No rest for the wicked: Institutional investors go out and into risk again

The State Street Risk Appetite Index picked up modestly at the end of August after cautious start of the month (see Figure 1 overleaf).

"August is supposed to be a quiet month, when investors rest up, catch up on projects, read and prepare for the final push into the year end. Not this year! – August started with the biggest spike in volatility all year: Tech sold-off and the carry trade unwound. Institutional investors were quick to respond – selling risky stocks, currencies and switching from stocks to cash. However, this bout of risk aversion did not last as the market quickly re-priced the Fed's rate cutting cycle. Risky assets recovered their losses, while institutional investors started dipping their toes back into risk trades (Figure 1 overleaf).

'Fed Chairman Jay Powell soothed the market saying that the time has come for policy to adjust, sparking a rebound in risk as well as more constructive equity and FX flows into month end following positioning adjustment. We are now watching those flows closely to see if the sparks of more constructive risk sentiment will fire up a risk rally or if recessionary fears will turn them into ashes." noted Marija Veitmane, Head of Equity Strategy at State Street Global Markets.

Institutional investors allocation to cash has increase a little (55bps) during August, but remains not far from long term averages (Figure 2 overleaf). Allocation to both stocks and bonds has come down.

"Institutional investors have responded to the sharp sell off in equity market in early August by reducing their allocations to stocks, despite the equity rally in the second half of the month. We find it encouraging that their allocation to stocks is lower than at the start of the previous rate cutting cycles. This gives us hope that even if economic data takes a turn for the worse, institutional investors are somewhat prepared for the market weakness, suggesting potentially less aggressive sell-off." added Marija Veitmane.

About the indicators

The Institutional Investor Indicators (the three i's) were developed at State Street Associates, State Street Global Markets research and advisory services business. They measure investor confidence or risk appetite quantitatively by analyzing the actual buying and selling patterns of institutional investors derived from State Street's USD44trn[1] in assets under custody and administration (note not investors' balances held at State Street itself). The *Risk Appetite Index* is derived from measuring investor flows in twenty-two different dimensions of risk across equities, FX, fixed income, commodity-linked assets, and asset allocation trends. The index captures the proportion of the twenty-two risk elements that saw either risk seeking or risk reducing behavior. A positive reading suggests that on balance investors are adding to their risk exposures, while a negative reading suggests risk reduction. State Street's *holdings indicators* capture the share of investor portfolios allocated toward equity, fixed income and cash going back to 1998.

Figure 1: State Street Risk Appetite Index – August ends with a small pick-up in risk appetite

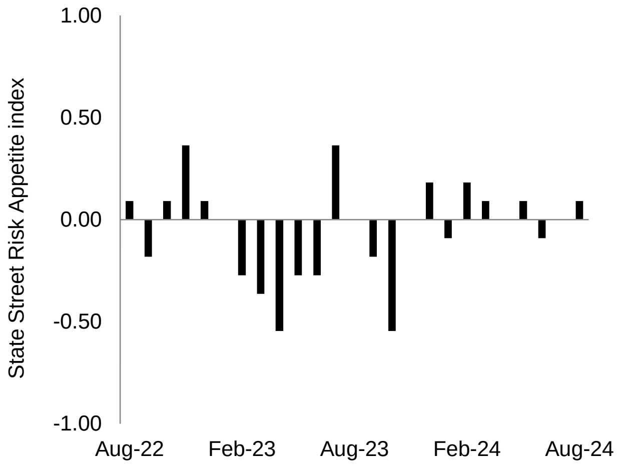
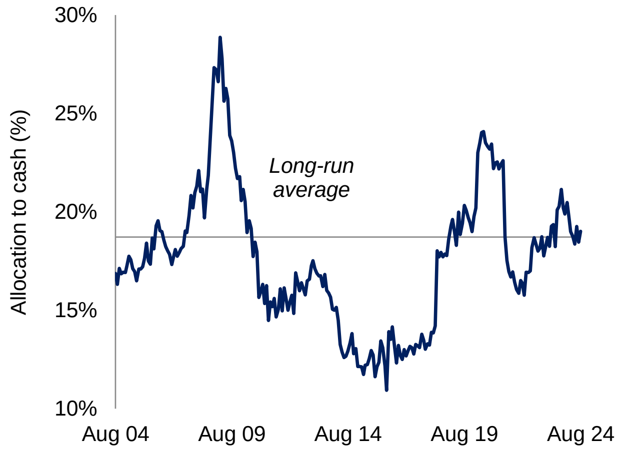


Figure 2: State Street Risk Holdings indicator – Cash holdings end August at long-run average



Source: State Street Global Markets

[1] As of Q1 2024 reported State Street earnings.

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