STATE STREET GLOBAL ADVISORS

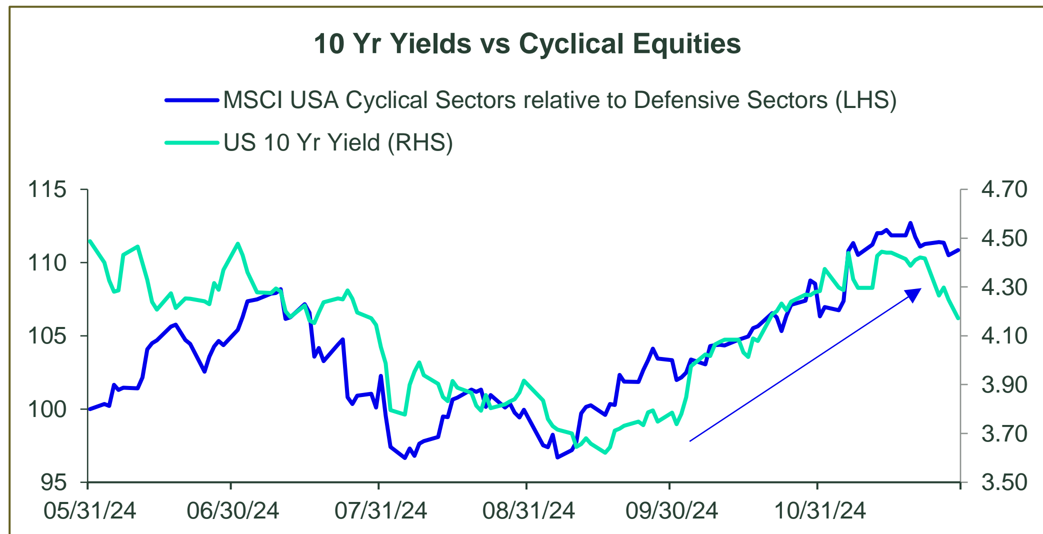
December 5, 2024
Commentary

Weekly Market Update

Insight of the Week

Cyclical Stock Performance Against Rising Yields

Rising bond yields can be an economic headwind, but rising yields can also signal underlying economic resilience. Since September, the 10-year yield has steadily increased, reaching close to 4.5% before rolling over a bit more recently. To get a deeper sense how risk assets are responding to the recent change in yields, the chart below shows the relative relationship of cyclical vs defensive equities, and how they are responding to the higher yields of the last few months.



Source: MSCI, FactSet. As of 11/29/2024.

The chart highlights a clear uptrend in both the 10 Yr yield and US cyclical sector relative performance since September. Cyclical sectors are particularly sensitive to economic growth, and their strong performance underscores confidence in the broader US economy, despite the headwinds of higher yields.

The current environment of rising yields is characterized by a balancing act between headwinds and opportunities. While businesses and consumers face increased financing costs, the broader economic picture remains strong, supported by a healthy consumer and stable inflation expectations. Corporate bond spreads also rhyme with this, as they remain at tight levels and reflect the continued optimism of economic growth. As the markets navigate these dynamics, it becomes clear that higher yields, when driven by growth rather than inflation, reflect expectations for a healthy economy.

Source: State Street Global Advisors, MSCI, FactSet. Data as of 11/29/2024.

Equities

Why We Favor U.S. Equities

As it stands, the current economic environment in the U.S. is supportive. At Jackson Hole in August, the Fed reminded us of their dual mandate when Chairperson Powell said, "We will do everything we can to support a strong labor market as we make further progress toward price stability." At the time, it looked like the consumer was feeling the strain of historically tight monetary policy. Since then, an accommodative Fed has delivered 75 bps of easing (with another 25-bps coming in Dec @72% market probability) and the unemployment rate in the US has settled at 4.1%, a very strong metric helping to support domestic consumption.

Additionally, consumers have built up a large amount of wealth, with home equity to disposable income ratios reaching historic highs. This is important for two reasons. Firstly, if recession risk re-emerges, households are not overly levered, and homeowners have liquid savings to tap into if needed. Secondly, if a soft landing remains intact, the falling interest rate environment makes utilizing this home equity even more attractive through products such as home equity loans, HELOCs, second liens, etc. Consumers unleashing this back-pocket tool in either scenario is likely to increase liquidity, and support consumption.

The consumer is alive and well in the U.S. As far as corporate health, the re-election of President Trump has ensured the continuation of the 2017 TCJA and deregulation in the banking and energy sectors, which supports healthy forward earnings growth expectations, in addition to stimulating higher economic growth.

Along with supportive macro-economic conditions, we foresee price momentum favoring US markets for the following reasons:

Stock Buybacks and R&D

According to S&P Global, S&P 500 share buybacks totaled $877.5 billion from June 2023 to June 2024. That is an increase of about 8% from the prior years total. Share buybacks inherently increase the value of outstanding shares and increase EPS, providing a natural tailwind to stock prices. Additionally, stock buybacks signal positive sentiment from company leadership, indicating growth potential.

Similarly, when a company spends in research and development, this signals a recommitment to its future potential, investing, to driving stock prices higher.

More Attractive Financing Rates for Smaller, Less Well Capitalized Companies

Companies on the smaller end of the cap spectrum are typically more reliant upon short term and variable rate debt. The prospect of lower interest rates will reduce borrowing costs for smaller companies, reducing expenses and boosting profits. The ability to finance more projects will also provide positive prospects. Both items are likely to pose a tailwind to market returns.

Continued technological transformation favors IT

The introduction and successful implementation of artificial intelligence has excited markets this year and improved the growth outlook for the U.S. Advancements in technology create more efficiency, shifting production curves outward, leading to increased worker productivity and stronger economic growth. The implementation

of AI has just begun, and we are likely to see tailwinds to sectors and industries that could benefit from this technology. Many benefactors are within the information technology sector which currently makes up around 31% of the S&P 500.

Sentiment and Momentum continue to look good

Within the U.S. the Consumer Confidence Index produced by the Conference Board provides insight into "consumer attitudes, buying intentions, vacation plans, consumer expectations for inflation, stock prices, and interest rates". In October, the consumer confidence print showed a strong gain, in fact, the strongest monthly gain since March of 2021. Consumption is the largest portion of GDP, accounting for 68% of the total print. Therefore, consumer health is of the utmost importance for further economic growth. The consumer confidence metric further evidences our thesis that the U.S. consumer is in decent shape, supporting the continued growth of the U.S. economy.

In the next Weekly Market Update we will explore the risks of investing in U.S. equities.

More on our 2025 view can be found in the State Street Global Advisors' 2025 Global Market Outlook (GMO).

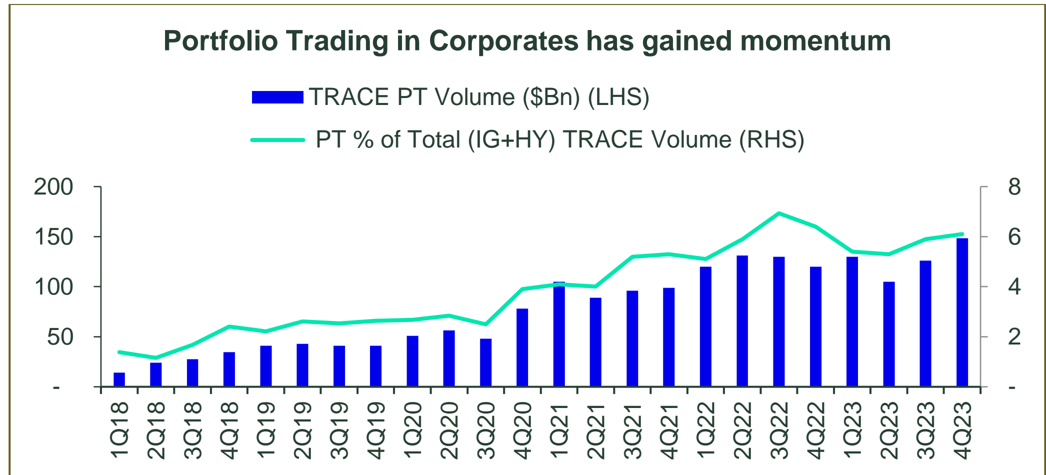
Source: FactSet, S&P Global, FRED. Data as of 12/3/2024 unless otherwise stated.

Fixed Income

Electronification of Fixed Income Markets

Unlike its equity counterpart, electronic trading in the fixed income market is a relatively new concept. The lag in adoption is due in part to how fixed income markets are structured. Initially dealers interacted with clients by voice and often deployed capital to hold bond inventory. Over time, dealers increasingly focused on being the intermediary, bringing counterparties together.

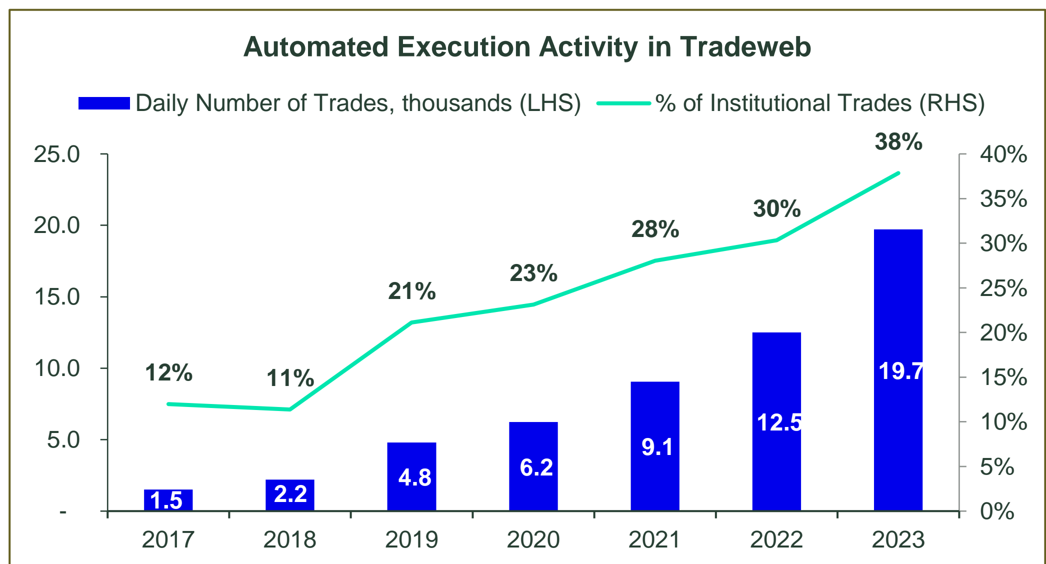
The evolution has continued over the last two decades, accompanied by an expansion in electronic trading and the rapid growth of fixed-income ETFs and portfolio trading. Portfolio trading involves trading a basket of bonds with variable credit quality and risk as a single, all or none transaction, resulting in lower aggregate transaction costs than if the bonds were traded individually. Portfolio trading has unlocked liquidity even in less liquid bonds and has increased from approximately 1% in 2018 to 14% in November 2024. The result is better market liquidity and price discovery resulting in lower transaction costs for clients.



Source: TRACE, Barclays, as of December 2023.

The adoption of electronic trading varies by sector due to differences in market size, number of instruments, turnover, minimum lot size, types and nature of market participants, trading protocols and liquidity among the sub-asset. Currently, 70% of government bonds are traded electronically, driven by automation which helps absorb the large number of orders in a rapidly growing treasury market (where treasuries outstanding are approaching $30 trillion). Within credit markets, 50% of investment grade bonds and between 30% and 40% of high yield and convertible bonds (respectively) trade electronically. Compared to rate markets, credit markets have been more fragmented due to their idiosyncratic nature. However, the rise of ETFs and the ability to trade less liquid corporate bonds through portfolio trading has propelled electronic trading within credit markets to a more mature stage.

Trading venue competition, innovation, and data proliferation have encouraged new entrants and helped to create a more efficient market. According to Tradeweb, automated execution activity reached 38% of the daily trade activity by the end of 2023.



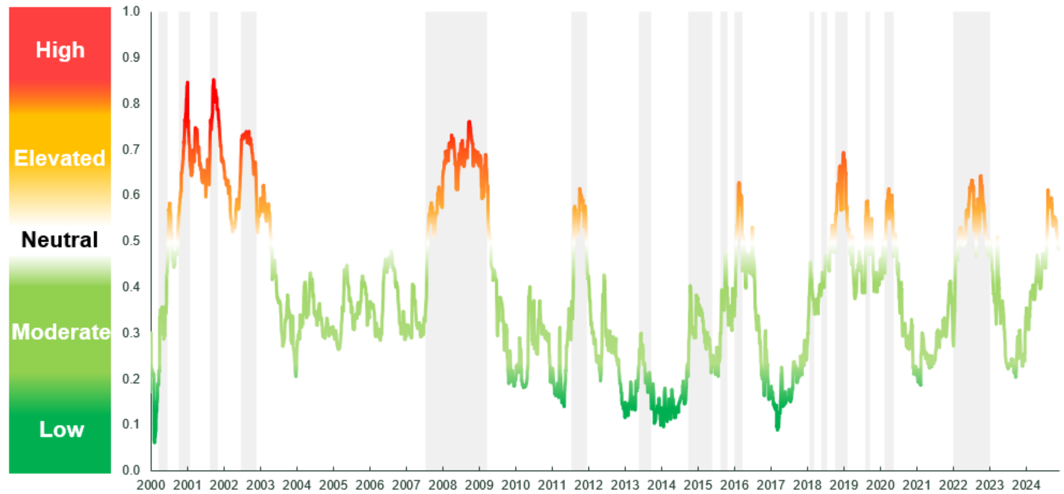
Source: Tradeweb as of 2023.

The “electronification” of fixed income markets is a work in progress as global exchanges, rates, and credit markets evolve at different paces, but there is no denying that electronic trading has increased the speed, efficiency, liquidity, and transparency within fixed income markets. The electronification of fixed income markets is unlikely to replace human expertise when trades are more complex, but technology can continue to boost efficiency, freeing time for more value-added tasks for asset managers. For more information please see: The Modernization of Bond Market Trading and its Implications.

Source: State Street Global Advisors, TRACE, Barclays, Tradeweb.

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 4, 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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For over four decades, State Street Global Advisors has served the world's governments, institutions, and financial advisors. With a rigorous, risk-aware approach built on research, analysis, and market-tested experience, and as pioneers in index and ETF investing, we are always inventing new ways to invest. As a result, we have become the world's fourth-largest asset manager* with US $4.73 trillion† under our care.

*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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Marketing Communication

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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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