Forecast
Market Outlooks

Q4 2020

Forecasts Q4 2020

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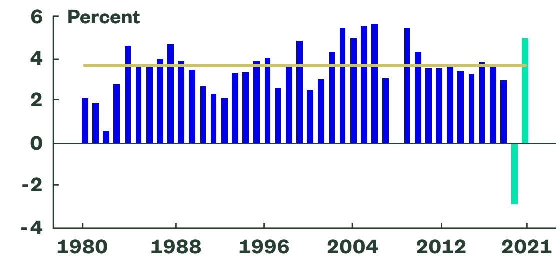
Figure 1
Poised for a 2021 Rebound

World Real GDP Growth

World GDP Growth (Forecast)

Long-Term Average Growth (3.65%)

Global Economic Outlook



Source: State Street Global Advisors Economics, International Monetary Fund. The above forecast is an estimate based on certain assumptions and analysis made by the State Street Global Advisors Economics Team. There is no guarantee that the estimates will be achieved.

- While set for a contraction of -2.9% in 2020, we expect the global economy to rebound strongly to grow by 4.9% in 2021.
- The eurozone appears poised to emerge from the COVID-19 crisis in better structural shape as the shock has driven greater transformative integration efforts than in earlier crises.

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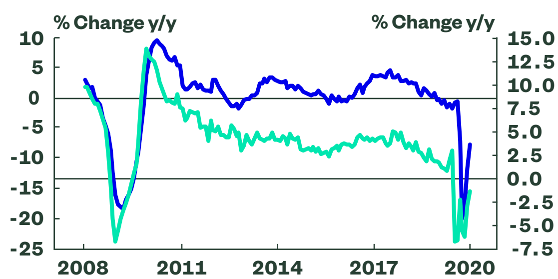
Figure 2
Emerging and Developed Market Business Cycles Aligned

Advanced Economies, Ind. Production Excl Constr, Volume SA (lhs)

Emerging Markets Ind. Production Excl Constr, Volume, SA (rhs)

Emerging Markets Outlook



Source: State Street Global Advisors Economics, Netherlands Bureau for Economic Policy Analysis (CPB).

- COVID-19 may cause emerging markets economies to contract by about 1.5% this year, an extraordinarily weak historical performance but a little better than projections in June.
- While EM growth will likely recover in 2021, any significant change to global supply chains as fallout from US-China relations may make future EM outperformance more challenging.

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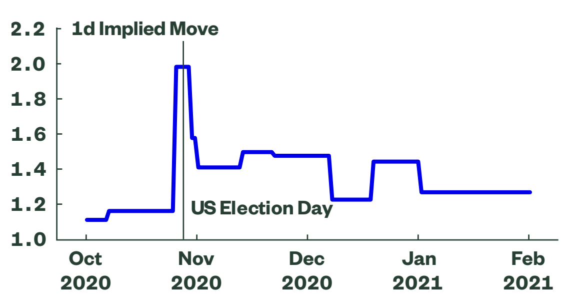
Figure 3
S&P 500 Options Implied 1-Day Move

Global Capital Markets



Source: UBS Equity Derivatives Strategy. Data as of October 2, 2020. The above forecast is an estimate based on certain assumptions and analysis. There is no guarantee that the estimates will be achieved.

- With counterbalancing risk and rewards across most major macro issues, a heightened focus on relative value trade-offs within broad asset classes characterizes our current outlook.
- Although pandemic uncertainty and the low level of interest rates have driven the corporate sector to lever up by issuing an avalanche of bonds, both investment grade and high yield bonds offer better prospects than government bonds.

STATE STREET GLOBAL ADVISORS

Global Economic Outlook

Simona Mocuta
Senior Economist
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After this year's deep contraction, the global economy is primed to rebound strongly in 2021, although the nature of the recovery will differ by sector and region.

Following big downgrades in March and June, we've made relatively small forecast changes in this latest update. At the global level, a slightly worse outcome for developed economies is partly offset by an upgrade in China such that the estimated contraction in global GDP is only a tenth worse than we anticipated back in June. 2021 should then bring a slightly stronger rebound that pushes global growth to its best since 2010.

One may argue that this is a V-shaped recovery. But we dislike letter labels since, as far as the recovery shape goes, what you'll see will really depend on where you look. Sectors such as housing or manufacturing should do much better and make a fuller/speedier recovery than travel services, for instance. The magnitude of the initial contraction and subsequent rebound will also vary across countries.

It is far better, in our opinion, to focus on the nature of this shock and the subsequent recovery. Along these lines, we've embraced the "relay recovery" concept. The successful race toward a full recovery depends on a succession of well-executed baton handovers. The first runner out of the gate, so to speak, was represented by powerful monetary and fiscal stimulus. The second runner was the process of economic reopening, of learning to resume and sustain economic activity while coping with and managing the virus outbreak. Experiences in the US, France, Spain, and the UK show this runner has been close to stumbling at times but so far it is still in the race.

Ultimately, though, a full recovery will require a medical solution. There is more than just a vaccine under this umbrella — cheap and widely available testing, contact tracing capacity, and good therapeutics are milestones along the way. But a vaccine is what will push us over the finish line. With every passing month, we are getting closer, but with every passing month, our vulnerability also grows. The race is not yet won!

United States: Getting Back Up

We are pleased to remark, as we take stock of macroeconomic developments since the last quarterly update, that incoming data have aligned well with our view of US economic performance. Back in June, our forecast of a 3.4% economic contraction in 2020 was squarely at the optimistic end of market forecasts (consensus then was -5.7%) and well outside the Fed's own range of projections. By September, however, reflecting sharp improvements in the labor market, consumer spending, and housing, consensus views have moved much closer to our own position. Unlike in March and June, we made few changes this round to our 2020–21 forecasts. As it happens, we are now perfectly aligned with the Fed's projections, anticipating a 3.7% contraction this year, followed by 4.0% growth in 2021. However, we would caution against taking any point forecast too seriously since many risks to the outlook remain. At the same time, with three quarters now "under the belt", the 2020 number should be close enough. Next year's performance will depend critically on virus and vaccine developments.

We do not believe it is possible to make a full recovery without a vaccine that facilitates a return to normalcy in the most impacted sectors: travel, leisure, and hospitality among others. Until such time as a vaccine becomes widely available, the summer surge experience in the US, as well as the latest case surges in Spain, France, and the UK, show clearly that societies cannot allow to lower their guard in terms of transmission-mitigating behavior such as face coverings and social distancing. This does not mean that business can't take place — indeed, it is critical that it does — but it must take place with the necessary safety precautions.

Economic Activity Improving From Q2 Shock

After contracting at a 31.7% seasonally adjusted annualized rate (saar) in the second quarter, US GDP is poised to grow by a similar magnitude in the third. The large monetary and fiscal stimulus quickly injected into the economy in the early days of the crisis have a lot to do with this. As a result, traditional relationships between key macroeconomic variables no longer held: personal income actually increased since the start of the year, the personal savings rate spiked to 33% (and remains abnormally elevated at 17%), and household net worth hit a record high in the second quarter, even as the unemployment rate spiked to 14.7%. August home sales hit their highest level since the summer of 2006. There is nothing even remotely close to "business as usual" here! As the economy reopened, aggregate employment has so far retraced about half of the earlier losses, with the unemployment rate down to 8.4% in August. But let there be no doubt: getting from 15% to 8% will prove easier and much faster than getting from 8% to the 3.5% level that prevailed at the start of 2020!

After a relentless salvo of stimulus measures early on, the last few months have been quiet on that front. In fact, earlier expectations of a fourth fiscal stimulus bill have been repeatedly pushed back as Congress failed to reach agreement on the size of the package. Preoccupation with the confirmation process for replacing Supreme Court Justice Ginsburg further dims prospects for additional fiscal stimulus in the short term, though this does not make agreement impossible. At least agreement has been found on a continuing resolution to avoid a government shutdown. While we would prefer to see some additional stimulus — especially for most impacted industries such as air travel and the most impacted among the unemployed — a delay of some weeks in agreeing a package of roughly USD1.0 trillion is unlikely to materially shift the economic trajectory. In fact, we'd happily trade the extra fiscal stimulus in exchange for avoiding a serious fall resurgence in COVID cases.

Fed Adopts Average Inflation Targeting

The big news on the monetary policy front was not about Fed action, but about the Fed's thinking. What had been anticipated for some time, is now official: the Fed has embraced an average inflation targeting (AIT) framework. AIT adoption was accompanied by a considerably extended and expanded forward guidance that laid out the conditions for lift-off from the current 0.00-0.25% interest rate level: the labor market has returned to full employment, inflation has returned to 2.0%, and inflation is also on track to moderately exceed 2 percent "for some time". The latest projections of the Federal Open Market Committee (FOMC) do not envision these conditions being met any time soon such that the Fed Funds rate is seen unchanged through 2023. Time will tell…

Inflation is not an issue. In the context of AIT, it would actually take a significant and protracted overshoot of the 2.0% rate to really deem such deviations problematic. Remember that a moderate overshoot for some time is currently the goal. We have modestly raised our inflation forecasts for both this year and next, but we are watching inflation developments closely to help us answer one of the most salient questions related to the COVID-19 crisis: will this prove to be an inflationary or deflationary shock over the medium term?

Eurozone: Rising to the Challenge

The eurozone presents an interesting case in the current COVID-19 drama. Cyclically, it is one of the worst affected regions, its vulnerabilities stemming from high level of economic openness, dependence on global tourism and luxury good demand, elderly populations, and macro policy constraints related to institutional rigidities in the eurozone and EU constructs. And yet, the region seems poised to emerge from this crisis in a much better shape from a structural standpoint as the intensity of this shock has energized transformative integrational efforts to a larger extent than either the GFC or the euro crisis were able to do.

After years when ECB rate cuts and quantitative easing (QE) seemed to mark the extent of macro policy support available to the region's economy, we are now finally witnessing a meaningful fiscal policy response. This is not just at the national level (and now including in traditionally austere countries like Germany) but — most importantly — also at the supranational level. The creation of the €750 billion recovery fund this summer marks an important moment in EU macro policy — a big step toward building a more effective policy response to aid the economy in times of crisis. Meanwhile, the ECB has also stepped on the stimulus gas pedal, having nearly doubled the size of its Pandemic Emergency Purchase Program to €1,350 billion.

These measures will not avoid a serious recession. Indeed, on account of the big surge in cases in both France and Spain in September (and which seem likely to get worse before getting better), we have slightly downgraded our expectations for eurozone GDP this year to a 7.0% contraction. But we feel more confident in next year's rebound, particularly in Italy, which should be among the biggest beneficiaries of the recovery fund. An opportunity exists for countries such as Italy, which had lagged in certain aspects of technology adoption, to come out of the COVID crisis stronger thanks to targeted investments in digitization and green investments.

Cross-country performance differences will persist, however. We anticipate a notably smaller contraction in Germany than in either France or Italy on account of a larger stimulus injection, stronger consumer finances, lesser dependence on tourism and higher dependence on manufacturing (a sector that's better positioned to make a fuller/faster recovery).

Inflation continues to badly undershoot targets but this nothing new, nor is this the biggest worry for policymakers at the moment. To some extent, it is a bit of a blessing as it shields households' purchasing power during the crisis while also helping build support for increased fiscal stimulus from would-be inflation hawks.

UK: Besieged!

Of all the developed economies we cover, the UK experience during the time of COVID is, in a sense, the most disappointing. It is not that other countries have not experienced more cases per capita of higher mortality rates — there are worse performers on both counts. In the UK's case, it had a good start in the crisis with a swift and powerful monetary/fiscal response early on, but then managed to squander that advantage. Somehow, the UK ended up with a very sub-optimal lockdown-virus case count-economic activity balance. Its initial lockdown was among the most severe globally, and the longest lasting among the G7. As a result, the economic cost was worse than its peers: while US, German, French, and Italian economies shrank by roughly 9-10% q/q in Q2, the UK contraction was twice as bad. GDP plunged 20.4% q/q during the second quarter as private consumption dropped by 23.5% and fixed investment collapsed by over 25%!

As the economy reopened, another sub-optimal choice of social distancing guidelines drove a quick new spike in cases and, in turn, triggered new restrictions on people movement and economy activity. These new restrictions are not nearly as severe as the earlier lockdown, but the risks are they would need to be tightened further should case numbers remain elevated. It pains us to say it, but the end result of all this is that the UK economy will underperform relative to other developed peers. In fact, we expect it to be the worst performing economy in our sample, faring worse than Italy and underperforming Germany by an almost 2:1 margin this year, and the US by an even wider margin.

UK Authorities Under Pressure

Early in the crisis, the Bank of England (BoE) cut the Bank Rate by 65 basis points to 0.1% and increased the QE program from £435 billion to £745 billion, engaging in various liquidity operations and extending real economy lending incentives. It has since taken no additional steps, but we know that "the MPC had been briefed on the Bank of England's plans to explore how a negative Bank Rate could be implemented effectively" and that "the Bank of England and the Prudential Regulation Authority will begin structured engagement on the operational considerations in 2020 Q4." The MPC is very worried about Brexit going awry at the last moment, just as the economy is still reeling from the COVID shock. Is it surprising that the MPC is looking to beef up the monetary policy defenses?

Indeed, the challenge facing the BoE would be formidable enough even if the pandemic were the only crisis on its hands. But, of course, there is more. The final scheduled round of talks regarding the future trading relationship between the EU and the UK is about to begin, but prospects for a deal look bleak; the government's own new base case implies a fallback to WTO rules at the end of 2020. A chaotic transition poses downside risks to our 2021 forecast. We assume that the government would accept a lax implementation of border controls (at least temporarily) and regulations to mitigate the negative business impact.

Fiscal policy has a role to play and it has played a role from the very beginning. But the actor must fill some very big shoes, so to speak. Cognizant of this, the government has just announced new support measures to replace expiring labor market support schemes. But these new measures are less generous and impose a larger burden-sharing cost on businesses. Whether they will be able to bear this burden, especially in the context of new restrictions that will likely impact revenues, is questionable. More fiscal stimulus will be needed.

Inflation has taken a dive recently, with the headline measure at only 0.2% y/y in August and the core rate at just 0.9% y/y — levels not seen since 2015. Base effects, higher oil prices, higher tariffs, and a weaker currency all suggest a reacceleration in inflation in 2021, but the weak demand backdrop will be a powerful headwind.

Japan: New Leader, Old Challenges

After close to a decade of stability under Shinzo Abe, Japan has a new prime minister in Yoshihide Suga to navigate the country through a delicate phase. Abe's policies had propped up economic growth to some extent, spurred corporate profits and sentiment through a weaker Japanese yen and higher stock markets. But inflation and wage growth still remain well below target. Fears of a COVID resurgence, especially after the "Go To Travel" comes into full swing, will dominate macroeconomic policy settings in the short run, and a revival in domestic demand remains the key to growth in the medium term.

GDP declined by the most on record during the second quarter, capping three consecutive quarters of declines, initially triggered by the VAT tax hike in the final quarter of 2019. Growth had already begun to slow in Q1 as inbound tourism collapsed and households began to reduce spending in the early stages of the COVID-19 outbreak. However, the worsening of the pandemic, both at home and abroad, led to a much sharper hit to second-quarter GDP. Domestic demand was very weak — an 8.6% q/q drop in private consumption was the most notable component. This explains why we have downgraded the GDP forecast for 2020 by 1.3 percentage points to -5.5%.

Prospects for 2021 Looking Up

We are slightly more positive on 2021 than we were back in June. The rise in Japan's unemployment rate has been relatively less than its peers. Though the number of active jobs per applicant is low, there are signs that the stress on the labour market is lessening. Expectations of additional fiscal stimulus via a third Fiscal Year 2020 (April-March) supplementary budget and an expanded FY 2021 budget remain unchanged. A rollback of the VAT tax hike remains unlikely, mainly because of pushback from the Finance Ministry. The "Go To Travel" campaign initiated in August to promote domestic tourism will support the most affected industries, like hotels and accommodations. We expect the July 2021 Tokyo Olympics to go ahead, perhaps with limited spectators. All in all, we see a slightly stronger recovery in 2021, with GDP expanding 3.3% on an improved outlook for consumption of services and more favorable base effects.

Longer term, Suga would ideally place more emphasis on structural reform — deregulation, industry consolidation, higher efficiency — than Abe. This has been a relatively underutilized aspect of Abe's economic agenda, and Suga has been keen to promote digitalization and tackle thorny issues such as regulatory reform and administrative inefficiency.

Headline inflation has been remarkably stable considering the drop in private demand and the fact that inflation hardly had any momentum even in the months leading to COVID. The underlying measures weakened considerably in August though — both the core measure of CPI (excluding fresh food) and the new BoJ core CPI (excluding fresh food and energy) fell by 0.5 percentage points to -0.5% and -0.1% y/y respectively. The declines were expected and an unintended consequence of the "Go To Travel" campaign. As much as half of the costs for domestic travel are being subsidized under this scheme, which caused accommodation costs component of CPI to plunge. Our outlook for inflation in 2020 remains unchanged at a negative 0.3%, but we have slightly upgraded the forecast for 2021 by 0.2 percentage points to 0.0%, on the back of a stronger recovery and favorable base effect.

Bank of Japan on Standby

The BoJ has adopted several measures to defend the economy — yield curve control, asset purchases and a dollar swap line with the Fed to provide USD liquidity. Suga has expressed his confidence in BoJ Governor Haruhiko Kuroda's policy moves. The current monetary policy framework (-0.1% short-term interest rate target and a pledge to cap 10-year government bond yields around zero) will thus likely be maintained going into 2021. The BoJ might be induced to cut the policy rate one more time if the yen appreciates rapidly and persistently. But further negative rates will face a high political hurdle as it would reduce banks' lending margin when the BoJ is encouraging them to provide more credit to firms and households. So the most promising tool remains credit easing through coordination with fiscal policy accompanied by generally accommodative financial conditions, where the government takes risks and the BoJ provides liquidity.

Emerging Markets Outlook

Simona Mocuta
Senior Economist
Global Macro and Policy Research

Emerging market growth will likely outpace developed markets again in 2021, but growth prospects within EM could diverge considerably by country.

Emerging Markets: COVID's Lasting Scars

The COVID-19 crisis may cause emerging markets economies to contract by about 1.5% this year. This is an extraordinarily weak performance given typical annual expansion rates in the mid-4.0%, but it is actually a little better than we expected back in June. A slightly faster than anticipated recovery in China, alongside broad improvements in the global economy, resumption in trade flows and reviving commodity prices, all contribute towards this "slightly less bad" outcome. 2021 could bring about a big rebound, with GDP growth nearing 5.5%.

But COVID-19 will leave lasting scars. What has been clear almost from the start is that this is the sort of crisis that temporarily negates many of the structural long-term advantages of emerging market economies while accentuating their shortcomings. Prime among those are the broadly favorable EM demographics. Abundant and relatively cheap labor resources have been a structural advantage that has supported an export-led growth approach in many emerging market economies in Asia and beyond. But abundant labor is not an advantage when that labor is idled by the necessities of social isolation policies. In fact, high population density is a key risk factor that can greatly exacerbate disease containment difficulties and escalate healthcare costs. Unfortunately, Brazil and India have become poster children of a demographic advantage turned into a drag as infection rates spiked. The costs of countering the health and economic crisis may be more onerous for EM economies whose access/cost of financing is more restrictive. Higher debt burdens and rising absolute poverty levels will take years to unwind.

The COVID-19 crisis has also laid bare vulnerabilities related to a long and complex global supply chains. Indeed, what in 2019 was primarily a bilateral US-China issue has since become a simultaneous and multilateral process of reassessing supply chains. One could think of it as a scaling up of the US-China trade tensions that had dominated headlines in 2019, albeit triggered by a different motivation. The changes may not be immediately apparent, but they could be significant. To the extent that the process of globalization has supported EM's relative growth outperformance, any change in trend here will make such an outperformance more challenging to accomplish.

The COVID-19 crisis also heightened the heterogeneity in EM economic performance. There are two layers to this heterogeneity. On one hand, there is a duality element (China vs the other EM countries) and, on the other, an increased divergence among the remaining EM economies. China's exceptionalism could not be starker at this point in time. Its superior policy implementation capacity — both social and economic — places it in a unique position: it is the only large emerging market, in fact, the only large economy in the world that will see its GDP expand this year.

Global Capital Markets Outlook

Jerry Holly
Senior Portfolio Manager
Investment Solutions Group

While global stock markets largely maintained their recovery through the latest quarter, a heightened focus on relative value trade-offs within broad asset classes characterizes our current outlook.

If the current economic recovery can be characterized as atypical due to the seemingly counter-intuitive interplay of key economic variables, then the ongoing repair across capital markets is primarily unique in terms of the speed at which it has transpired. Many of the circles, both vicious and virtuous, that have embodied the COVID capital market experience are not terribly dissimilar from volatile episodes of the past. In narrative terms, a real crisis leads to a shock which curtails liquidity and dents investor sentiment, leading to a downward spiral in the midst of the panic. Investor capitulation helps put in a bottom, and aggressive policy response ultimately leads to economic improvement, improved sentiment and a rebound in risk assets. From a more data-oriented perspective, we have witnessed historically-consistent relationships across any number of market-priced instruments in the wake of the COVID bear market. In money markets, the TED spread retreated to its pre-pandemic level inside of three months. That particular indicator of stress took longer to stabilize after the second quarter of 2010 when stock markets were barely down 10%. In fixed income, the typical crisis-induced surge in real yields and collapse in breakeven rates reversed course inside of a month — something that took roughly a year during the global financial crisis in 2008/09. And, of course, the S&P 500 managed to re-claim new all-time highs in August, representing the fastest recovery from a decline of greater than 30% in history. While most stock markets around the world can't lay claim to fresh records just yet, in the quarter just passed, almost all asset classes delivered positive results and continued to heal from the damaging effects of the pandemic.

Healing Continued in Third Quarter

Though the healing was broad, the third quarter was not without important developments and turning points that may help frame the final stanza of what has been an arduous 2020 saga. During July and August, equity markets meandered higher despite mixed news on the economy, vaccine optimism that was offset by COVID flare-ups and waning hopes for additional fiscal stimulus. Favorable early data on vaccine development from a handful of pharmaceutical and biotech companies helped to lift equity markets out of the gate, even though new daily COVID cases in the United States eclipsed 50,000 for the first time. Stocks exhibited some slight hiccups as widespread flooding ravaged parts of China and COVID-related reopening plans were halted or reversed in different hotspots around the world. An increase in US-China tensions didn't help sentiment as President Trump signed an executive order ending Hong Kong's privileged trading status and the two countries engaged in a tit-for-tat closure of consulates. Meanwhile, the view from Europe looked more optimistic and the euro rallied to an 18-month high following an agreement on a EUR 750 billion joint stimulus package to combat the impact of COVID-19. And while Congressional inaction on additional fiscal stimulus in the United States continued to raise concerns, the President announced a series of executive orders to try to bridge the gap in economic assistance. At the same time, US equity markets were wrapping up an earnings season that handily outpaced analyst expectations. A couple of firm inflation readings pressured bond returns and also cut gold prices down a notch, but the S&P 500 would ultimately reach an all-time high in the middle of August just as gold prices revisited $2,000/oz.

The end of August and the turn to September brought with it a confluence of events that altered the course of some important market trends. The Federal Reserve's adoption of average inflation targeting may have been anticipated to happen eventually, but it came a bit sooner than most observers thought, leading to a bump in stock prices and wider breakeven inflation rates. Shortly thereafter, the US dollar would put in a bottom on the same day that real yields troughed. Ordinarily one might point to a firmer US dollar and higher real interest rates as potential sources of instability for equity markets. And while that may have influenced some investors, the sharp drop in technology stocks and broader equity indexes appeared to be triggered by above average options activity. An uptick in short-dated call-buying on the part of both retail and institutional investors fueled volatility as high-flying tech stocks like Apple and Tesla got tripped up just after announcing stock splits. In turn, market makers reinforced the downturn by unloading underlying equity exposure to reset their hedges. As the sell side was scrambling to manage delta and gamma exposures, political and policy changes cropped up outside the United States. In Japan, Prime Minister Shinzo Abe resigned for health reasons but the Nikkei kept chugging higher and the yen continued to appreciate versus the US dollar. The same could not be said in the United Kingdom where the pound fell sharply after Boris Johnson proposed reneging on parts of the Brexit withdrawal agreement. The quarter would close with other political fireworks as the US held its first presidential debate with a little over a month to go until election day.

Sentiment More Balanced

From a risk sentiment perspective, our Market Regime Indicator (MRI) has been tracking in the upper range of what we consider a normal market regime. The components of the index have eased to varying degrees. Spreads on risky debt are calming the waters a bit, as this factor has been the most stable. The equity implied volatility signal flared up in early September but has otherwise been steadily improving. Implied volatility in currency markets has continued to bounce around, driven by Brexit concerns and the impact that has had on the pound. Elsewhere in options markets, it might be difficult to decipher the overall directional view of investors — but based on the cost of S&P 500 option straddles the market is bracing for significant moves the day after election day and beyond.

Equities: Alpha or Beta?

In terms of US election risk, our colleagues in the policy sphere have outlined a nice framework for thinking through potential outcomes. Might we end up with a Trump victory and a continuation of the "beta" trade that has floated the vast majority of corporate boats? Or will we be operating under a President Biden where there may be less broad-based support for corporates and a greater need to pick winners and losers (alpha regime). Elevated premiums for both put and call options could suggest that market participants are bracing for an alpha regime whereby it would be more challenging to deliver strong returns in broadly diversified stock market exposures. Our perspective on markets generally fits into this narrative, even if we arrive at our conclusions based on more than electoral considerations alone. For our purposes, we tend to think of the beta regime in terms of our directional exposure and we would think of alpha decisions as those relating to relative value across markets.

From a beta, or directional, perspective we have adopted a mostly neutral stance in terms of our total equity exposure. The stasis on the directional front is influenced by a variety of factors. Beginning with our quantitative models, we have seen steady improvement in earnings and sales diffusion indexes which has been encouraging. But a broad base of valuation factors continue to point to a market that looks relatively rich. A normal reading from our regime indicator, as discussed above, is just as it sounds and does not gear itself to taking on large pro-growth or defensive allocations. The progression of COVID is a source of concern, especially as it resulted in scaled-back re-opening plans in California and more aggressive lockdowns in places like Melbourne in the recent past. But this risk has been offset by increasing optimism and apparent progress in terms of developing and distributing some form of vaccine. Elections, in our view, usually are not that much of a cause for concern when considering the impact on equity markets from a directional perspective, even if the policy mix changes and imposes additional constraints through regulations or taxes. But the notion of a prolonged and contested US election event introduces tail risks for which we find little historical precedence. Barring any big changes in guidance from our modeling or anomalous fundamental dislocations, a relatively neutral position seems appropriate.

However, from a relative value perspective we continue to see much greater opportunities and that is where the bulk of active risk resides in our portfolios today. From a regional standpoint, the US election would appear to pose most risk to US equities, which we continue to favor. After all, if Vice President Biden prevails and the Democrats manage to win contested Senate races in Arizona, Colorado and a couple of toss-up states, it's quite likely that US stocks will have to clear an additional 7 percentage points of statutory corporate taxes. That same hurdle would not directly impact stocks in Europe, the Pacific region or Emerging Markets. But the US stock market also looks better placed in terms of earnings delivery and still strong momentum. Provided we don't see any more gamma-induced de-risking, it's quite possible that some of the big tech, communications and consumer discretionary companies that report earnings in late October could continue to beat expectations and provide some additional momentum for US stocks leading up to election day.

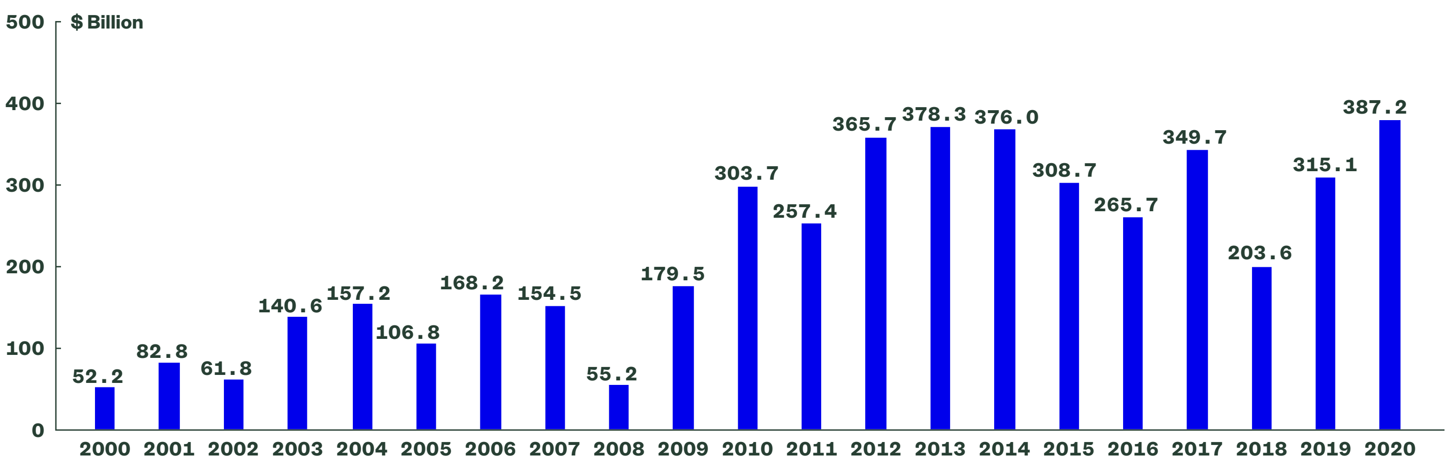
Similar drivers inform our outlook across sectors where we prefer exposure to a relatively diversified basket including technology, consumer discretionary and consumer staples. Sectors like technology and consumer discretionary both look attractive when evaluating our intermediate horizon momentum indicators. But it's not just price trends that lend support. The tech sector continues to espouse strong profitability ratios with low debt levels, while consumer discretionary maintains a clear advantage with respect to advancing sales and earnings revision data. Consumer staples offers the most balanced risk/reward in our view, with above-average scores across nearly all of the factors we evaluate. And if Walmart can continue to deliver and advance its online sales while Proctor & Gamble keeps its shelves stocked, that would go a long way toward bolstering the performance of this lower beta sector.

Fixed Income: Targeting Above Average Credit Exposure

The emphasis on relative value is nowhere more evident to us than in fixed income. While we don't view the current market environment as one in which to take on large stock-versus-bond trades, we are firmly risk-on within the narrower universe of fixed income assets. Some of our earlier thoughts continue to hold in the sense that significant central bank supports exist for all types of fixed income instruments. But several upside surprises in inflation data alongside the Federal Reserve's shift to average inflation targeting continued to push inflation breakevens wider up until September when inflation expectations reversed course as real yields nudged higher. Even if market-based expectations of inflation suggest some skepticism that the Federal Reserve can eclipse its inflation goals over any durable period of time, the steady steepening in the yield curve that we have observed in 2020 may indicate that investors are equally concerned about tying capital up in fixed coupon investments — particularly for longer time horizons. We would concur with that view for the time being. Though risk-off events might create some episodic support for longer-term government bonds, duration exposure does not appear compelling with economic sentiment continuing to improve and interest rate momentum suggesting some risk to the upside as well.

In credit markets, liquidity conditions have continued to improve and the modest levels of indigestion witnessed in September leave valuations marginally more attractive. Additionally, receding market volatility, low borrowing costs and a turn to more favorable seasonal patterns toward the end of the year may offer some support for both investment grade and high yield bonds. That's not to say all is clear in corporate credit markets. The flip side of low interest rates has been record levels of issuance — which should give a buyer pause, especially as it pushes gross leverage up towards all-time highs. But with the Federal Reserve continuing to provide a backstop for corporates and a lack of remunerative alternatives across bond markets, credit should continue to find ready buyers.

Figure 4
Covid-19 Record New Issuance in Developed High Yield Markets



Source: BofA Global Research as of 30 September 2020.

Commodities: Trend Still Intact for Gold

Broad-based commodities enjoyed a sound recovery during the third quarter as industrial production ramped back up, Chinese demand continued to recover and supply in certain markets was curtailed on account of COVID-19. More recently, rising infections, weaker US gasoline demand and plateauing mobility readings have weighed on sentiment and we've taken a split position across commodities. For broad exposure to commodities, we hold an underweight allocation in our cross-asset portfolios. But we continue to view gold as an attractive investment. Even though gold experienced a parabolic ascent early in the third quarter, and a relatively sharp downturn thereafter, we are still seeing the technicals as being overwhelmingly supportive of the metal. The fundamentals are a bit more mixed. Higher (much higher) debt levels, low real interest rates and the potential for gold to act as a political hedge all lend support to holding a meaningful allocation. But some features of the investment landscape suggest a more cautious stance with gold. For instance, gold hasn't been acting as much of a diversifier for equity market exposure as its correlation to stocks (while generally unstable) has become quite positive of late. Additionally, the easing of market volatility indicators — whether in fixed income markets or equity — would argue that there is less of a need for assets like gold. To us, the sum total of risk factors still place gold high on our list of tactical exposures as we look towards closing out a year that will not soon be forgotten.

Unless noted otherwise, all returns are in US dollars as of September 30, 2020.

Sources: Bloomberg, FactSet, J.P. Morgan, Barclays, Wall Street Journal, The Economist, MSCI as of September 30, 2020.

SSGA Forecasts as of September 30, 2020

	2020 (%)	2021 (%)
Real GDP Growth		
Global	-2.9	4.9
US	-3.7	4.0
Australia	-2.8	3.9
Canada	-5.6	5.7
Eurozone	-7.0	5.0
France	-7.9	5.5
Germany	-5.0	5.2
Italy	-8.8	6.0
UK	-9.2	7.9
Japan	-5.5	3.3
Brazil	-4.6	3.9
China	2.6	7.0
India	-8.0	8.1
Mexico	-8.0	6.0
South Africa	-8.0	5.0
South Korea	-1.0	2.9
Taiwan	0.6	2.6
Inflation		
Developed Economies	0.9	1.6
US	1.3	2.0
Australia	0.6	1.1
Canada	0.9	1.5
Eurozone	0.4	1.1
France	0.6	1.2
Germany	0.7	1.4
Italy	-0.1	0.7
UK	0.8	1.7
Japan	-0.3	0.0
China	2.6	2.3

	September 30, 2020 (%)	September 30, 2021 (%)
Central Bank Rates		
US (upper bound)	0.25	0.25
Australia	0.25	0.25
Canada	0.25	0.25
Euro	0.00	0.00
UK	0.10	0.10
Japan	-0.10	-0.10
Brazil	2.00	2.00
China	4.35	4.35
India	4.00	3.50
Mexico	4.25	4.25
South Africa	3.50	3.25
South Korea	0.50	0.50
10-Year Bond Yields		
US	0.68	0.81
Australia	0.79	0.86
Canada	0.57	0.66
Germany	-0.53	-0.46
UK	0.22	0.29
Japan	0.02	0.07
Exchange Rates		
Australian Dollar (A$/$)	0.71	0.75
British Pound (£/$)	1.28	1.44
Canadian Dollar ($/C$)	1.34	1.24
Euro (€/$)	1.17	1.19
Japanese Yen ($/¥)	105.69	98.00
Swiss Franc ($/SFr)	0.92	0.99
Chinese Yuan ($/¥)	6.82	6.89

One-Year Return Forecasts	USD (%)	EUR (%)	GBP (%)	JPY (%)	AUD (%)	CAD (%)
S&P 500	6.6	4.8	-5.2	-1.2	0.8	-1.1
Russell 2000	6.0	4.2	-5.7	-1.7	0.3	-1.6
MSCI EAFE	4.9	3.1	-6.7	-2.7	-0.8	-2.6
MSCI EM	8.3	6.4	-3.7	0.4	2.4	0.5
Barclays Capital Aggregate Bond Index	1.0	-0.7	-10.2	-6.3	-4.5	-6.3
Citigroup World Government Bond Index	-0.2	-1.9	-11.2	-7.5	-5.6	-7.4
Goldman Sachs Commodities Index	1.3	-0.4	-9.9	-6.1	-4.2	-6.0
Dow Jones US Select REIT Index	3.5	1.7	-7.9	-4.0	-2.1	-3.9

Forecasts are as of September 30, 2020.
The above estimates based on certain assumptions and analysis made by State Street Global Advisors. There is no guarantee that the estimates will be achieved

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* This figure is presented as of June 30, 2020 and includes approximately $69.52 billion 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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Marketing communication.

Glossary

Basis Point One basis point is equal to one-hundredth of 1 percent, or 0.01%.

Capital Expenditure (Capex) refers to investment by a company to acquire or upgrade physical assets, such as a building, IT hardware or a new business.

Citigroup World Government Bond Index The WGBI is a widely used benchmark that currently comprises sovereign debt from over 20 countries, denominated in a variety of currencies.

Consumer Price Inflation (CPI) A widely used measure of inflation at the consumer level that helps to evaluate changes in cost of living.

Deflation A decrease in the general price level of goods and services over a given period.

GFC The global financial crisis, or GFC, refers to the period of extreme stress in financial markets and banking systems between mid-2007 and early 2009.

Goldman Sachs Commodities Index GSCI is the first major investable commodity index and includes the most liquid commodity futures.

Gross Domestic Product (GDP) The monetary value of all the finished goods and services produced within a country's borders in a specific time period. Economic growth is typically expressed in terms of changes in GDP.

Group of Seven (G7) A group consisting of Canada, France, Germany, Italy, Japan, the United Kingdom and the United States.

MSCI EAFE Index An equities benchmark that captures large- and mid-cap representation across 22 developed market countries around the world, excluding the US and Canada.

MSCI Emerging Markets Index The MSCI Emerging Markets Index captures large and mid-cap representation across 23 emerging markets countries. With 834 constituents, the index covers approximately 85% of the free float-adjusted market capitalization in each country.

MSCI World Index The MSCI World Index is a free-float weighted equity index. It includes about 1,600 stocks from developed world markets, and does not include emerging markets.

Organization of Petroleum Exporting Countries (OPEC) 13-member group of oil exporting nations founded to manage global supply and coordinate pricing.

Purchasing Managers' Index An indicator of the economic health of the manufacturing and services sectors compiled from a survey of purchasing executives.

Quantitative Easing (QE) An extraordinary monetary policy measure in which a central bank buys government fixed-income securities to lower interest rates, encourage borrowing and stimulate economic activity.

Russell 2000 Index A benchmark that measures the performance of the small-capitalization segment of the US equity universe.

S&P 500 Total Return Index The benchmark that reflects returns after reinvestment of dividends of the 500 large cap stocks in the S&P 500 Index.

The US Dollar Index Measures the performance of the US Dollar against a basket of major currencies.

Value Added Tax (VAT) is a broadly-based consumption tax assessed on the value added to goods and services.

Yield Curve A graph or line that plots the yields of bonds with similar credit quality, typically from shortest to longest duration.

Marketing Communication

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