Remove benchmark constraints.
Better manage risk.
Unhook your return potential.

State Street Global Advisors’ Active Quantitative Equities team has created unique active equity solutions that put investors’ financial goals at the centre of portfolio construction. The State Street Australian Equity Fund and State Street Global Equity Fund aim to achieve strong risk-adjusted returns, facilitating a smoother ride for investors towards their financial goals.
Individual investors often define their primary investment objective as the "highest risk adjusted-returns". They think of “return” as capital growth over time and “risk” as capital loss or a large variability in capital value over time.

Many actively managed equity funds respond by trying to minimise risk defined instead as “tracking error” or deviation from the benchmark. They construct portfolios so the portfolios’ securities and sectors stay close to benchmark weights. As a result, the funds’ performance also stays close to the benchmark. This means that risk and return stay close to benchmark outcomes, which some see as a benefit. However, evaluating return and risk relative to a market hurdle or benchmark return leaves investors vulnerable to major market movements, particularly on the downside.

### WHAT IS TRUE SUCCESS?

While some may say that a benchmark-relative approach is the best way to select and assess active equity managers, we believe investor objectives, not benchmarks, belong at the centre of portfolio construction.

At State Street Global Advisors (SSGA), we define true success as not only producing “alpha”1, but also helping investors achieve their long-term goals. We believe there is a better, more efficient way to deliver risk-adjusted returns and to reduce the impact of market losses.

### WHY THE TRADITIONAL “BENCHMARK-AWARE” APPROACH IS LIMITED

Market capitalisation-weighted indices, the most common benchmarks in equity investing, pose some risks. For example, there may be stock, sector and country concentration risk in market-cap-weighted indices. This is particularly true for the S&P/ASX 200 Index, which tracks Australia’s largest 200 listed companies ranked by market capitalisation.

Equity portfolios constructed around a benchmark rest on a belief that the index offers the greatest return for a given level of risk. Anchoring stock selection and portfolio construction to the index minimises the risk of deviating too far from the market performance. These active managers try to limit the risk of making wrong decisions about which stocks to buy by evaluating a stock’s return and risk relative to the benchmark rather than considering its absolute return and risk potential. These portfolios generally limit stock, sector and country weights within predetermined ranges relative to the benchmark.

SSGA research suggests that market capitalisation-weighted benchmarks may not offer investors the optimal balance of risk and return. As a result, it may be possible to manage an active equity portfolio to deliver returns with significantly less risk than that of a portfolio tied to a benchmark.

Also, a portfolio that’s not tied to a benchmark may avoid risks from “crowding” around a benchmark. The benchmark’s largest stocks and sectors can experience significant volatility due to the movements of large, benchmark-constrained institutional investors. This concentrated exposure also limits a manager’s ability to appropriately diversify, enhance returns and manage risk for market volatility and declines.

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1 In the investment management industry, “alpha” means an excess return over a benchmark, adjusted for exposure to the benchmark.
UNHOOK YOUR RETURN POTENTIAL

Higher a fund’s Sharpe ratio, the better its returns have been relative to the amount of investment risk it has taken.

A Sharpe ratio is calculated by dividing the fund’s excess return over the risk-free rate by its standard deviation.

Now is the time to ask: Is there a better way to invest?

Unaware, be agile to market movements and explicitly manage risk in order to deliver returns more efficiently. This type of strategy should be benchmark unaware; it provides a more balanced outcome of return and risk.

In traditional portfolio construction, equities have been assigned the “Grow My Assets” objective. But what if we could incorporate both of these objectives into our approach to managing the equity portfolio?

We believe a winning strategy “makes more by losing less”.

In rising markets, with an explicit focus on drawdown mitigation.

• the herding effect due to tracking.
• the glamour effect of investing in stocks that attract the headlines.
• the effect of asset managers incentivised to generate high returns by taking on more risk.
• the risk of asset managers using error-constrained managers which are encouraged to markets-like portfolios by reducing volatility.
• the micro-cap effect—stocks underperforming lower-risk companies.

The team has developed an alternative approach to managing equity portfolios. This approach seeks to capture the long-term benefits of equity markets whilst simultaneously hedging against market declines.

We have observed a long-term phenomenon known as the “Low Volatility” Phenomenon. Over time periods across regions and asset classes, this is a proven asset management strategy.

The “Low Volatility” Phenomenon

In the equity universe, low volatility stocks underperform higher-volatility stocks over many different periods. This phenomenon of higher-volatility stocks over many different periods is known as the “Low Volatility” Phenomenon.

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OUR APPROACH

RESEARCH — EXPLORE THE MARKET’S FULL OPPORTUNITY SET.

Rigorous and ongoing research is the first step in our active investment process. Global research professionals and portfolio managers work collaboratively to generate new ideas that refine and develop our investment process for exploring all opportunities across the entire investment universe.

The team does not screen out any companies before forming a view. Through our sophisticated systems and access to vast amounts of company data, we monitor daily every stock in the investment universe on its return and risk characteristics. We form comprehensive views on thousands of stocks and seize opportunities in all sectors and countries.

STOCK SELECTION

Effective active stock selection requires skill and technique, thorough research and sound risk management. By monitoring the market each day, we assess every stock based on its return and risk characteristics. This active stock selection serves as the first layer of risk management.

What we look for:

**Return**
We focus only on the best investment ideas, with stocks that exhibit:
- High quality
- Reasonable value
- Sustainable earnings and dividends
- Ability to generate internal growth
- Positive outlook

We also incorporate the impact of global investor behaviour and macroeconomic events into the stock selection model.

**Risk**
Estimating the risk of stocks in the universe happens on three levels:
- Estimate the risk associated with a company’s exposure to common characteristics such as its industry or fundamental themes like size, liquidity, value and leverage.
- Assess the stock-specific risk not explained by these common characteristics. The risks unique to an individual company could include management corruption or environmental disasters (e.g., a mine collapse or oil spill).
- Incorporate how the common characteristics move together. If groups of companies are uncorrelated, combining them can reduce overall portfolio risk.

PORTFOLIO CONSTRUCTION

When constructing the portfolio, we consider the return potential of a stock as well as expectations for its future volatility. We seek out stocks whose expected risk is appropriately compensated with expected return. Expected return being equal, we would favour a stock with a lower risk. But low historic volatility itself does not equal safety.

**Fundamentals matter**
If your historically low-risk investment exhibits, for example, poor quality of earnings, a deteriorating growth outlook or weak momentum, the past may not be a reliable guide to the future.

**Valuations matter**
If you overpay, it is unlikely you will reap a substantial return on your investment – no matter how safe the investment.

**Risks matter**
If your portfolio is diversified across sectors such as consumer discretionary, industrials, utilities, healthcare and telecommunications, as well as financials and resources, it is more likely to successfully weather the ups and downs of the market.

**Currencies matter**
We manage currency risk using SSGA’s Dynamic Strategic Hedging programme (“DSH”). Rather than choosing the Fund to be unhedged or fully hedged, we adjust the hedge ratio for each currency in the portfolio according to our medium to long term assessment of that currency’s economic value relative to the Australian dollar.

Where the Fund’s assets are invested in foreign securities, our approach of dynamic strategic hedging means there will not be a constant full hedge of currency risks. Currency movements relative to the Australian dollar can cause changes in the value of your investments. Currency losses are possible and, if this occurs, it will have a negative impact on the Fund’s investment returns.

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WHY INVEST WITH SSGA ACTIVE EQUITIES?

The team has a proven track record in delivering strong and consistent performance while minimising losses in periods of market stress.

1. Maintain and Grow your Portfolio

The Funds focus on delivering strong total returns to investors whilst managing the total level of risk. Through a full market cycle it is expected that this approach will result in strong capital appreciation for investors, owing to active stock selection.

The charts below show the Funds have achieved significantly higher return than the broader market and performed strongly through a range of market environments.

Figure 1. Growth of $100 Since Inception

Source: SSGA, as at 30 September 2016, net of fees. ‘AEQ Fund’ refers to the State Street Australian Equity Fund, ‘AEQ Benchmark’ refers to S&P/ASX 300 Accumulation Index, S&P/ASX 200 All Australian Accumulation Index prior to February 2013. ‘GEQ Fund’ refers to the State Street Global Equity Fund and ‘GEQ Benchmark’ refers to the MSCI World ex Australian NR Index. The inception dates for the AEQ Fund and GEQ Fund are 30 September 2009 and 31 January 2014, respectively.

*The 2014 returns for the State Street Global Equity Fund and MSCI World ex Australia NR Index is for an 11-month period: 31 January 2014 to 31 December 2014.

Past performance is not a reliable indicator of future performance. Performance returns for periods of less than one year are not annualised. The performance figures contained herein are provided on a net of fees basis, before taxes but after management and transaction costs. Returns have been calculated assuming reinvestment of all distributions. Index returns reflect capital gains and losses, income, and the reinvestment of dividends. Index returns are unmanaged and do not reflect the deduction of any fees or expenses.

2. Smoother Return Path

Smoother returns are achieved for investors in two ways: 1) actively picking stocks with high quality attributes that fundamentally exhibit lower risk and 2) adopting a portfolio construction approach that seeks to deliver an optimal balance of return potential and risk reduction.

Due to a strong focus on total portfolio risk, the portfolios have delivered higher returns than the broader market and, more importantly, significantly lower risk.

Figure 2. Calendar Year Returns

Figure 3. Rolling 3 Year Volatility

Source: SSGA, as at 30 September 2016, net of fees. ‘AEQ Fund’ refers to the State Street Australian Equity Fund, ‘AEQ Benchmark’ refers to S&P/ASX 300 Accumulation Index, S&P/ASX 200 All Australian Accumulation Index prior to February 2013. ‘GEQ Fund’ refers to the State Street Global Equity Fund and ‘GEQ Benchmark’ refers to the MSCI World ex Australian NR Index. Volatility is measured by standard deviation. Standard deviation is a historical measure of the degree to which a fund’s returns varied over a certain period of time. The higher the standard deviation, the greater the likelihood (and risk) that a fund’s performance will fluctuate and have greater potential for volatility; a lower standard deviation indicates past returns have been less volatile.
3. Investment Team and Resources

State Street Global Advisors is a global leader in asset management. Sophisticated investors worldwide rely on us for their investment needs. For more than three decades, we have contributed experience, depth of resources, strength and dedication toward a single goal: to achieve our clients’ goals.

We currently manage in excess of US$29 billion1 in a range of active quantitative global equity strategies across the risk spectrum. Our team is backed by a strong research foundation, and our core investment philosophy and process rests on practices developed over 30 years of experience. We continuously look to evolve our approach, as a result of ongoing change in both market structures and regulatory environments. Our global investment team shares insights and experience with one another so the nuances associated with different markets can be understood and exploited appropriately.

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1 Source: SSGA, as at 31 October 2016

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Source: SSGA, as at 30 June 2016, net of fees. ‘AEQ Fund’ refers to the State Street Australian Equity Fund. ‘AEQ Benchmark’ refers to S&P/ASX 300 Accumulation Index, S&P/ASX 200 All Australian Accumulation Index prior to February 2013. ‘GEQ Fund’ refers to the State Street Global Equity Fund and ‘GEQ Benchmark’ refers to the MSCI World ex Australia NR Index. The inception dates for the AEQ Fund and GEQ Fund are 30 September 2009 and 31 January 2014, respectively.

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Drawdown: The decline between the peak and trough during a specific period of time for an investment. It is usually quoted as the percentage difference between the peak and trough.

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Figure 4. Drawdown Since Inception

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<th>Date</th>
<th>AEQ Fund</th>
<th>AEQ Benchmark</th>
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<table>
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<th>Date</th>
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</thead>
<tbody>
<tr>
<td>Feb-14</td>
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<td>-4%</td>
</tr>
<tr>
<td>Apr-14</td>
<td>6%</td>
<td></td>
</tr>
</tbody>
</table>

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MEET THE TEAM

Ted Gekas
Chief Investment Officer – Active Quantitative Equities
Boston

Toby Warbuton, CFA, Ph.D
Senior Portfolio Manager of the State Street Australian Equity Fund
Sydney

Olivia Engel, CFA
Head of Active Quantitative Equities – Asia Pacific
Lead Portfolio Manager of the State Street Australian Equity Fund
Sydney

Ben Wong, CFA
Portfolio Manager of the State Street Australian Equity Fund
Sydney

Vladimir Zdorovtsov, Ph.D
Head of Active Quantitative Equity Research
Boston

Leap Sok, CFA
Portfolio Manager of the State Street Australian Equity Fund
Sydney

Chee Ooi, CFA
Lead Portfolio Manager of the State Street Global Equity Fund
Boston

Simon Sukhaseume
Head of Currency, Asia Pacific ex Japan
Lead Portfolio Manager (currency component) of the State Street Global Equity Fund
Sydney

Figure 4. Drawdown Since Inception
About SSGA

Invest with a Global Leader

SSGA is a global leader in asset management with over US$2.40 trillion in AUM.* Sophisticated investors worldwide rely on us for their investment needs. For more than three decades, SSGA has contributed experience, depth of resources, strength and dedication toward a singular goal: to achieve our clients’ goals.

Our global presence and focus on research allow us to invest effectively in markets around the world, while working to meet the objectives of our clients. Our scale and experience afford us extensive access to financial markets around the world. For clients, this translates to client-centred solutions that are focused on maximising risk-adjusted returns and providing consistent investment results.

* Assets under management were $2.40 trillion as of September 30, 2016. AUM reflects approx. US$40.29 billion (as of September 30, 2016) with respect to maximising risk-adjusted returns and providing consistent investment results.

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Investing involves risk including the risk of loss of principal. Equity securities are volatile and can decline significantly in response to broad market and economic conditions.

Investments in small-sized companies may involve greater risks than in those of larger, better known companies.

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

Currency hedging involves taking offsetting positions intended to substantially offset currency losses on the hedged instrument. If the hedging position behaves differently than expected, the volatility of the strategy as a whole may increase and even exceed the volatility of the asset being hedged. There can be no assurance that the Funds’ hedging strategies will be effective.

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