased prevalence of cyber warfare could mean wars that have less physical harm, but further reach into the economy, with the potential to severely damage infrastructure and/or disrupt markets.

Source: FactSet, S&P Global, FRED. Data as of 12/3/2024 unless otherwise stated.

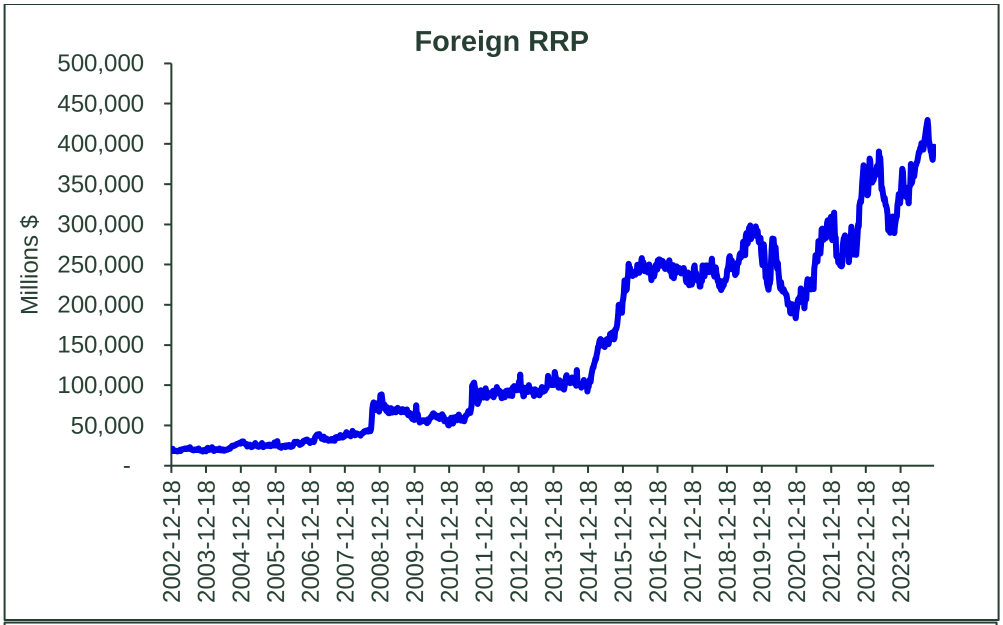
Fixed Income

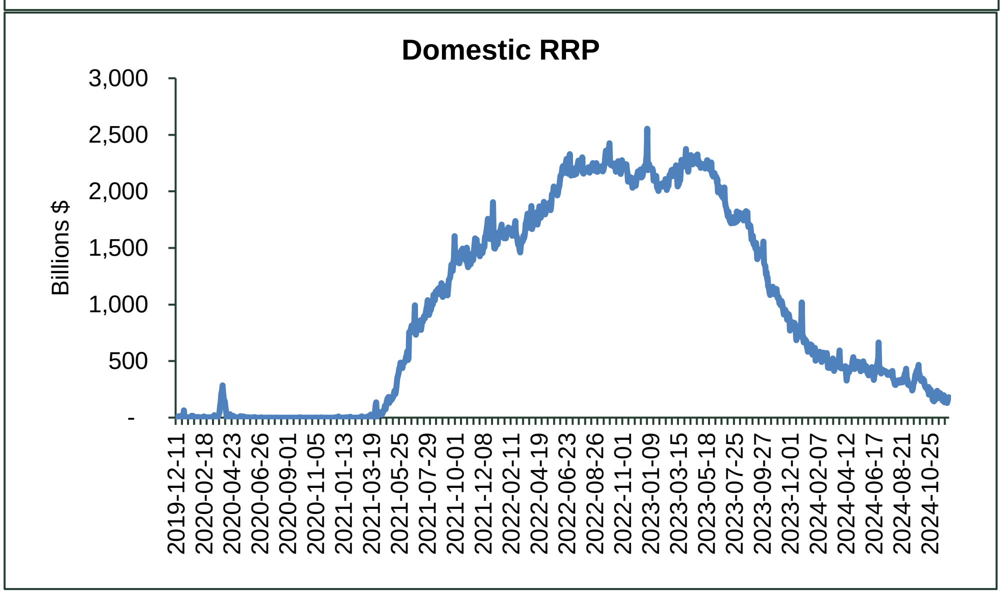
Foreign RRP Balances Continue to Increase Amid Uncertainty

The foreign reverse repurchase facility (FRRP), allows foreign central banks and international monetary authorities (FIMA) to lend money to the Federal Reserve overnight, using their U.S dollar assets as collateral. The facility provides an alternative temporary source of U.S. dollars for approved FIMA account holders.

The foreign RRP facility is structurally similar to the domestic RRP facility. In both cases, the Federal Reserve acts as a counterparty and the collateral pledged comes from the Fed's securities portfolio and represent liabilities on its balance sheet. Increases in either of the facilities drain bank reserves. The terms of the agreement can be overnight or up to seven calendar days (with rates set at the minimum bid of the Standing Overnight Repurchase agreement operations for overnight transactions, or at a rate equal to the rate on overnight index swaps of a weekly maturity plus 25 basis points for a seven-day term).

Although structurally similar, both facilities fulfil different purposes. The domestic program is designed to absorb surplus liquidity, while the foreign facility is designed to help foreign institutes manage their cash and daily liquidity. Foreign RRP program is settled in DVP (delivery versus cash), so at the end of each day the foreign institutes cash is swept up into a treasury repo, allowing them to hold onto their dollar cash throughout the day in case of any unexpected liquidity needs. Although foreign balances have been subject to rate sensitivity in the past, the current environment increase in balances is showing that foreign institutes are less rate sensitive, prefer liquidity and are reluctant to take on counter party risk via the private sector.





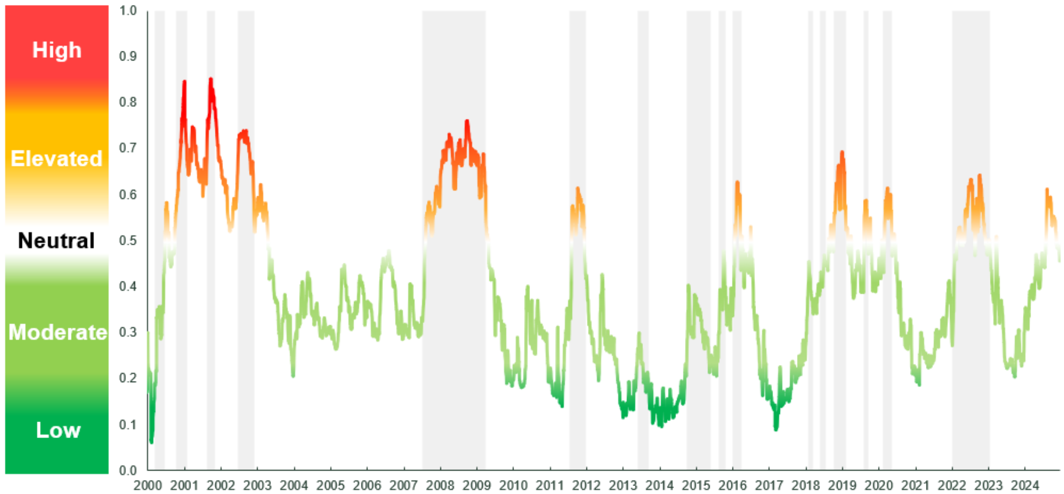
Source: Federal Reserve Economic Data. Data as of December 4, 2024

Foreign RRP balances has been higher than domestic balances as of August 2024, absorbing approximately more than 250bn more in reserves. FIMA account holders have increased the utilization of this facility as global uncertainty mounts, and these institutions looks for a secure place to park excess reserves at a guaranteed rate of return. The implication of increased usage is a stronger dollar as more funds flow into the U.S causing a greater level of illiquidity in global markets which can ultimately complicate the Fed’s ability to manage domestic monetary policy.

Source: State Street Global Advisors, FRED.

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 December 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 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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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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