SSGA Market Regime Indicator Update

Strategy Update
Multi-Asset Solutions

June 2023

The Market Regime Indicator (MRI) is a proprietary macro indicator developed by the SSGA Investment Solutions Group (ISG). Based on forward-looking market information, it is designed to identify the level of Risk aversion/appetite in the market. The factors utilized to generate the signal include implied equity and currency volatility as well as spreads on fixed income.

The Investment Solutions Group uses the MRI as one of the inputs into its global tactical asset-allocation decision-making process.

The MRI is the result of over twelve months of rigorous testing by the Investment Solutions Group. The test results showed that the MRI tracked historical market stress events and trading strategies based on the level of outperformance generated by the indicator. By design, the MRI signal varies between 0% and 100%. On this scale, a high level is often characterised by market tensions, such as a significant increase in volatility and a drop in Risky asset prices.

We Have Identified Five Different Market Regimes:

Crisis (level close to 100%) — Extreme Risk aversion ('Fear/Panic')

High Risk Aversion (level above the average) — Aversion towards Risky assets

Normal (level oscillating around the mean) — Characterised by neutral market sentiment

Low Risk Aversion (level below the average) — Appetite towards Risky assets

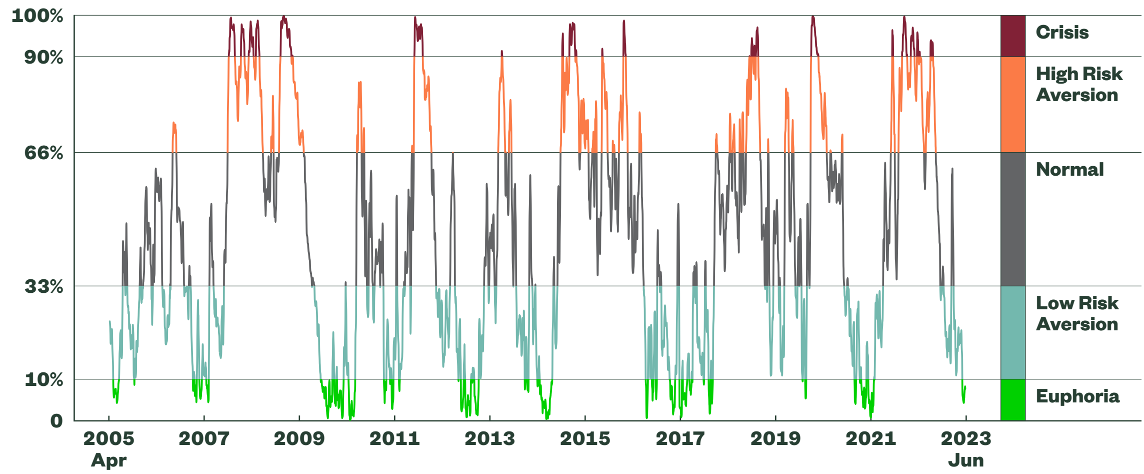
Euphoria (level close to 0%) — Extreme Risk appetite ('Greed/Complacency')

Figure 1 **Market Regime Indicator**

Market Regime Indicator	31/03/2023	30/06/2023
Average — Equity Implied Volatility	Low	Euphoria
Average — Risky Debt Spreads	Normal	Low
Average — Currency Implied Volatility	Low	Euphoria
MRI Level	Low	Euphoria

Source: State Street Global Advisors Investment Solutions Group, 30 June 2023.

Figure 2 **Market Regime Indicator (MRI) Evolution**



Source: As of June 30, 2023. The data displayed is not indicative of the past or future performance of any State Street Global Advisors product. The portion of results through March 31, 2011 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, equity implied volatility, currency pairs implied volatility and bond spreads, 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 five risk regimes: Euphoria, Low Risk, Normal, High Risk, and Crisis. A slight calculation change was made as of June 28, 2019.

Market Commentary

The second quarter of 2023 was generally a strong one for risk assets. Global equities gained amid enthusiasm over AI (artificial intelligence) and speculation that central banks could be closing in on the end of the rate hiking cycle. Against this back drop the MRI moved lower over the period. Having moved back into Low Risk regime at the end of March the signal moved into Euphoria regime in early June. This was the first move into Euphoria regime since the summer of 2021 at which point markets were still in the midst of the post COVID rally.

The Implied Volatility on Equities factor began the period in Low Risk regime, which given mid-March had seen the demise of Silicon Valley Bank and Credit Suisse, was somewhat surprising. Equity volatility had however reverted remarkably quickly after this episode and continued to move lower at the start of the quarter with the factor moving into Euphoria regime. Hawkish developments including the surprise move by the Bank of New Zealand to hike by a larger-than-expected 50bps, and U.K. inflation remaining in double-digits, alongside weak data that increased fears regarding a potential US recession, dented sentiment somewhat in early April, however equities remained resilient and the factor stable.

Early May saw the Implied Volatility on Equities factor move higher into Low Risk regime as renewed banking turmoil hit markets. First Republic was seized by regulators and then sold to JPMorgan and the KBW bank index fell beneath the lows it had reached during the SVB and Credit Suisse collapses. In addition US debt ceiling concerns moved to the fore as Treasury Secretary Yellen warned that the government could default on debt as soon as June 1. The factor moved between Low Risk and Euphoria regimes for the reminder of the month as debt ceiling concerns continued but markets grew more confident that the Fed would pause their rate hikes following a CPI release that pointed to a lasting slowdown in inflation.

In early June the factor moved lower once again into Euphoria regime as the debt ceiling deal was approved by Congress and the VIX Index (Cboe Volatility index) moved to its lowest level since February of 2020, prior to the COVID pandemic. The factor remained in Euphoria until the end of the quarter with the key market event the Fed pausing as it ended a series of 10 successive rate hikes.

The movements of the Implied Volatility on Currencies factor were rather uninteresting over the second quarter. In mid-April the factor moved from Low Risk into Euphoria regime where it remained until the end of June. This stability was however in itself very unusual and is in fact the longest single period the factor has been in Euphoria regime since 2014, and one which could of course still extend into July.

The Risky Debt Spread factor was the most elevated of the three MRI inputs over the quarter. The factor began April in Normal regime where it remained until the end of May with spreads remaining largely stable throughout the two months.

The improvement in the risk environment in June with the debt ceiling resolution and the Fed pause saw risky debt spreads tighten with both Emerging market and High Yield spreads tightening towards their lows for the year. The High Yield market was also supported by technical factors in the US where close to $65 billion of have been bonds upgraded to investment grade ratings this year, while new issue volume has remained manageable. The factor moved into Low Risk regime in early June where it closed the quarter.

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Marketing communication.
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