SSGA Market Regime Indicator Update

Strategy Update
Multi-Asset Solutions

Q2 2024

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 toward Risky assets

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

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

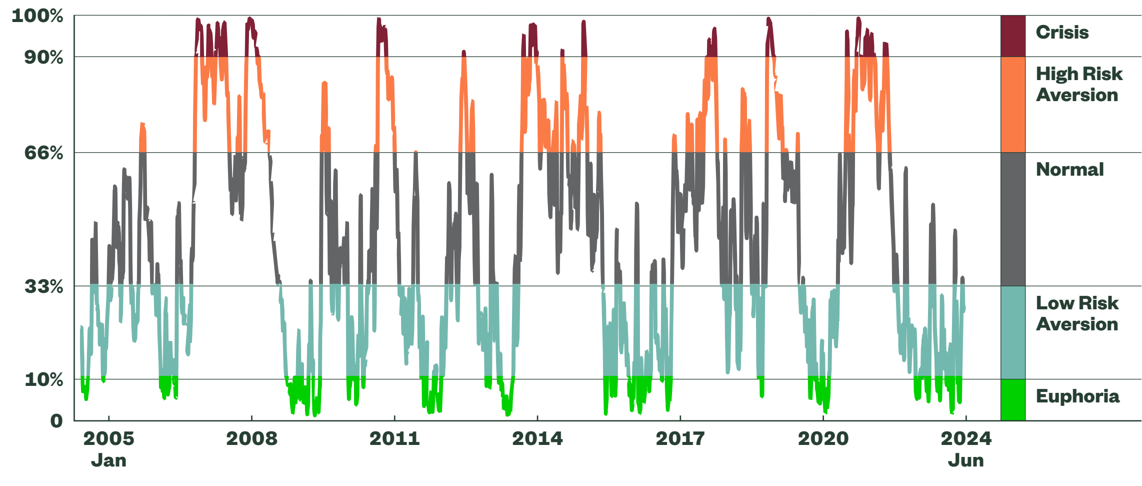
Euphoria (level close to 0%) — Extreme Risk appetite (‘Greed/Complacency’)

Figure 1 **Market Regime Indicator**

Market Regime Indicator	31/03/2024	30/06/2024
Average — Equity Implied Volatility	Euphoria	Low
Average — Risky Debt Spreads	Euphoria	Low
Average — Currency Implied Volatility	Euphoria	Low
MRI Level	Euphoria	Low

Source: State Street Global Advisors Investment Solutions Group, 30 June 2024.

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



Source: Investment Solutions Group, as of 30 June 2024. The data displayed is not indicative of the past or future performance of any SSGA product. The portion of results through 31 March 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 28 June 2019.

Market Commentary

Familiar themes continued to steer markets and sentiment over Q2. Mega-cap stocks, driven by enthusiasm about artificial intelligence, powered US equity market gains, while uncertainty regarding inflation and the path of interest rates continued to keep markets guessing. Geopolitical uncertainty, in the shape of numerous elections, also impacted markets in Q2. The Market Regime Indicator, having closed Q1 in Euphoria, moved higher in April, into Normal regime by the middle of the month. The signal then reversed, spending much of May in Euphoria regime. In June, the MRI moved into Low Risk, spiked to Normal regime mid-month, but fell back into Low Risk to close the quarter.

The Implied Volatility on Equities factor entered Q2 in Euphoria regime, with equity markets having delivered strong gains over the first three months of the year — the S&P 500 was up more than +10% and the Nikkei surpassed its previous record high from 1989. The first few days of April saw the factor move higher into Low Risk and then Normal regime as stronger US manufacturing data increased the prospects of delayed Fed rate cuts. The factor continued to move higher as another upside surprise in US inflation — year-on-year headline consumer price index (CPI) moved to a six-month high — saw equity markets sell off. The signal moved into High Risk regime mid-month following an increase in geopolitical risk as Iran launched a major drone and missile attack on Israel, and briefly touched Crisis regime, for the first time in two years, as Israel responded with missile strikes against Iran. The lack of significant escalation from this point onwards, combined with disappointing flash purchasing managers' index data releases in the US, which improved expectations for rate cuts this year, helped to calm markets, with the factor moving back into Normal regime by the end of the month.

The central theme during May was one of increased confidence that inflation was normalizing and rate cuts would occur in 2024. Supporting this narrative early in the month was a Federal Open Market Committee meeting that passed without any hawkish surprises alongside softer employment and payrolls data, which reignited hopes of a soft landing for the US. Later in the month, Sweden's Riksbank became the second central bank with a G10 currency to cut rates in this cycle, while April CPI in the US brought the lowest annual core inflation level in two years. This saw the factor move back into Euphoria regime by mid-month. Despite the surprise announcement by UK Prime Minister Rishi Sunak that a general election would take place, the factor remained in Euphoria regime for much of the remainder of the month, as the VIX hit its lowest intraday level since the COVID-19 pandemic. In June, the factor moved higher into Normal Risk regime, where it remained for most of the month as the political uncertainty caused by the news that France President Emmanuel Macron was calling a snap election weighed on European assets. At the end of the quarter, the Implied Volatility on Equities factor had moved lower back into Low Risk regime.

The Risky Debt Spread factor entered the quarter in Euphoria regime, where it remained throughout April despite the increase in equity volatility outlined above. Indeed, spreads on both high yield and emerging market debt reacted only very marginally to these events and in fact closed the month tighter than they opened it. The factor remained in Euphoria until early June, when it moved up into Low Risk regime after six months of stability. Spreads continued to remain largely stable and in tight ranges until the end of the quarter, with the factor closing June in Low Risk regime.

The Implied Volatility on Currencies factor entered April in Euphoria regime but by mid-month had increased to Normal regime. The Japanese yen was a key contributor to this move as it fell to its weakest level since 1990, prompting repeated warnings over potential currency market intervention. Despite financial authorities intervening in the market in late April and early May, the broad positivity surrounding inflation and rate cuts was the dominant theme and the factor moved lower into Euphoria regime by the end of May. In June, the factor moved higher into Normal Risk regime once again as volatility in the euro increased on the back of the surprise election announcement in France, before moving back into Low Risk regime to close the quarter.

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Marketing Communication

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