Commentary
Investment Solutions Group

November 2020

Asset Allocation and Market Regime Review

Daniel P. Farley, CFA
Executive Vice President,
CIO of the Investment
Solutions Group

Andrea Anastasio
Managing Director,
Head of Strategy and
Research, North America

- The relationships across various asset classes and factors have been influenced by the high level of liquidity added to the markets by central banks.
- Our outlook for equities continues to be cautiously optimistic, and we anticipate broader participation across regions.

Perspectives on the Year

COVID-19 has severely tested the global economy and markets in 2020. Aided by unprecedented monetary and fiscal stimulus, markets responded with surprising resilience beginning in late March and throughout the second quarter. The market recovery continued to gather momentum in the third quarter as economic growth rebounded strongly across the globe amid relaxation in COVID-19-related lockdowns, fiscal and monetary policy support, and the release of pent-up demand. Though infection rates were re-surging in some developed economies, the worst seemed to be behind us at that point as key vaccine trials continued to make quick progress.

At the end of the third quarter, however, growth momentum began to decelerate as fiscal support waned and services growth remained restricted; investors worried about stretching valuations, rising infection rates, and uncertainty associated with the US elections. This bout of negativity proved to be short-lived though. As we turned the corner on the US election, developments on a number of fronts, starting with improving prospects for fiscal stimulus, positive earnings sentiment, and reports of 90% efficacy for the Pfizer vaccine, bolstered investors' outlook on risky assets and propelled global equities to a strong post-election rally.

Asset Class Returns and Correlations

Equity factors had a mixed year in terms of performance. Value struggled over the course of the year, with brief but notable periods of outperformance, while Growth led the pack for a second consecutive year. Most notably, US equities offered further evidence of this dominance, outperforming all major equity markets by virtue of a sizable exposure to growth-driven Information Technology, Consumer Discretionary, and Communication Services sectors. Looking at other standout performers, observers won't be surprised to see three bond sectors rounding out he top of the leader board in a year characterized by massive monetary easing and asset purchase programs by central banks.

Figure 1
Return Analysis of Major Asset Classes (%)

	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	YTD 09/2020
Higher ↑	Emerging Markets 19.14	Treasuries 9.81	Emerging Markets 18.50	Growth 33.49	US Equity 13.68	Growth 5.67	High Yield 17.49	Emerging Markets 37.74	Treasuries 0.86	Growth 36.39	Growth 20.16
	Growth 16.70	EM Debt (Hard) 7.35	Developed Markets ex-US 17.71	Value 32.56	Value 13.45	US Equity 1.37	Value 17.33	Growth 30.21	Investment Grade Credit -0.52	US Equity 31.48	Treasuries 7.88
	Commodities 16.67	Investment Grade Credit 7.07	Value 17.51	US Equity 32.37	Growth 13.05	EM Debt (Hard) 1.18	US Equity 11.95	Developed Markets ex-US 25.53	Growth -1.51	Value 26.52	Investment Grade Credit 6.25
	Value 15.50	High Yield 4.38	EM Debt (Hard) 17.44	Developed Markets ex-US 23.21	EM Debt (Hard) 7.43	Investment Grade Credit 0.92	Emerging Markets 11.66	US Equity 21.82	Global Agg ex-US -2.15	Developed Markets ex-US 22.59	Global Agg ex-US 5.26
	High Yield 15.19	Global Agg ex-US 4.36	US Equity 15.99	High Yield 7.42	Investment Grade Credit 6.35	Treasuries 0.84	Commodities 11.40	Value 13.64	High Yield -2.26	Emerging Markets 18.78	US Equity 2.76
	US Equity 15.06	Growth 2.64	High Yield 15.58	Emerging Markets -2.36	Treasuries 5.05	Developed Markets ex-US -0.44	EM Debt (Hard) 10.15	Global Agg ex-US 10.51	EM Debt (Hard) -4.26	EM Debt (Hard) 15.04	Emerging Markets 1.11
	EM Debt (Hard) 12.24	US Equity 2.11	Growth 15.26	Investment Grade Credit -2.42	High Yield 2.50	Value -3.84	Growth 7.07	EM Debt (Hard) 10.26	US Equity -4.39	High Yield 14.41	High Yield 0.17
	Developed Markets ex-US 8.16	Value 0.39	Investment Grade Credit 6.25	Treasuries -2.75	Emerging Markets -2.06	High Yield -4.64	Investment Grade Credit 3.60	High Yield 7.48	Value -8.28	Investment Grade Credit 10.53	EM Debt (Hard) -0.54
	Investment Grade Credit 7.29	Developed Markets ex-US -11.85	Global Agg ex-US 4.09	Global Agg ex-US -3.08	Global Agg ex-US -3.08	Global Agg ex-US -6.02	Global Agg ex-US 1.49	Investment Grade Credit 4.63	Commodities -12.99	Treasuries 6.86	Developed Markets ex-US -10.46
	Treasuries 5.87	Commodities -13.37	Treasuries 1.99	EM Debt (Hard) -5.25	Developed Markets ex-US -4.49	Emerging Markets -14.68	Developed Markets ex-US 1.44	Treasuries 2.31	Developed Markets ex-US -13.43	Commodities 5.44	Commodities -11.18
↓ Lower	Global Agg ex-US 4.95	Emerging Markets -18.25	Commodities -1.14	Commodities -9.58	Commodities -17.04	Commodities -24.70	Treasuries 1.04	Commodities 0.75	Emerging Markets -14.32	Global Agg ex-US 5.09	Value -12.64

Source: Sate State Global Advisors, Bloomberg as of 09/30/2020. Data provided is for information use only. Past performance is not a reliable indicator of future results. Developed Markets ex-US represented by MSCI EAFE Index. Value represented by Russell 1000 Value Index. Growth represented by Russell 1000 Growth Index. US Equity represented by S&P 500 Index. Emerging Markets represented by MSCI Emerging Markets Index. Commodities represented by Bloomberg Commodities Index. High Yield represented by ICE BofAML US High Yield Index. EM Debt (Hard) represented by JP Morgan EM Bond Index (EMBI) Global Diversified Index. Investment Grade Credit represented by Bloomberg Barclays AA Corporate Index. Treasuries represented by Bloomberg Barclays US Treasuries Index. Global Agg ex-US represented by Bloomberg Barclays Global Agg ex-US Index.

Figure 2

Correlation Table of Major Asset Classes

	Developed Markets ex-US	Value	Growth	US Equity	Emerging Markets	Commodities	High Yield	EM Debt (Hard)	Investment Grade Credit	Treasuries	Global Agg ex-US
Developed Markets ex-US	**1.00**	0.84	0.83	0.86	0.83	0.59	0.78	0.63	0.16	-0.40	0.46
Value	0.85	**1.00**	0.88	0.97	0.72	0.56	0.79	0.54	0.07	-0.51	0.26
Growth	0.84	0.86	**1.00**	0.97	0.72	0.49	0.72	0.53	0.16	-0.34	0.31
US Equity	0.87	0.96	0.97	**1.00**	0.74	0.54	0.77	0.54	0.12	-0.43	0.30
Emerging Markets	0.84	0.74	0.72	0.75	**1.00**	0.64	0.75	0.68	0.26	-0.29	0.57
Commodities	0.61	0.63	0.51	0.58	0.63	**1.00**	0.63	0.49	0.04	-0.36	0.46
High Yield	0.78	0.80	0.70	0.76	0.74	0.72	**1.00**	0.80	0.43	-0.25	0.46
EM Debt (Hard)	0.65	0.59	0.53	0.57	0.69	0.55	0.86	**1.00**	0.61	0.05	0.60
Investment Grade Credit	0.20	0.17	0.25	0.21	0.33	0.08	0.47	0.64	**1.00**	0.69	0.52
Treasuries	-0.43	-0.50	-0.29	-0.40	-0.27	-0.41	-0.28	-0.03	0.66	**1.00**	0.25
Global Agg ex-US	0.36	0.21	0.29	0.25	0.57	0.31	0.42	0.58	0.63	0.38	**1.00**

5 Years ended October 31, 2020   10 Years ended October 31, 2020

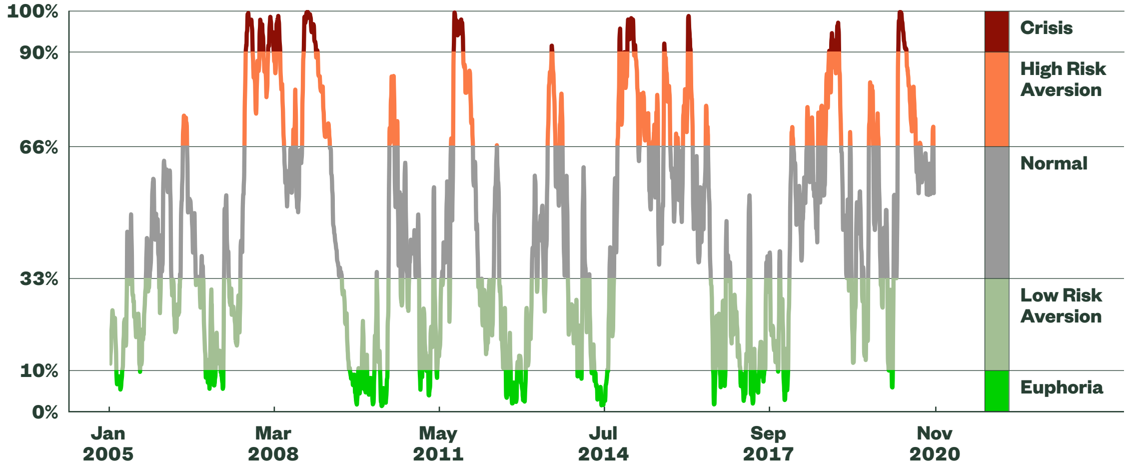
Correlations Source: State Street Global Advisors, Bloomberg as of 10/31/2020. The table shows the monthly return correlation between various asset classes (represented by market indices as defined in this disclosure) over the past five and ten years. Data provided is for information use only. Past performance is not a reliable indicator of future results, Developed Markets ex-US represented by MSCI EAFE Index. Value represented by Russell 1000 Value Index. Growth represented by Russell 1000 Growth Index. US Equity represented by S&P 500 Index. Emerging Markets represented by MSCI Emerging Markets Index. Commodities represented by Bloomberg Commodities Index. High Yield represented by ICE BofAML US High Yield Index. EM Debt (Hard) represented by JP Morgan EM Bond Index (EMBI) Global Diversified Index. Investment Grade Credit represented by Bloomberg Barclays AA Corporate Index. Treasuries represented by Bloomberg Barclays US Treasuries Index. Global Agg ex-US represented by Bloomberg Barclays Global Agg ex-US Index.

The relationships across various asset classes and factors have been influenced by the high level of liquidity added to the markets by central banks over the past several years. This has negatively impacted a historical level of "mean reversion" across the factors, which we see by increased correlations and continued outperformance of areas such as US Equities and Growth. Given vastly increased commitment by central banks globally in the aftermath of the COVID pandemic, this is may not reverse in the immediate future, but remains an area that investors need to be mindful of in order to ensure their portfolios are properly diversified when necessary.

Market Regime Indicator (MRI)

The Market Regime Indicator (MRI) is a tool used to assess the level of investor risk sentiment in the marketplace. By looking across implied volatility in equity, currency, and spreads on risky debt, we are able to get a global, multi-asset-class view on investors' appetite to take on risk.

Figure 3
Market Regime Indicator[1]



Source: State Street Global Advisors Investment Solutions Group. As of November 6, 2020.

As one would expect, the global economic disruption that followed the initial spread of COVID cases quickly soured risk sentiment into the new year, sending the MRI signal into Crisis regime in early March. The MRI then eased somewhat, straddling the line the between the High Risk Aversion and Normal regimes, as risky assets staged an impressive recovery in the face of elevated volatility levels. As we now move past the US election, we have seen the MRI ease from High Risk Aversion back to the Normal regime, signaling an improvement in market participants' willingness to take on risk.

Macro Outlook

While US election litigation still lies ahead of Presidential certainty, equity market performance in the days following the election confirmed that investors' worst election-related anxieties have abated to a large extent. Additional fiscal stimulus was initially believed to be limited, but the Senate run-off elections in Georgia may incent both sides to deliver a package. COVID cases have been surging across Europe and US, but the recent Pfizer announcement indicating that their vaccine was 95% effective in trials provides us with some cautious optimism. There remain details to be worked through on the production and distribution of the vaccine, so its actual impact on economic results may appear well into 2021. However, investors have clearly started to look through to that outcome in terms of potential company results. Corporate earnings have been resilient, especially in the US where roughly 89% of companies have reported earnings and, of those, 86% have reported a positive EPS surprise, albeit against lowered expectations. Perhaps more importantly, management has begun to raise those expectations for the remainder of the year and into 2021. Economically, consumers have been resolute, while strong manufacturing PMIs globally suggest broader recovery.

As we move into 2021, uncertainty persists on many fronts. While the world waits for a medical resolution to the pandemic crisis, infections are once again surging and restrictions on movement are scaling up. Meanwhile, the liquidity unleashed to fight the crisis is triggering questions about the inflation outlook. And finally, policy uncertainty persists following tense US elections, with control of the US Senate still pending. Brexit deadlines are looming; no agreement is yet in hand. As the helpful influence of earlier stimulus recedes, markets will likely face another major test in 2021.

Amid all this, it’s important to recognize that there is potential for some upside risk as well, in the form of an effective, quickly scalable vaccine. Such a development would go a long way to reducing the lasting scars from the COVID-19-induced recession. However, a full, broad, and genuine resolution to the crisis must by necessity also involve a remedial medical solution that will not only provide immunity to the virus, but also eliminate the stigma and fear currently associated with travel, mass gatherings, and normal human interaction. A vaccine is indeed a crucial step in that direction, but improvements in testing, contact tracing, and treatment remain critical to achieving this goal.

Inflation

Inflation may seem like a distant concern as we write these lines. However, inflation uncertainty has spiked recently. Investors are looking at the recent flood of debt issuance and wondering whether this might finally ignite inflation. Consumers are looking at higher food prices and questioning whether this does signals a new trend. Both are looking at the rising likelihood of supply chains moving back on-shore and wondering if the resulting higher costs of production will ultimately be passed on to the end buyers.

On that front, the US Federal Reserve’s decision to implement average inflation targeting is influential and could allow for inflation to run hotter, above their 2% target, as the Fed focuses on unemployment and supporting growth. In that context it would actually take a significant and protracted overshoot of the 2% inflation target rate to deem such deviations problematic for the Fed. In response to this, we have modestly raised our inflation forecasts for both this year and next, and we are watching inflation developments closely to help us answer one of the most salient questions related to the COVID-19 crisis: Will it prove to be an inflationary or deflationary shock over the medium term?

In this context, it may be prudent for investors to assess their portfolios’ sensitivity to inflation. While rising inflation is often seen as a major downside risks to nominal bonds by eroding the purchasing power of future cash flows, equities aren’t immune to its effects either. In the current environment where declining nominal yields drove up equity valuations, the notion that equities may function as a hedge against inflation must be brought into question if yields were to increase in reaction to higher inflation. Given this vulnerability, investors may want to consider diversifying their exposures to potential inflation hedges such as real assets to help offset the impact of inflation on traditional equities and bonds.

Currency Outlook

We remain positive to neutral in our near-term outlook for the USD. While an oversized fiscal stimulus remains a downside risk for the dollar, the prospect of a split Congress could take away a catalyst for this scenario to materialize in the near term. Furthermore, the lack of growth outside of the US, coupled with the outsized economic impact of the pandemic in Europe, is likely to delay a sustained USD depreciation.

Our outlook for the Euro remains soundly negative, as the Eurozone remains trapped in a negative-yield environment. A new round of lockdowns, coupled with a timid fiscal response, increase the risk of a double-dip recession. We are slightly less negative on the British Pound, as the team expects some sort of Brexit resolution that prevents a worst-case outcome — although headline risk could continue to weigh on the Pound in the meantime.

After some early gains, the Yen may face some near-term retracement as the second round of COVID restrictions sets in, but the team remains positive over the longer term, supported by relative valuation.

Finally our view on Emerging Market (EM) currencies remains positive in the mid to long term, as valuations and higher domestic yields remain supportive for the regions. EM economies may also benefit from a somewhat less mercurial approach to trade policy under a new US administration. In the near term, however, as is the case with all trade-driven economies, EM countries remain highly vulnerable to any slowdown in global growth caused by reacceleration of the pandemic.

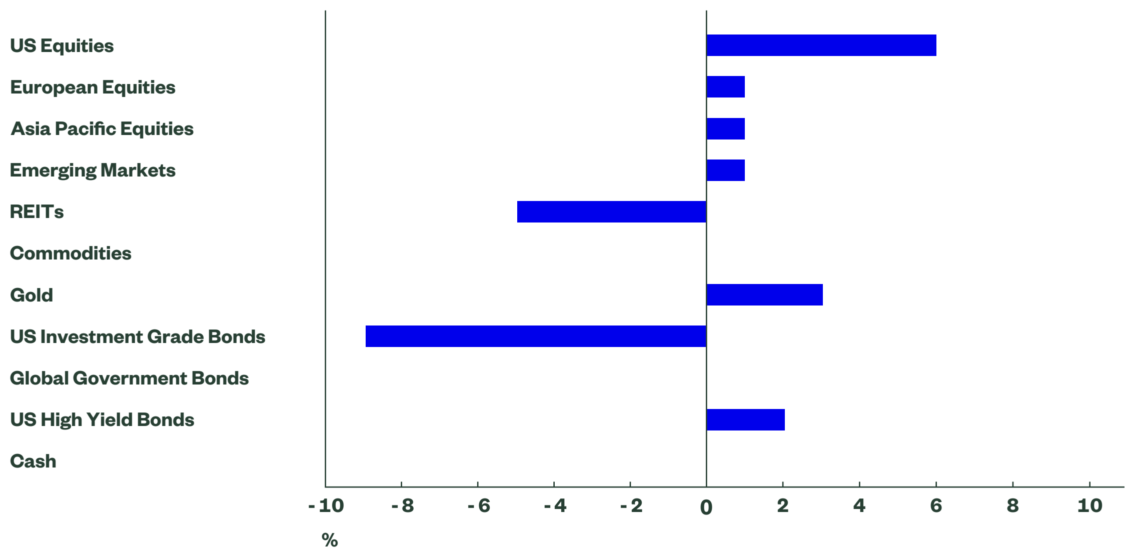
Tactical Asset Allocation Outlook: Directional Trades and Positioning

With the US election now in the rearview mirror, we have removed the risk limits that we had imposed and increased our allocation to growth-oriented assets such as equities and broad commodities. Our forecast for global equities remains serendipitous, as supportive macro and momentum factors offset stretched valuations. Additionally, 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 improve our commodities forecast.

Our forecast for high yield bonds has become more muted as recent weakness in equity momentum, coupled with higher volatility and tighter spreads, have dimmed the outlook. We have reduced our position but maintain a modest overweight, as still-favorable levels of government bond yields remain supportive and the asset class should benefit from improved risk appetite. Our forecast for core bonds also deteriorated slightly, as our quantitative models suggest a steeper curve and dent the outlook for both core and longer-term bonds.

Gold remains our preferred tactical hedge against bouts of volatility or negative sentiment arising from risks related to COVID, while low real rates and rising debt levels offer additional support.

Figure 4
Asset Class Summary



Source: State Street Global Advisors Investment Solutions Group. As of November 10, 2020.

Tactical Asset Allocation Outlook: Relative Value Trades and Positioning

Our outlook for equities continues to be cautiously optimistic, and we anticipate broader participation across regions. As a result, we diversified our position by increasing our regional exposure to Pacific equities, and slightly trimmed our US large cap overweight while maintaining our modest overweight to Europe. US earnings and sales expectations remain strong, while price momentum continues to help offset disadvantageous valuations. Valuations remain attractive for Pacific equities, and the improvement in quantitative and macro factors combined with comparatively successful pandemic management have boosted the outlook.

European equities have some favorable valuations, but generally remain challenged across our quantitative models, at least on a relative basis. Still, the forecast has continued to improve, and prospects for more amicable US-Eurozone trade and asymmetric upside to vaccine progress suggest maintaining our overweight at this time.

We also maintain an overweight to emerging market equities, as improved economic growth and a weaker US dollar continue to favor EM. Moreover, the potential for less trade consternation could act as a tailwind for the trade-dependent asset class. REITs continue to score poorly across all factors we consider and remain our largest underweight within the equity portfolio.

From an equity sector perspective, we continue to like technology and consumer staples. Consumer staples appears attractive across all of the factors 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 weaker scores for valuation, macro, and quality led to a move away from the sector. In its place we made an allocation to communication services, where improving momentum and sentiment data led to an upgrade in our view.

Looking at our fixed income sector allocation, we reduced exposure to longer-term investment grade corporate bonds, but remain overweight. Prospects for curve steepening weigh on our forecast. With concerns about rising interest rates, especially at more distant maturities, the sell allows us to trim some duration. Proceeds were deployed to non-US government bonds, which are supported by the outlook for US dollar weakness.

Endnote

1 The data displayed is not indicative of the past or future performance of any State Street Global Advisors 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

Our clients are the world's governments, institutions and financial advisors. To help them achieve their financial goals we live our guiding principles each and every day:

- Start with rigor
- Build from breadth
- Invest as stewards
- Invent the future

For four decades, these principles have helped us be the quiet power in a tumultuous investing world. Helping millions of people secure their financial futures. This takes each of our employees in 31 offices around the world, and a firm-wide conviction that we can always do it better. As a result, we are the world's third-largest asset manager with US $3.15 trillion* under our care.

* 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.

ssga.com

Investment professionals use only.

State Street Global Advisors Worldwide Entities

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.

All material has been obtained from sources believed to be reliable. There is no representation or warranty as to the accuracy of the information and State Street shall have no liability for decisions based on such information.

The views expressed are of the Investment Solutions Group through November 19, 2020, 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.

Actively managed funds do not seek to replicate the performance of a specified index.

Equity securities may fluctuate in value in response to the activities of individual companies and general market and economic conditions.

Investing in foreign domiciled securities may involve risk of capital loss from unfavorable fluctuation in currency values, withholding taxes, from differences in generally accepted accounting principles or from economic or political instability in other nations.

Investments in emerging or developing markets may be more volatile and less liquid than investing in developed markets and may involve exposure to economic structures that are generally less diverse and mature and to political systems which have less stability than those of more developed countries.

All the index performance results referred to are provided exclusively for comparison purposes only. It should not be assumed that they represent the performance of any particular investment.

The trademarks and service marks referenced herein are the property of their respective owners. Third party data providers make no warranties or representations of any kind relating to the accuracy, completeness or timeliness of the data and have no liability for damages of any kind relating to the use of such data.

ID354566-3339958.1.1.GBL.INST 1120
Exp. Date: 11/30/2021