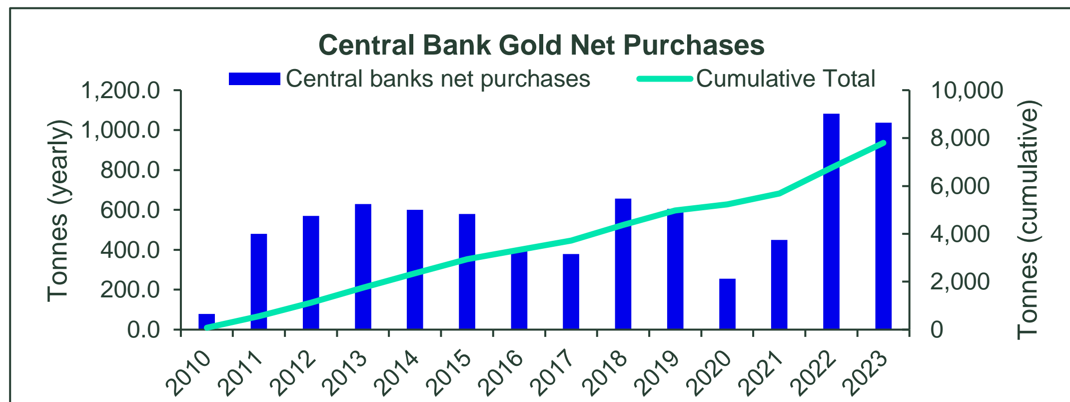
April 11, 2024
Commentary

Weekly Market Update

Insight of the Week

Gold at All Time Highs

In the past couple months, we've seen a breakout rally in Gold, bringing it to all-time highs. The price of gold is influenced by a multitude of factors, such as the strength of the US dollar, real rates, safe haven demand, gold ETF inflows/outflows, physical gold demand, and the supply of gold. It's a complex set of forces and it's interesting to note that the ongoing rally illustrates a decoupling from two of the biggest influencers of gold, the strength of the US Dollar and real rates. Gold usually has a negative correlation with real rates and a strong US dollar, both of which haven't budged during the recent rally. However, general uncertainty along with ongoing demand from central banks have been supportive, enough to overcome those headwinds.



Source: World Gold Council. Annual data as of December 31, 2023.

The above chart shows that central banks have been consistent net buyers of gold since 2010, accumulating over 7,800t over this period, while 27% of the total amount was bought in the last two years. In 2023, China (225 tonnes) emerged as the largest buyer followed by Poland (130 tonnes). Last year's Middle East frictions between Israel and Hamas, in addition to the ongoing Russia-Ukraine conflict, spurred additional safe haven demand for gold. Further, countries like China and other BRICS nations have been buying gold to reduce their dependency on the US dollar in their foreign exchange reserves.

As gold remains at all-time highs, expectations of Fed rate cuts and a weakening dollar could turn them into tailwinds. Additionally, uncertainty around global economic growth and geopolitical tensions may also continue to support safe haven demand for gold. Overall, geopolitics remain an important topic for investors. To learn more about investing during potential geopolitics shocks, please read our latest research piece How to Position for Geopolitical Shocks in 2024.

Source: State Street Global Advisors, World Gold Council.

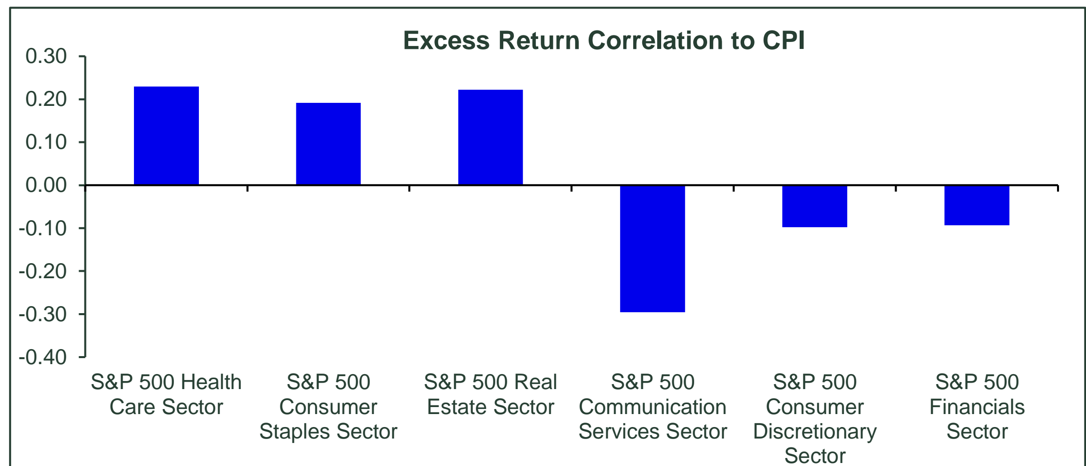
Equities

Inflation Sensitivity Over the Last 36 Months

On the bumpy road to lower inflation the March CPI report came in hotter than expectations. The MoM headline print showed an increase of 0.4%, and a YoY print of 3.5%. Core CPI also surprised to the upside at 0.4% MoM and 3.8% YoY. The equity market reacted negatively digesting what this means for the Fed's policy rate.

At the end of trading on the date of the release (April 10th) the S&P 500 was down 0.95% on the day. All large cap S&P 500 sectors were in the red with the Energy sector the only exception. The S&P 500 Real Estate sector was hurt the most down 4.10%. The Russell 2000 was especially rattled, down 2.84%, as investors contemplate the ultimate fate of small caps if rates are to remain high. Fed funds futures are now pricing in just two cuts for this year, a drastic change from the ~6 cuts that were priced in at the end of 2023. The market is now suggesting a 17% probability of a 25bp rate cut at the June FOMC.

In grappling with the above, we've analyzed the correlation between sector performance and inflation in order to explore what changes in CPI have meant for each sector. For the analysis, we took the performance of S&P 500 sector returns relative to the S&P 500, and mapped excess returns to changes in inflation. Utilizing the last 36 months, the correlations show sectors such as Real Estate, Consumer Staples, and Health Care have the strongest positive correlation. Interestingly, these sectors tend to exhibit defensive characteristics due to their products which have low elasticity of demand. Alternatively, Communication Services, Financials, and Consumer Discretionary have exhibited negative correlation to moves in inflation.



Source: FactSet. Data from 4/30/21 to 3/28/24.

As the equity market rally this year broadens out from the Mag 7 names, it is helpful to observe which sectors will be impacted by the rise/fall in inflation. We believe inflation will continue to fall moving forward and expect CPI to be at 2.9% at year end. Although the market has lowered expectations for a rate cut in June, we still think it's possible and eagerly await the remaining employment and inflation reports which will provide the Fed with further evidence on how the economy is faring.

Source: S&P, FactSet. Data as of 4/10/2024 unless otherwise stated.

Fixed Income

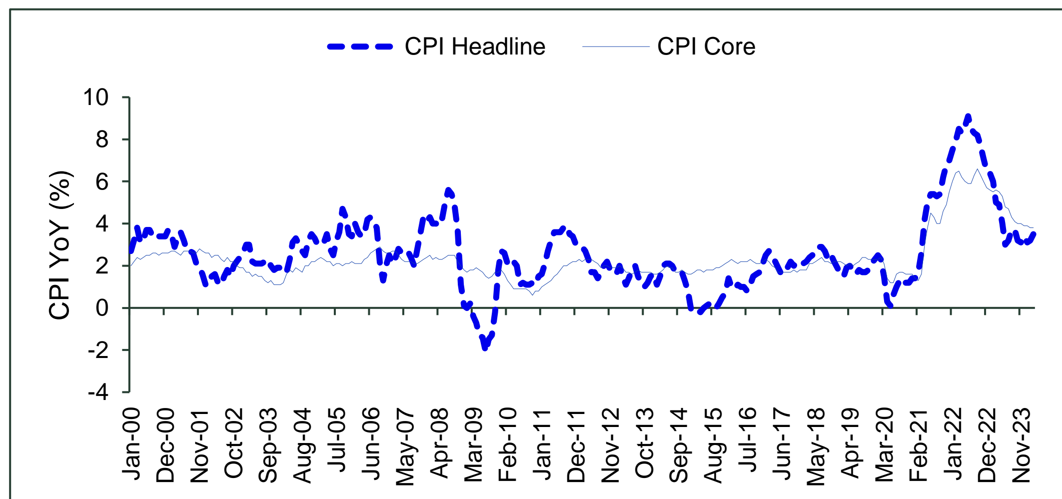
Q1 2024 Fixed Income Update

The first quarter of 2024 was a challenging period for the U.S. bond market. Strong economic growth, a resilient labor market and upside surprises in inflation prints continued to push out the timing of the first rate cut by the Federal Reserve, causing a bond market sell off.

The overall U.S. Composite PMI data remained relatively steady at 52.1 in March (versus 51.2 in February and 52.0 in January). The PMI Services data remained in expansionary territory coming in at 51.4 in March (versus 52.6 in February and 53.4 in January). PMI Manufacturing activity expanded over the quarter, coming in at 50.3 for March, (versus 47.8 in February and 49.1 in January). Real GDP growth in the last quarter of 2023 registered at 3.4% (QoQ annualized), driven by an increase in consumer spending, state and local government spending, federal government spending and exports.

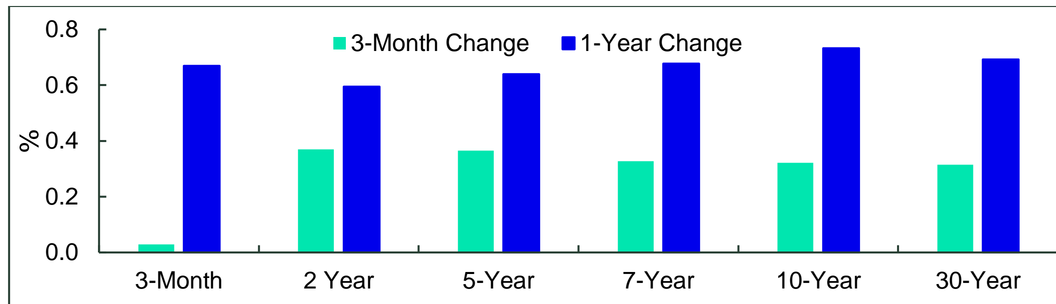
The labor market continued to remain resilient. According to the Bureau of Labor Statistics (BLS), the U.S economy added 303,000 jobs in March, up from 275,000 in February (and 353,000 in January). The unemployment rate at the end of the quarter came in at 3.9%.

Inflation continued to surprise to the upside. Year over year, headline inflation came in at 3.5% (versus 3.2% in February, and 3.1% in January). Core inflation also remained stubbornly high, coming in at 3.8% in March (versus 3.8% in February and 3.9% in January).



Source: Bloomberg as of March 31, 2024

Against this backdrop of strong data, market expectations of rates cuts have been pushed further down the year. As a result, we saw yields increase across the curve during Q1. The 2-year increased by 37 bps (to 4.62%) the 5-year increased 36 bps (to 4.21%), the 10-year increased 32 bps (to 4.20%), the 20 year increased 26 bps (to 4.45), and the 30- year increased 31 bps (to 4.34%). This all happened during the first quarter, and rates have only continued to rise since the beginning of this month. The 2s10s curve flattened from -37 bps to -43 bps, and the 5s30s flattened from 18 bps to 13 bps over the quarter.



Source: Bloomberg as of March 31, 2024

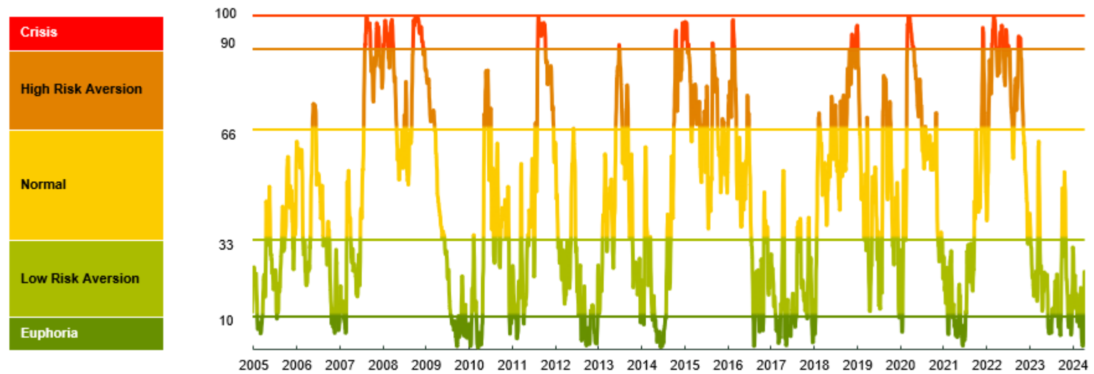
At the beginning of the year, markets had priced in six rate cuts with a high probability of the first rate happening in March. After three months of strong economic data, markets have now priced in two rate cuts, with the first rate cut in either July or September, leaving interest rates in a highly restrictive territory for much longer, and potentially putting the soft landing narrative at risk.

Source: State Street Global Advisors, Bloomberg.

Market Regime Indicator

The Market Regime Indicator (MRI) represents a proprietary multi-asset class model designed to characterize risk appetites within the capital markets.

Days in the Low Risk Regime (since April 4): 5 days



As of April 10, 2024. The data displayed is not indicative of the past or future performance of any SSGA 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.

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*Pensions & Investments Research Center, as of 12/31/22.
†This figure is presented as of December 31, 2023 and includes approximately $64.44 billion USD of 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.

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