STATE STREET GLOBAL ADVISORS

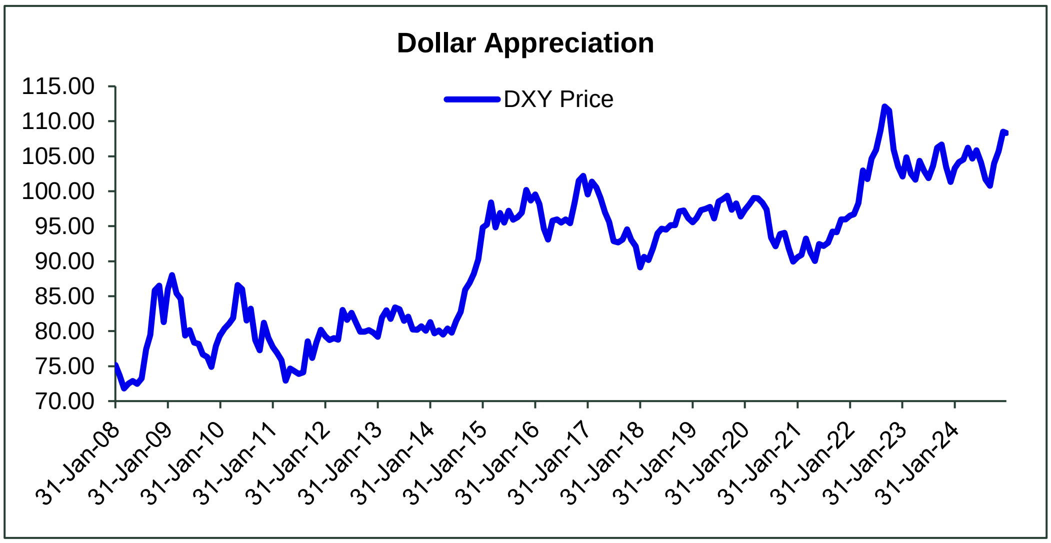
January 23, 2025
Commentary

Weekly Market Update

Insight of the Week

Dollar Continues Appreciating

The DXY, which tracks the dollar's value against other major currencies, has experienced significant appreciation over the last 20 years. Over time, the dollar has been viewed as both a safe haven, and an avenue to access growth potential in the U.S. Recently, higher rates and the Trump administration have highlighted the Dollar's role as a tool for growth.



Source: DXY, FactSet. Data as of 1/22/2025.

Over the last few years we have seen the dollar spike and remain at elevated levels. This is due to superior US growth opportunities but also due to its protective qualities. In 2022, the index hit its highest level since 2002, while global equities had one of its worst performing years in recent memory with the MSCI All Country World Index returning -18% in USD. Despite global weakness, the USD appreciated in times of economic and geopolitical uncertainty exhibiting its safe haven characteristics.

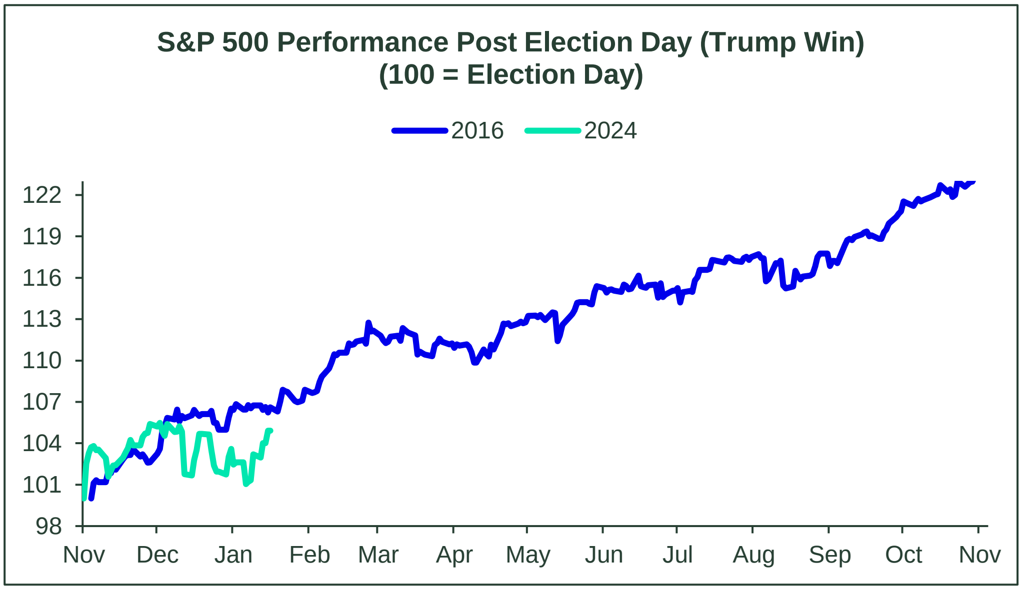
President Trump has made it clear he favors a weaker US dollar and lower interest rates, but his policies seem to favor stickier inflation, higher growth, and a stronger USD overall. Unless we see growth soften, it is hard to see anything beyond periodic, but temporary, corrections lower in the dollar. To learn more about USD strength under the new administration please check out our latest insight Don't Sell the US Dollar Yet.

Source: FactSet. Past performance is not a reliable indicator of future performance. Index returns are unmanaged and do not reflect the deduction of any fees or expenses.

Equities

Post-Inauguration Market Sentiment: What to Expect Next

Around the time of a presidential inauguration, it's natural to assess the incoming administration's policy agenda and its potential impact on markets. Following Donald Trump's victory in the 2024 election, markets reacted quickly to the anticipated policy changes he outlined soon after the results were announced. Much of this optimism appears to have been priced in, yet examining market movements since Election Day 2024—and even from Trump's first term in 2016—offers insight into shifting market sentiment.



Source: FactSet. 2016 data from 11/8/2016 to 11/8/2017, 2024 data from 11/5/2024 to 1/21/2025.

Following Trump's 2016 victory, the S&P 500 gained over 5% in the first month, and a similar rise of just over 5% followed his 2024 win. However, as January unfolded, equities exhibited more weakness, signaling a shift from previous cycles. This divergence stems from several underlying factors:

- Higher Valuations and Limited Upside

Current valuations are significantly higher than in 2016, leaving less room for further price appreciation without corresponding earnings growth. While markets historically reacted positively to the pro-business stance of a Republican administration, these higher starting points limit the impact of similar optimism.

- Fiscal Policy Concerns

The fiscal environment today is notably more constrained than it was during Trump's first term. Elevated government debt levels and higher interest rates make borrowing more expensive, reducing the flexibility for large-scale spending programs without exacerbating deficits. In 2016, fiscal policy centered on tax cuts and ambitious infrastructure investments. In contrast, the current economic landscape demands more disciplined measures, which could cap market performance despite initial optimism.

- ETF Inflows Highlight Positive Reaction

Positive market sentiment extended beyond equities to ETFs. In Q4 2024, U.S. equity ETFs recorded $290 billion in inflows, with November and December setting records at $122 billion and $107 billion, respectively. This robust activity mirrors the enthusiasm seen after the 2016 election, although it remains to be seen whether this momentum can be sustained. More on ETF flows can be found in the recent SSGA article.

- U.S. Equity Leadership in Global Markets

The U.S. remains a dominant force in the global equity universe, strengthening its position over the past decade. The U.S. share of the MSCI ACWI Index rose to 67% in 2024, up from 53% in 2020 and 51% in 2018. This trend underscores the continued global preference for U.S. equities, though high valuations may temper future gains.

Looking Ahead

While executive orders have begun to take shape around immigration, trade and energy, the market has not been surprised and responded favorably. Key policy milestones will take time to execute, playing a critical role in shaping market sentiment moving forward. Investors should remain vigilant, as new policy is negotiated, and watch for geopolitical developments that could introduce volatility.

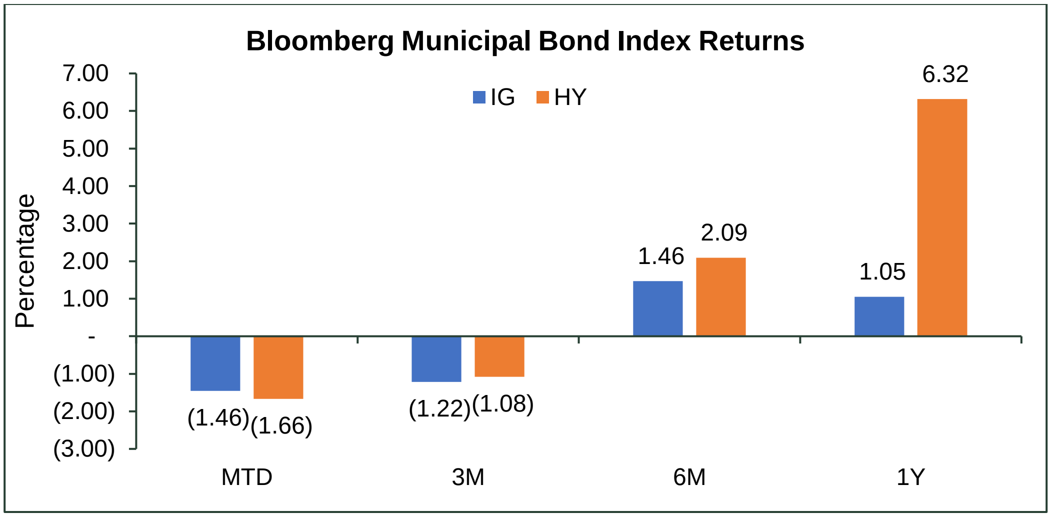
Source: FactSet, S&P, MSCI. Past performance is not a reliable indicator of future performance. Index returns are unmanaged and do not reflect the deduction of any fees or expenses.

Fixed Income

The Municipal Market Outlook 2025

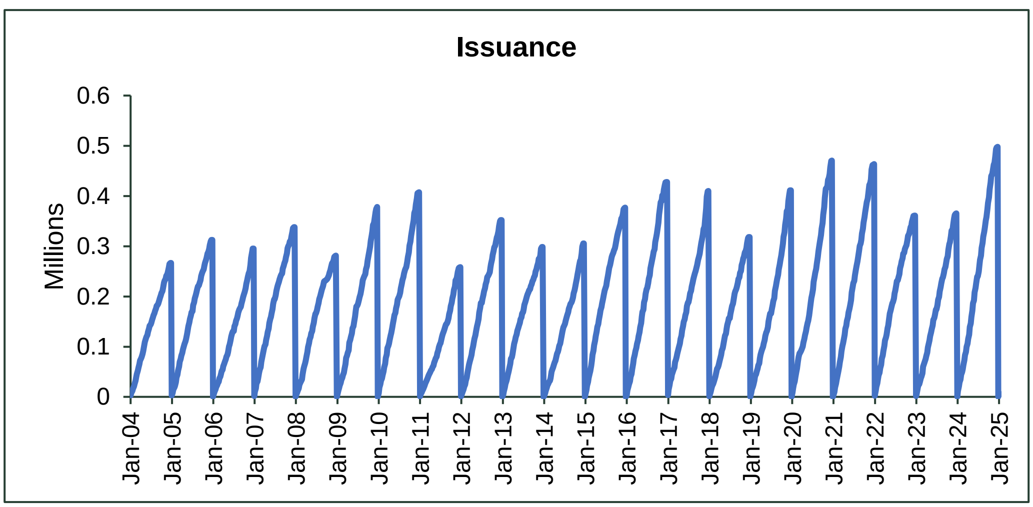
The past year was one of adaptation for economies and markets worldwide, presenting both challenges and opportunities as we adjusted to a new growth and policy regime. Central banks concentrated on fine-tuning monetary policy amidst growth concerns, inflation pressures, geopolitical instability, and US politics, resulting in bouts of volatility.

From a performance perspective, municipals had a solid year with stable credit spreads and solid total returns. Rates started the year at their lows and hit peaks in June, early November and as we closed out December. While 2024 was primarily about the Fed, and the elections, 2025 may also see increased volatility with potential policy shifts from the new administration as well as the Fed working with higher inflation than its target. We expect yields to decline in 2025, helping tax-exempts perform, with returns driven by coupon income and spread compression.



Source: Bloomberg as of 12/31/2024.

From an issuance perspective, municipals saw record new issuance in 2024. We expect issuance to remain strong in the first half of 2025, as policies relating to the status of tax exemption comes into focus. While investors might want to mis-weight market segments that could be more susceptible to changes, we believe that even if tax-exemption is somehow curtailed for certain parts of the municipal market, all outstanding bonds would be grandfathered, which should benefit investors in the longer run.



Source: Bloomberg as of 1/10/2025.

As federal aid winds down, municipalities will once again need to fund projects in capital markets. There will be a bifurcation among those that were fiscally prudent and those that were not. Identifying opportunities will require an understanding of the borrowers' fundamentals. Although there will be headwinds for certain municipalities, the expectations remain that once again high yield will outperform investment grade as a result of healthy economic growth and fundamentals.

Source: State Street Global Advisors , Bloomberg. Past performance is not a reliable indicator of future performance. Index returns are unmanaged and do not reflect the deduction of any fees or expenses.

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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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