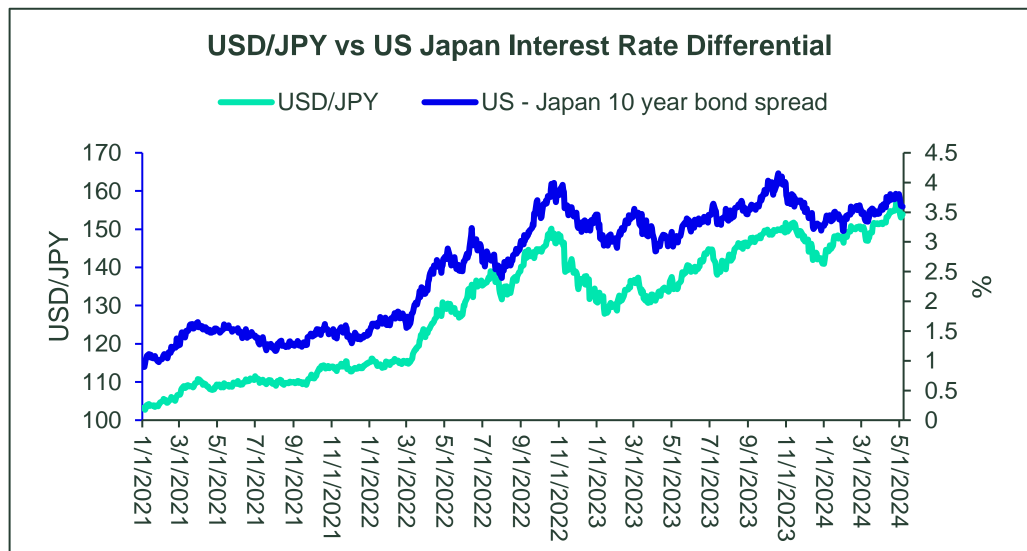
May 9, 2024
Commentary

Weekly Market Update

Insight of the Week

Japanese Yen Depreciation

Interest rates and momentum are key drivers within currency markets. These factors have both worked against the Yen, which has deprecated steadily by 50% against the US Dollar over the last 3 years. Interest rate differentials encourage investors to make carry trades- borrowing a currency with a low interest rate to buy a currency with a higher interest rate. The US Federal Reserve's higher for longer has put upward pressure on the USD while the Bank of Japan's lower for longer has put downward pressure on the Yen. Momentum then gains traction in the market – the Yen falls because investors are selling, leading to more selling.



Source: Bloomberg. Data as of May 7, 2024.

The above chart shows that the widening of the US Japan interest rate differential has been positively correlated with the depreciation of the Yen. The widening of interest rates reflects the different growth and inflation environments in the US and Japan. The US has been fighting with multi decade high inflation whereas Japan has welcomed some inflation after struggling to get prices and wages to rise after decades of economic stagflation. As a result, the Fed hiked from rock bottom to a target range of 5.25-5.50 while the BOJ continued to rely on ultra-low interest rates between 0%-0.1%.

Going forward, we maintain a negative view of the Yen versus the US dollar, given high US interest rates and strong relative growth, along with the dollar's superior recent performance as a safe-haven asset. Until we see a more definitive turn lower in global yields, the yen is likely to remain weak. Yet, we see further Yen

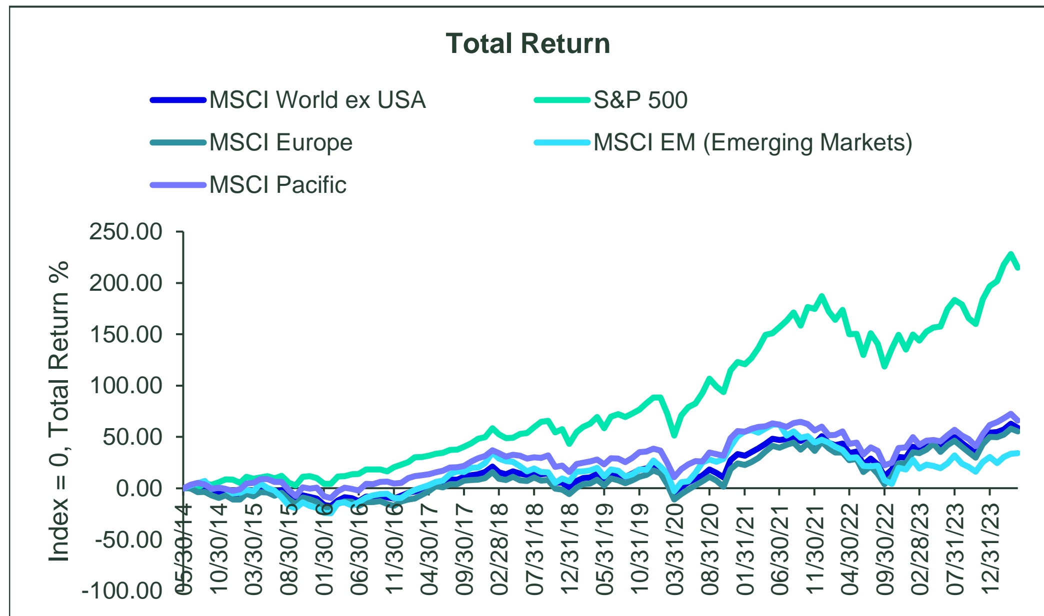
weakness as somewhat limited due to the increased potential of currency intervention, something which we have already begun to witness. To learn more about our views on other developed currencies, please read our latest currency commentary.

Source: State Street Global Advisors, Bloomberg.

Equities

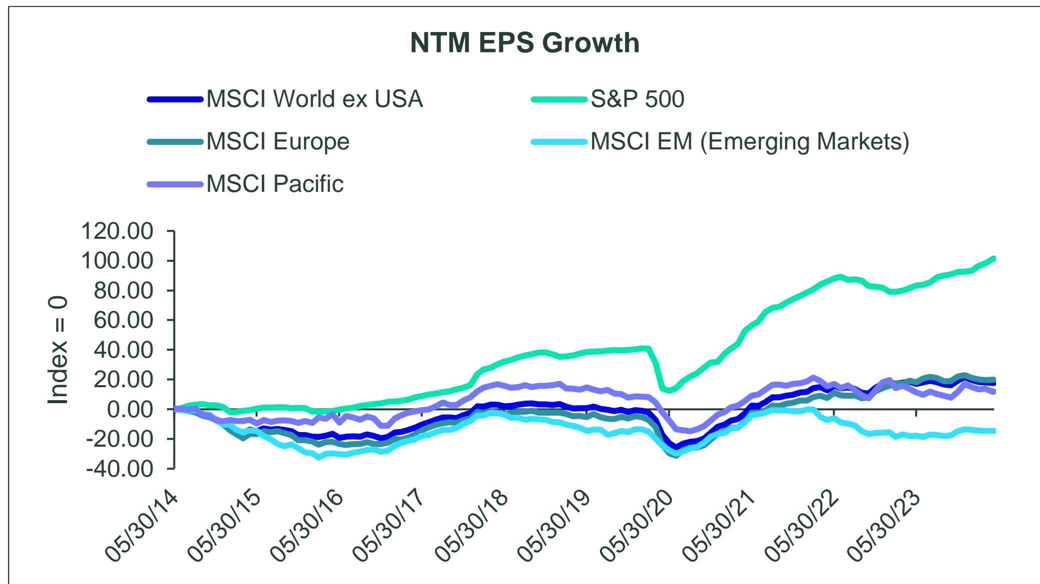
Drivers of US Outperformance

The US equity market performance over the past ten years has been stellar. In total return, the S&P 500 has returned 214% from May 2014 to the end of April. The chart below depicts this performance along with regional peers who have fallen behind, especially over the past five years.



Source: FactSet. Data as of 4/30/2024 in USD.

Equity market returns are reflective of the following factors: earnings, multiple expansion, dividends, and overall economic growth. Of these, corporate earnings in the US has driven equity market performance. The below chart illustrates leading EPS growth, and mirrors the performance pictured above. Earnings growth in the US has been hard to compete with, especially over the more recent years where the economic backdrop has been restrictive. Earnings have been resilient with margins remaining high and improving.



Source: FactSet. Data as of 4/30/2024 in USD.

Along with earnings growth, which provided the largest boost to US equity market prices, valuations have also expanded materially over the past ten years. Investors have placed an even higher premium on US earnings with the S&P 500 moving from a NTM PE of 15.2 to 20.3x earnings. Since markets tend to be forward looking the more recent rise in valuations could be due to a confluence of factors such as: optimism surrounding the potential productivity gains from technological advancements such as artificial intelligence, increased confidence surrounding a soft landing in the U.S., or anticipation of higher economic growth. Comparatively, multiples have been relatively unchanged for the MSCI World ex US index where valuations fell from 14.0 to 13.9x earnings from May 2014 to April 2024. Compared to the US, the rest of the developed world's equity market performance has relied on dividends to increase total return.

Looking ahead, earnings estimates for the S&P 500 this year and in 2025 look constructive and have been increasing, providing support for the continued positive momentum of S&P 500 performance. This is reliant upon the strength of corporations during a period of restrictive monetary policy. Should sentiment reverse, the more volatile component of total return, multiple expansion, could falter. Although the market has largely priced in a soft landing, we remain in ultra-restrictive territory which exerts pressure on corporate earnings and overall economic health. Sentiment can change quickly. S&P 500 performance will depend upon how earnings hold up and whether overall sentiment remains positive.

Source: FactSet. Data as of 5/8/2024 unless otherwise stated.

Fixed Income

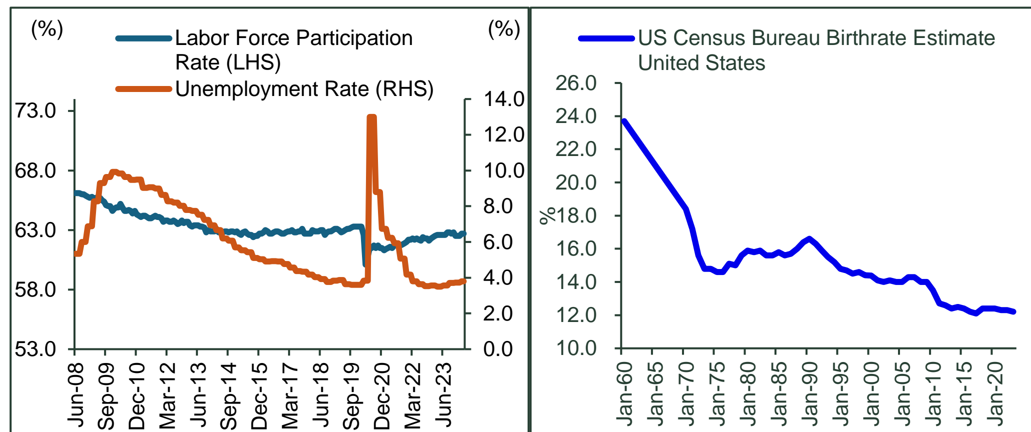
Shrinking Labor Force and Participation Rates

At the height of the COVID 19 pandemic, 120k businesses closed and 30 million workers became unemployed. The unemployment rate rose to 14.8% and labor force participation decreased to a four-decade low of 61.5% (April 2020).

As economic activity began to accelerate, there was a greater need for businesses to hire workers. The limited supply of, and increased demand for labor put upward pressure on wages. At the height of this disequilibrium, we saw the ratio of job openings to the number of unemployed reach an all-time high of 2 (meaning there were two jobs available for every worker looking for a job). Currently this ratio sits at 1.3 (March 2024).

The availability of workers within the economy remains an issue. Current labor force participation remains lower than pre-pandemic averages (62.7%) and may continue to remain low in the near future. Reason being, that many adults retired during the pandemic and with a wave of baby boomers reaching their peak retirement age of 64 in 2024, we can expect approximately 4.1 million workers to retire (per year) through 2027.

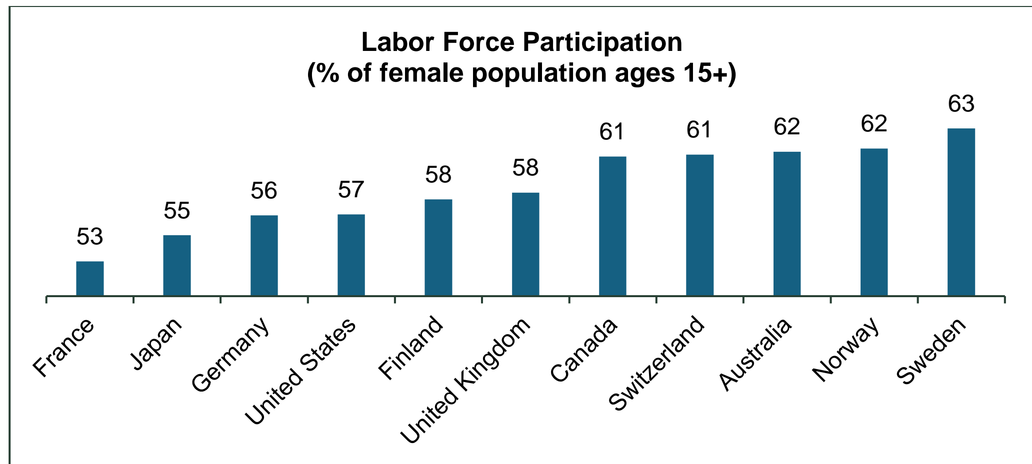
Low birthrates continue to present headwinds. The birth rate in the U.S. has been approximately 12% over the last decade as the younger generation has fewer children compared to their predecessors, affecting both the size and age of the population. The average age of the U.S. population is currently 38.9 years compared to the global average of 30.5 years.



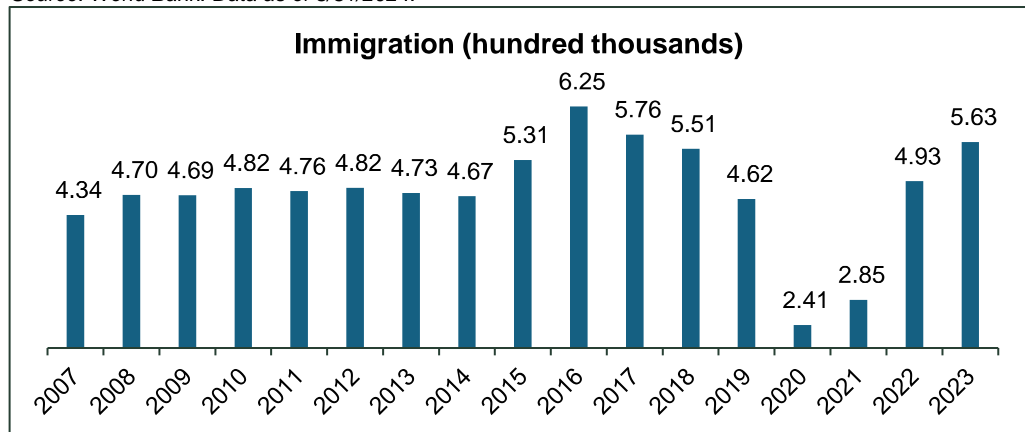
Source: Bloomberg. Left chart data as of 4/30/2024, right chart data as of 12/31/2023.

Net positive immigration and more women returning to the workforce has somewhat alleviated labor force supply pressures, but the U.S. still has a 2 million worker shortage.

After the pandemic more women began to return to work. Women currently make up 47% of the labor force, and the overall participation rate for women has increased to 57%. These are an improvement but remain below other developed nations. Immigration, which had slumped in 2020 and 2021, increased the workforce by 1 million between 2022 and 2023, but also remains below pre-pandemic averages.



Source: World Bank. Data as of 3/31/2024.



Source: MacroBond. Data as of 12/31/2023.

A shrinking labor force has continued to contribute to a tight labor market, where there are 6.4 million unemployed workers, 8.4 million job openings and the unemployment rate lingers at 3.9%. In the absence of a natural increase in population growth or an increase in net immigration, we can expect to see headwinds to both long term productivity and economic growth.

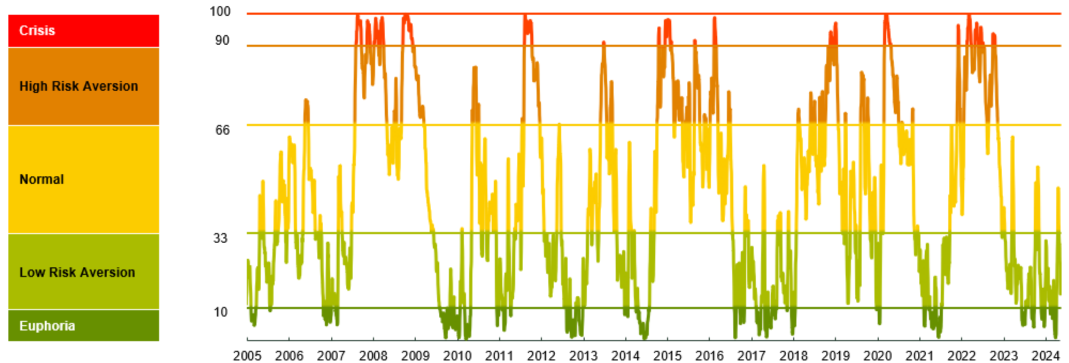
While long term structural trends are concerning, we continue to hold our view that the current labor market is starting show signs of softening. Nonfarm payrolls data came in at 175k (versus expectations of 240k) presenting the Federal Reserve an opportunity to initiate cuts sooner than markets are currently pricing in.

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 26): 9 days



As of May 8, 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 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.

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