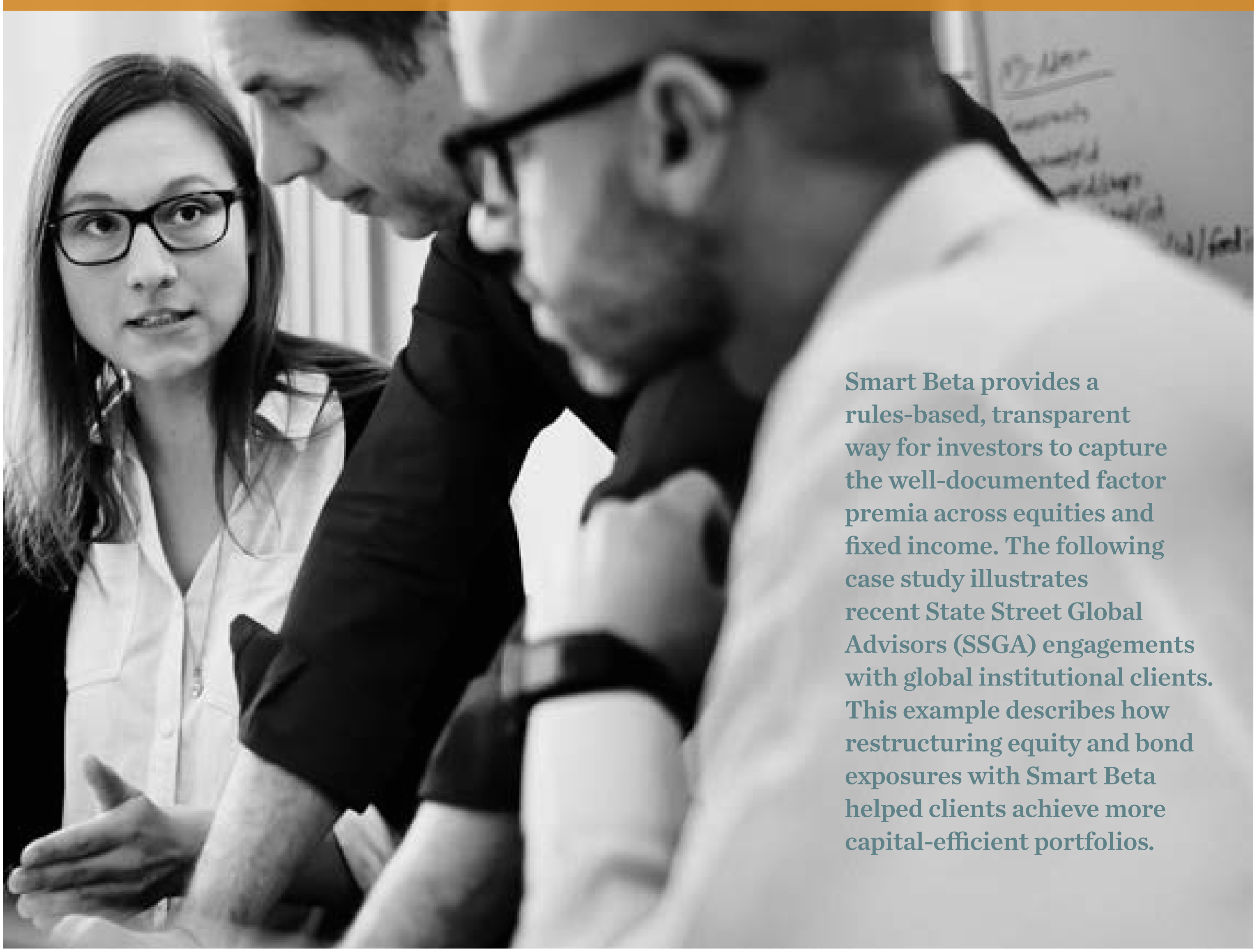
MAKING IT WORK

Factor Pathways



Smart Beta provides a rules-based, transparent way for investors to capture the well-documented factor premia across equities and fixed income. The following case study illustrates recent State Street Global Advisors (SSGA) engagements with global institutional clients. This example describes how restructuring equity and bond exposures with Smart Beta helped clients achieve more capital-efficient portfolios.

BROADENING Smart Beta Approaches

CASE STUDY	FUND	REGION	AUM	EXISTING EQUITY ALLOCATION
	Large Pension Fund	Nordic	$6–7 billion	Predominantly invested in passive equity strategies

Challenge

Our client manages Defined Contribution plans for public sector employees. It has consistently placed the vast majority of its equity funds into passive strategies. As part of a portfolio review, the investor sought options to help it achieve specific factor exposure to improve returns over the long term. This led to investigating the possibility of tilting those exposures to some of the well-known factor-based risk premia in a transparent and rules-based form.

Engagement

On commencing our engagement with the client in 2012, the initial emphasis was on a two-factor strategy (quality and volatility). Subsequent analysis weighing the pros and cons of all fundamental factors, and how these might best be combined, led to a focus on a broader multi-factor approach that would also include value as a factor, in addition to quality and low volatility.

SSGA illustrated how a multi-factor Smart Beta approach allows investors to express views on more than one factor. A combination of factors offers additional advantages such as a lower correlation between certain factors to improve portfolio diversification. Furthermore, SSGA's process of bottom-up construction has been shown to deliver better risk-adjusted results relative to simple "bolt-on" approaches of combining single factor indices.

Solution

We collaborated closely with the client to build a solution that would meet their requirements and would subsequently be rolled out to a wider investment audience. The client agreed to seed an SSGA UCITS fund vehicle, launched in 2014, that targets three factors — value, quality and low volatility. SSGA overweights the stocks with the best scores on these factors and underweights or removes stocks that score poorly. This strategy allows clients to take exposure in three underlying traditional factors instead of one, recognizing that market timing is notoriously difficult. Our client appreciates that the multi-factor strategy permits them to take simple factor exposures — the simplicity and transparency of SSGA's methodology in building the factor was a key attraction. The client has sector, country and factor views in their overall equity portfolio and thus required detailed reporting on this investment strategy to ensure accurate updates.

As an early adopter of the multi-factor approach, our client has since expressed interest in pursuing a similar strategy for its Emerging Market equity exposure in partnership with SSGA. The evolution of EM Smart Beta has not been as rapid as it has been for similar Developed Market products, in part because of differences between the functioning of markets and the EM data set for research purposes has not been as readily available. However, this is changing. The proposed solution under consideration would invest in the same factors included in the global version; value, volatility and quality.

Key Measures and Their Impact on Economic Growth Cycle

Average Relative Fundamental/Price Based on Five measures
- Earnings
- Sales
- Dividends
- Book Value
- Cash Earnings

60-Month Volatility of Monthly Returns

Combination of Three Normalized Factors
- High Return on Assets
- Low Variability of Earnings
- Low Leverage (Debt/Equity)

	Downturn Positive Economic Growth but Slowing	Recession Negative Economic Growth but Slowing	Recovery Negative Economic Growth but Improving	Boom Positive Economic Growth and Improving
VALUE	Neutral	Falling	Rising Significantly	Rising
VOLATILITY	Rising	Rising Significantly	Falling Significantly	Falling
QUALITY	Rising	Rising Significantly	Falling	Falling
SIZE	Falling	Falling	Rising	Rising
MOMENTUM	Neutral	Falling	Neutral	Rising

Neutral · Rising · Rising Significantly · Falling · Falling Significantly

Source: SSGA. For illustrative purposes only. There can be no assurance that developments will transpire as forecasted and that the expectations are accurate. Past performance is not a guarantee of future results. While diversification does not ensure a profit or guarantee against loss, investors in Smart Beta may diversify across a mix of factors to address cyclical changes in factor performance. However, factors may have high or increasing correlation to each other.

Factor investing is grounded in years of academic research and covers a wide spectrum of approaches and applications. They can be implemented in a variety of ways to help achieve specific risk, return and portfolio diversification objectives. For more examples of factor solutions, visit ssga.com.

GLOSSARY

SMART BETA A set of investment strategies that use alternative index construction rules to achieve outperformance over first-generation market capitalization based indices. Most smart beta indices isolate six particular "factors" — individually or in some combination. Those six factors include small size, value, high yield, low volatility, quality and momentum. Smart bet indices are designed to deliver better risk-adjusted returns than cap-weighted indices.

ACTIVE RISK is a type of risk that a fund or managed portfolio creates as it attempts to beat the returns of the benchmark against which it is compared.

On page 3, Specific Risk refer to the amount of Active Risk that is due to factor exposures or stock-specific risk.

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Equity securities are volatile and can decline significantly in response to broad market, individual company activities, and economic conditions.

Past performance is not a guarantee of future results.

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.

Bonds generally present less short-term risk and volatility than stocks, but contain interest rate risk (as interest rates raise, bond prices usually fall); issuer default risk; issuer credit risk; liquidity risk; and inflation risk. These effects are usually pronounced for longer-term securities. Any fixed income security sold or redeemed prior to maturity may be subject to a substantial gain or loss.

While diversification does not ensure a profit or guarantee against loss, investors in Smart Beta may diversify across a mix of factors to address cyclical changes in factor performance. However, factors may have high or increasing correlation to each other.

A Smart Beta strategy does not seek to replicate the performance of a specified cap-weighted index and as such may underperform such an index. The factors to which a Smart Beta strategy seeks to deliver exposure may themselves undergo cyclical performance. As such, a Smart Beta strategy may underperform the market or other Smart Beta strategies exposed to similar or other targeted factors. In fact, we believe that factor premia accrue over the long term (5-10 years), and investors must keep that long time horizon in mind when investing.

Value stocks can perform differently from the market as a whole. They can remain undervalued by the market for long periods of time.

Volatility management techniques may result in periods of loss and underperformance, may limit the ability to participate in rising markets and may increase transaction costs. Low volatility funds can exhibit relative low volatility and excess returns compared to the Index over the long term; both portfolio investments and returns may differ from those of the Index. The fund may not experience lower volatility or provide returns in excess of the Index and may provide lower returns in periods of a rapidly rising market. Active stock selection may lead to added risk in exchange for the potential outperformance relative to the Index.

A quality style of investing emphasizes companies with high returns, stable earnings, and low financial leverage. This style of investing is subject to the risk that the past performance of these companies does not continue or that the returns on "quality" equity securities are less than returns on other styles of investing or the overall stock market.

A momentum style of investing emphasizes investing in securities that have had higher recent price performance compared to other securities, which is subject to the risk that these securities may be more volatile and can turn quickly and cause significant variation from other types of investments.

Companies with large market capitalizations go in and out of favor based on market and economic conditions. Larger companies tend to be less volatile than companies with smaller market capitalizations. In exchange for this potentially lower risk, the value of the security may not rise as much as companies with smaller market capitalizations.

Investments in mid-sized companies may involve greater risks than in those of larger, better known companies, but may be less volatile than investments in smaller companies.

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

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IQ

Q1&2 2016

About Us

For nearly four decades, State Street Global Advisors has been committed to helping our clients, and those who rely on them, achieve their investment objectives. We partner with many of the world's largest, most sophisticated investors and financial intermediaries to help them reach their goals through a rigorous, research-driven investment process spanning both indexing and active disciplines. With trillions* in assets under management, our scale and global reach offer clients access to markets, geographies and asset classes, and allow us to deliver thoughtful insights and innovative solutions.

State Street Global Advisors is the investment management arm of State Street Corporation.

* Assets under management were $2.61 trillion as of June 30, 2017. AUM reflects approx. $34.06 billion (as of June 30, 2017) with respect to which State Street Global Advisors Funds Distributors, LLC serves as marketing agent; State Street Global Advisors Funds Distributors, LLC and State Street Global Advisors are affiliated.

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