A Balanced Exposure to Risk Assets in the Evolving Recovery

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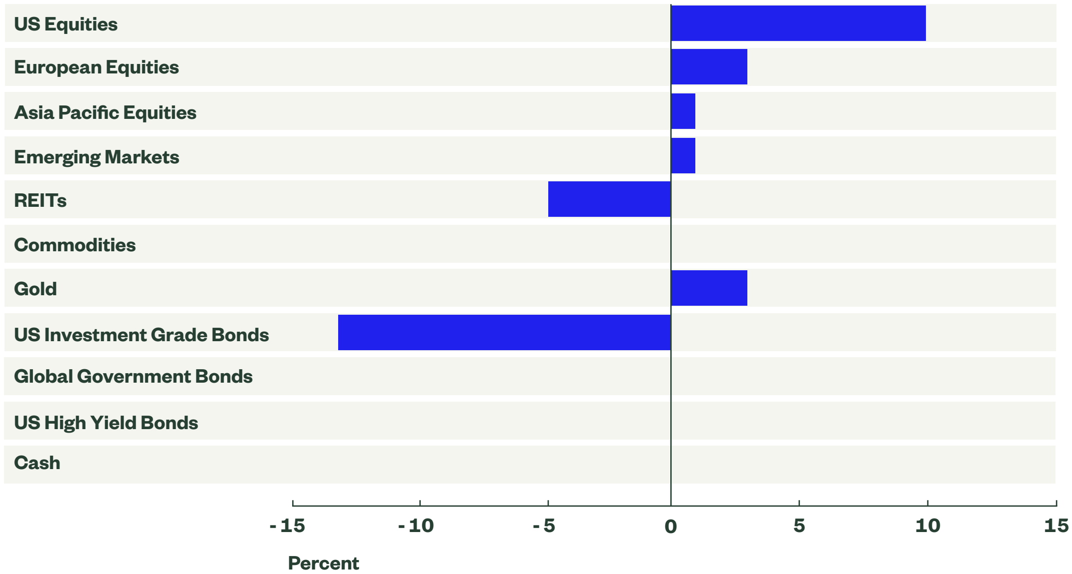
As noted in our macroeconomic outlook for 2021, the global economy has shown resilience in the wake of the pandemic shock. Unprecedented fiscal and monetary policies have provided substantial support to global economies, which continue to recover, but progress has been uneven. Further progress will be vulnerable to setbacks. Against this backdrop, our current tactical views on multi-asset allocation modestly favor growth assets in equities and fixed income, hedged by exposure to gold.

Tactical Asset Allocation Today

Just prior to the US election, State Street Global Advisors' Investment Solutions Group incorporated a "governor" on the active risk exposure of its tactical portfolio. Given improving clarity on US election outcomes, we have resumed the setting of standard active risk targets based on our models. Improving risk appetite has been informed by corporate earnings, which have been resilient, especially in the US where roughly 89% of companies have reported, and 86% of those have reported a positive earnings per share (EPS) surprise. In addition, consumers have been resolute, and strong manufacturing Purchasing Managers' Indexes (PMIs) globally suggest broader recovery.

We therefore recommend a balanced exposure to risk assets, and our evolving Tactical Asset Allocation (TAA) weights reflect our baseline assumption of economic recovery (see Figure 1). Overall, we continue to favor global equities, credit, and gold, while becoming more sanguine on broad commodities. Real estate investment trusts (REITs) and core bonds look less attractive.

Figure 1
Summary of Asset Class Views



Source: State Street Global Advisors Investment Solutions Group, as of November 24, 2020.

Risk Positioning

Our Market Regime Indicator is in a "Low Risk" regime as of this writing. Risky debt spreads have remained rather subdued, while implied volatility on both equities and currencies has eased meaningfully from recent highs. A low risk regime suggests investors are willing to seek risk and can lead equity markets to deliver favorable results. We have therefore recently increased our allocation to growth-oriented assets, both equities and broad commodities. Our forecast for global equities remains promising, as still-supportive macroeconomic and price momentum factors offset stretched valuations. In addition, the ongoing economic recovery has buoyed both sales and earnings sentiment.

- Strength in industrial metals and improvement in agriculture fundamentals have offset some weakness within energy, helping to improve our commodities forecast. Energy supply and demand dynamics remain mixed, but appear to be turning more favorable.

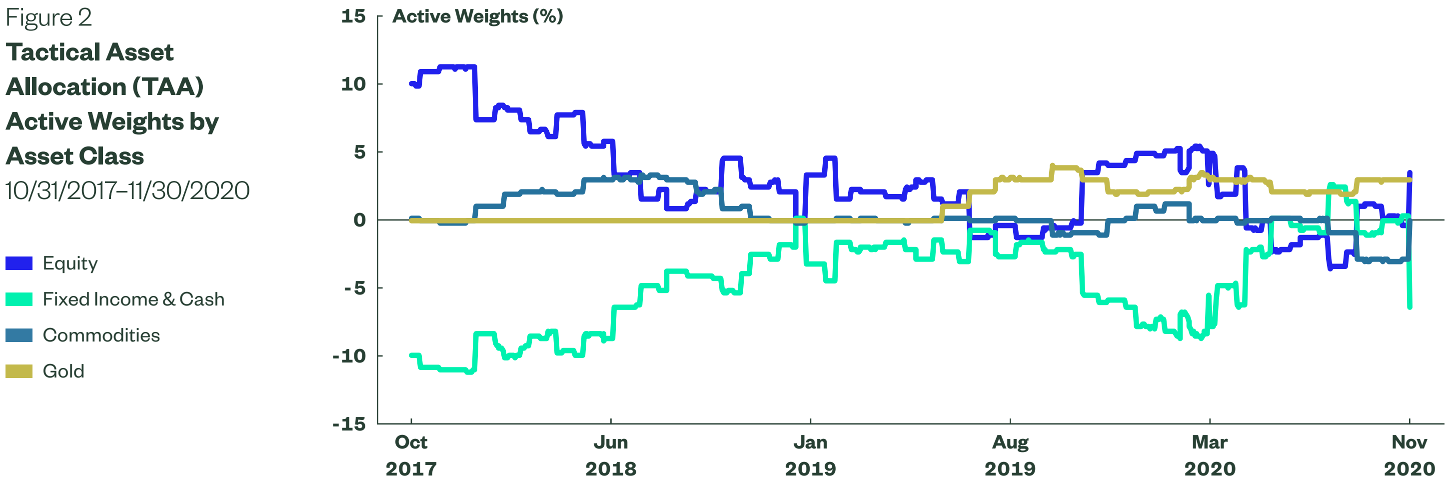
- We are less enthusiastic about high yield as some weakness in equity momentum, coupled with higher volatility, weigh on our return forecast. Further, the recent shift lower in our MRI suggests greater opportunities in equities, which has led us to reduce our position to neutral in favor of broad equities.

- Gold remains our preferred tactical hedge against bouts of volatility; the precious metal continues to look attractive across all the technical factors we monitor. Low real rates and rising debt levels also render gold attractive.

- We anticipate marginally higher rates and a steeper yield curve for core bonds. The improvement in Q3 GDP has made the case for lower rates less compelling, while level momentum and improving manufacturing PMIs signal higher rates ahead. Slope momentum along with still-depressed leading economic indicators suggest a steeper curve and dent the outlook for longer-term bonds.

In general, our evolving tactical asset allocation weights reflect our baseline assumption of economic recovery (see Figure 2).

Figure 2
Tactical Asset Allocation (TAA) Active Weights by Asset Class
10/31/2017–11/30/2020



Source: FactSet and State Street Global Advisors Investment Solutions Group, as of November 30, 2020. Past performance is not a guarantee of future results. At State Street Global Advisors, the Investment Solutions Group positions its TAA portfolio based on a one- to three-month forward-looking horizon, and active weights change on a monthly basis.

Cautiously Optimistic on Equities

Our outlook for equities continues to be cautiously optimistic, and we anticipate broader participation across regions. We still prefer US equities — our highest-conviction position — but now also hold modest overweights to non-US equities. Earnings and sales expectations remain strong for the US, while price momentum continues to help offset weaker valuations. To diversify this position, we recently increased our exposure to both European and Pacific equities in addition to increasing our US large cap overweight.

- Pacific equity valuations have been attractive, but the improvement in price momentum and quality factors has boosted the outlook. Comparatively successful pandemic management, improving PMIs, and government subsidies that have supported domestic spending also support a positive outlook.
- While European equity valuations also appear favorable, the region continues to lag on a relative basis. Still, improvements in sales and earnings sentiment as well as macro indicators have ameliorated our European return forecast, while prospects for more amicable US-Euro area trade along with an asymmetric upside to vaccine progress suggest optimism.
- We continue to maintain an overweight to emerging market equities, as improved economic growth and a weaker US dollar continue to favor the segment. Moreover, the potential for less trade consternation could act as a tailwind.
- REITs continue to score poorly across all indicators we consider and remain our largest underweight within the equity portfolio.

Prospects for Curve Steepening in Fixed Income

Within fixed income, elevated equity volatility and prospects for curve steepening have weighed on our return forecast for longer-dated bonds and suggest trimming of the duration of our overall portfolio.

- Non-US government bonds are supported by an outlook for US dollar weakness. Even with negative yields, recent currency trends have helped our total return expectations to become more positive.

- Current GDP to 30-year yield differentials and subdued headline inflation readings suggest non-US yields could move lower.

Sector Perspective

Finally, from a sector perspective, we continue to support technology and consumer staples. Consumer staples appears attractive across all of the signals we evaluate, with the exception of momentum where we've witnessed some deterioration. Technology ranks above average for all factors except value, and the sector continues to deliver on earnings.

Consumer discretionary still looks good across momentum and sentiment factors, but its weaker scores for valuation, macro, and quality led us to a move away from the sector. Communication services has seen improving momentum and sentiment data, leading to an upgrade in our view.

Closing Thoughts

We are cautiously optimistic on investment prospects for 2021. That optimism is reflected in our directional positioning, which favors equities over bonds, with recent increases in equities and commodities.

We expect growth to improve in 2021, but risks and uncertainty of course remain, including risk connected to the timing of vaccines, and uncertainty related to the composition of the US Senate which will have policy implications. In addition, although expectations for inflation have been muted so far, monetary accommodation will likely remain; inflation pressures could build and will need to be watched. Finally, near-term expectations for fiscal stimulus have improved, which would boost equities but could impact inflation. As the global recovery unfolds and the resiliency of global markets is retested in the months to come, we'll be monitoring the evolving situation closely.

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* This figure is presented as of September 30, 2020 and includes approximately $80.51 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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