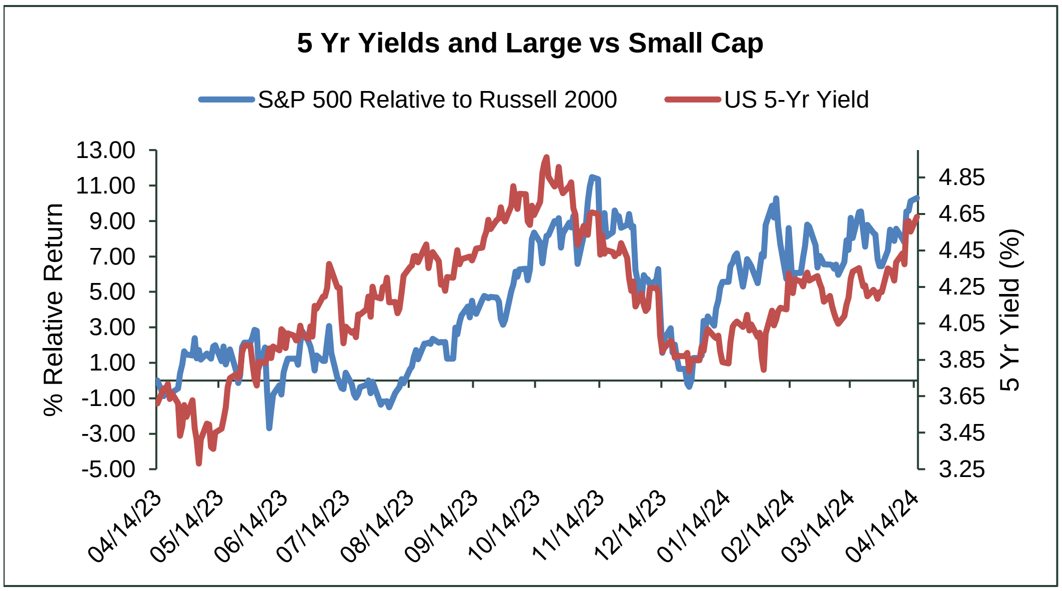
April 18, 2024
Commentary

Weekly Market Update

Insight of the Week

When Can Small Caps Lead?

The large vs small cap race has been dominated by large caps for quite some time. Yes, there are periodical spurts where small caps have tried to regain some stature, but the bigger brother has been the structural winner for a while. Small caps generally have less exposure to technology and other secular winning areas, and generally excels when there is thirst to move up the risk spectrum.



Source: S&P, Russell, FactSet. Data from 4/14/2023 - 4/15/2024 in USD.

There is little doubt that interest rates, along with its volatility, have been whipsawing markets around for multiple years now. In particular, as seen in the chart above, the path of rates have been a true driver of the relative returns of small caps. Higher interest rates means higher costs to finance operations. While this effects both large and small caps, higher rates effects small caps more for two reasons. First, since small caps are generally more risky, they already start with a higher cost of debt. Second, small caps are usually unable to refinance and lock in long term debt in the same way and horizon that some large caps can. For instance, some large cap's were able to issue 10 year bonds a couple of years ago when rates were low, locking in this cost over a long period. Many small caps however need to roll their debt over every 3-5 years, meaning they are closer to refinancing at current high rates, which will directly affect their bottom lines.

So far this year, large caps have been the outperformer and something we continue to believe in. But when should we change this view? The chart above may give us an idea as to when.

Source: State Street Global Advisors, S&P, Russell, FactSet.

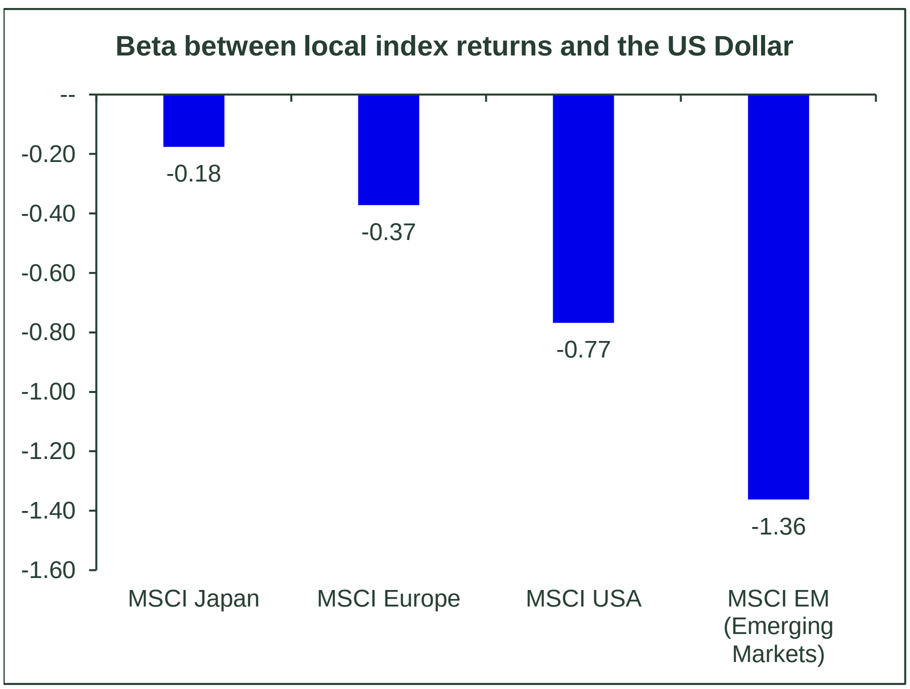
Equities

USD Dollar Strength Continues: What Does this Mean for Equities?

The US Dollar has remained strong amid escalating tensions in the Middle East, and stronger economic data, which has caused the market to alter assumptions for rate hikes. Investors are drawn to dollars especially when they believe other G10 economies are closer to rate cuts. However, equity markets typically dislike what a strong dollar represents.

When the dollar is strong, relative to other international currencies, US companies that rely on exports to drive revenue are typically challenged as USD denominated items become more expensive for international consumers to purchase. However, companies that rely on imports typically benefit from a strong dollar as the items they are purchasing from overseas become more affordable.

Observing the beta between various regional/country index returns and the US Dollar, the relationship is apparent; equities are sensitive to a strong dollar. Emerging markets have historically felt the largest impact. An article published by the IMF finds that emerging markets tend to take the strain of a stronger dollar citing "falling imports, worsening credit availability, and diminished capital availability". Indeed the MSCI EM index is down 0.4% year to date in USD.



Source: FactSet, MSCI. Data as of 3/31/2024 .

Apart from EM, the MSCI USA index also shows to be quite sensitive to dollar movements. Observing sectors within the S&P 500 we've used data from FactSet to reconcile the geographic revenue that flows into each sector.

S&P 500 Sector	U.S. Revenue Exposure
Information Technology	43%
Materials	49%
Communication Services	52%
Consumer Staples	60%
Energy	63%
Health Care	65%
Industrials	67%
Consumer Discretionary	67%
Financials	71%
Real Estate	82%
Utilities	98%

Source: FactSet. Data as of 4/17/2024.

Most reliant upon foreign revenue is the Information Technology sector followed by the Materials sector. From this finding, we would expect these sectors to be challenged by a stronger dollar, and indeed both are negatively correlated to the nominal broad dollar index. For the time period between 3/31/2014 to 3/31/2024, the S&P 500 Information Technology sector had a correlation of -0.25 to the USD index and for the Materials sector, a correlation of -0.33. Interestingly, although the dollar has strengthened this year with the ICE US Dollar Index up 4.5%, IT and Materials have continued to perform well. Should we see the dollar weaken as we approach an interest rate cut from the Fed or if uncertainty subsides, these sectors could possibly continue to perform well as a weakening USD creates a tailwind from exports.

Source: State Street Global Advisors, FactSet, IMF. Data as of 4/17/2024 unless otherwise stated.

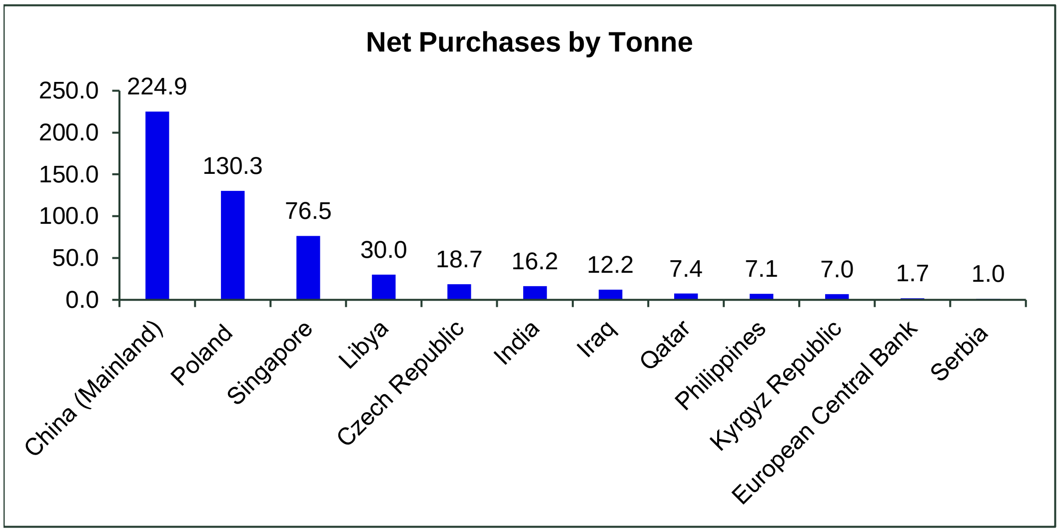
Fixed Income

Central Bank Gold Reserves

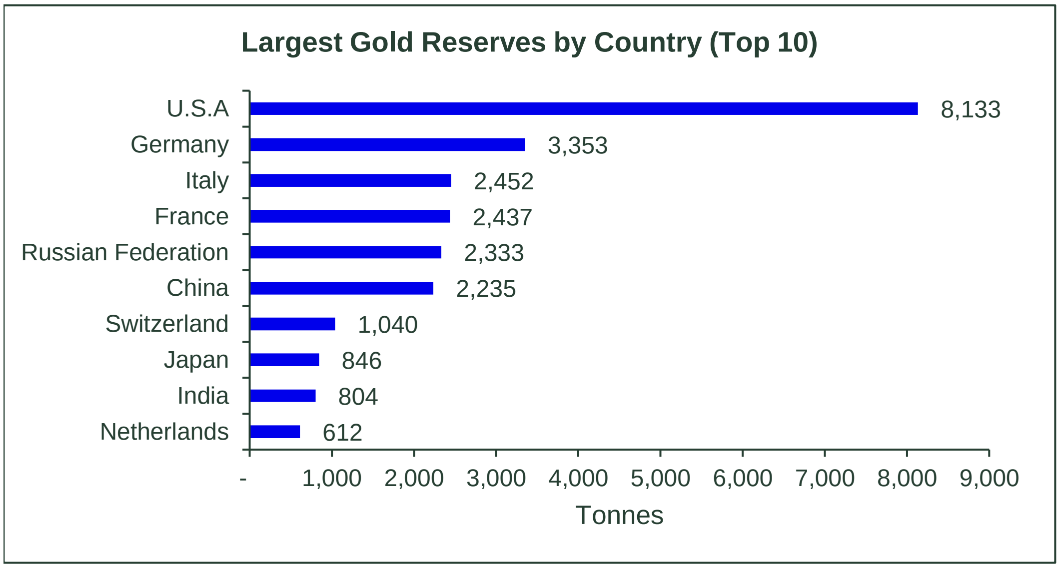
Although we shifted away from the gold standard in 1971, central banks around the world continue to hold substantial gold reserves as a store of value, and as a hedge against hyperinflation and other economic shocks. It is estimated that approximately one fifth of all gold mined throughout history is held by central banks. This number seems to be increasing especially since the beginning of the Russia-Ukraine war.

When Russia invaded Ukraine in February 2022, the U.S. and several of its European allies cut Russia off from the SWIFT (Society for Worldwide Interbank Financial Telecommunications) system. SWIFT is a member owned international financial system that allows for international payments and settlements. The SWIFT ban against Russian banks was one of several international sanctions against Russia that were aimed at weakening the country's economy and, ultimately, intended to end the invasion. These financial sanctions did begin to create concerns on the reliance of the dollar as reserves. The possibility of potential financial sanctions in a volatile geopolitical environment is but one catalyst leading countries to increase their gold reserve holdings in order to make the dollar less prominent in the future.

Central Banks have been continuous net buyers of gold since 2010 accumulating over 7,800t, a quarter of which was purchased in 2022 and 2023. In 2023, the largest central bank gold purchases were as follows; People's Bank of China 225t (lifting gold reserves to 2,235t), National Bank of Poland 130t (lifting gold reserves to 369t), Monetary Authority of Singapore 77 t(lifting reserves to 230t), Central Bank of Libya 30t (lifting gold reserves to 147t), and Czechs National Bank 19t (lifting gold reserves to 31t).



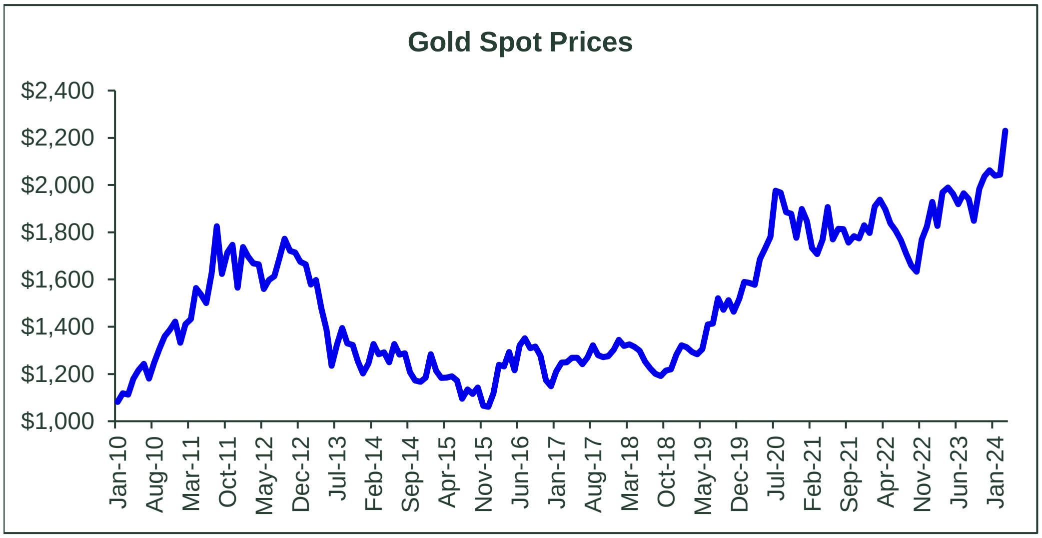
Sources: Central Banks, Federal Reserve Bank of St. Louis, International Monetary Fund, World Bank, World Gold Council as of December 2023.



Sources: Central Banks, Federal Reserve Bank of St. Louis, International Monetary Fund, World Bank, World Gold Council as of February 2024.

Russia, which is the fifth largest holder of gold reserves (2,350t) purchased 324t in 2023, while India, which is the ninth largest holder of gold serves (801t) increased purchases by about 16.2t during the year.

The need for Central banks around the world to find alternatives to the dollar and diversify away from dollar denominated assets is underpinning the all-time high prices for the commodity. Gold traded at $2,362 as of April 17, 2024.



Source: Bloomberg. Data as of March 29, 2024.

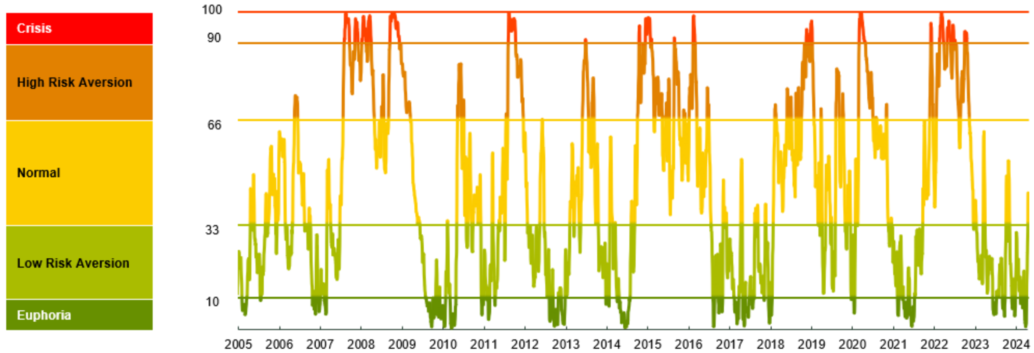
In the short term, the dollar and dollar denominated assets (especially treasuries) will retain their safe haven status. However, in the long term, the decisions of central banks to build reserves with a more neutral commodity and reduce their holdings of U.S. dollars could have significant consequences for the U.S., especially given concerns around the economy's ballooning debt levels.

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 Normal Regime (since April 16): 1 day



As of April 17, 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.

About State Street Global Advisors

For 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, we build from a breadth of index and active strategies to create cost-effective solutions. As pioneers in index, ETF, and ESG investing, we are always inventing new ways to invest. As a result, we have become the world's fourth-largest asset manager* with US $4.34 trillion† under our care.

*Pensions & Investments Research Center, as of 12/31/22.
†This figure is presented as of March 31, 2024 and includes ETF AUM of $1,360.89 billion USD of which approximately $65.87 billion USD is 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.

ssga.com

State Street Global Advisors Global Entities

Marketing Communication

The information provided does not constitute investment advice and it should not be relied on as such. It should not be considered a solicitation to buy or an offer to sell a security. It does not take into account any investor's particular investment objectives, strategies, tax status or investment horizon. You should consult your tax and financial advisor.

The information contained in this communication is not a research recommendation or 'investment research' and is classified as a 'Marketing Communication' in accordance with the applicable regional regulation. This means that this marketing communication (a) has not been prepared in accordance with legal requirements designed to promote the independence of investment research (b) is not subject to any prohibition on dealing ahead of the dissemination of investment research.

This communication is directed at professional clients (this includes eligible counterparties as defined by the "appropriate EU regulator") who are deemed both knowledgeable and experienced in matters relating to investments. The products and services to which this communication relates are only available to such persons and persons of any other description (including retail clients) should not rely on this communication.

The views expressed in this material are the views of Christopher Carpentier, Zanub Raza, Christine Norton and Dane Smith through the period ended April 18, 2024 and are subject to change based on market and other conditions. This document contains certain statements that may be deemed forward-looking statements. Please note that any such statements are not guarantees of any future performance and actual results or developments may differ materially from those projected.

Investing involves risk including the risk of loss of principal.

The whole or any part of this work may not be reproduced, copied or transmitted or any of its contents disclosed to third parties without SSGA's express written consent.

All information is from SSGA unless otherwise noted and has been obtained from sources believed to be reliable, but its accuracy is not guaranteed. There is no representation or warranty as to the current accuracy, reliability or completeness of, nor liability for, decisions based on such information and it should not be relied on as such.

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.

AdTrax: 5064514.64.1.GBL.INST

Exp. Date: 5/31/2024