Quarterly Commentary
ETF Model Portfolios

Q1 2020

For Financial Advisers/Wholesale Clients Only. Not for Distribution to Retail

State Street ETF Model Portfolios

- Global equity markets suffered from steep declines as markets digested the economic fallout from the COVID-19 pandemic crisis. The global economy is expected to recover; however heightened market volatility is expected to continue
- Although global equities suffered in the first quarter of 2020, in the past 12 months global equities have delivered a positive 4.4% return[1]
- The State Street ETF Model Portfolios are designed with varying objectives which aim to deliver strong risk-adjusted returns over the long term through multi-asset allocation

The Market in Review

At the end of 2019 progress had been made on resolving the US/China trade war, with an expectation in 2020 this would take a back seat as the markets focused on improving global growth profile. Further, the expectation was the markets focus would shift to the US election and the ongoing saga surrounding Brexit. As such the markets rewarded risky assets as concerns faded into the background. Fast forward to the end of the first quarter of 2020 and these developments seemed an age ago. The COVID-19 pandemic engulfed markets in the second half of the first quarter. This harsh reality of a steep but hopefully brief economic contraction in global GDP had consumed the markets attention.

With COVID-19 at the forefront of the market's attention, global equity markets delivered negative returns in the first quarter with sell offs in all regions across the globe. Other assets classes also sold off with commodities, high yield and corporate bonds, infrastructure and listed property also posting negative returns.

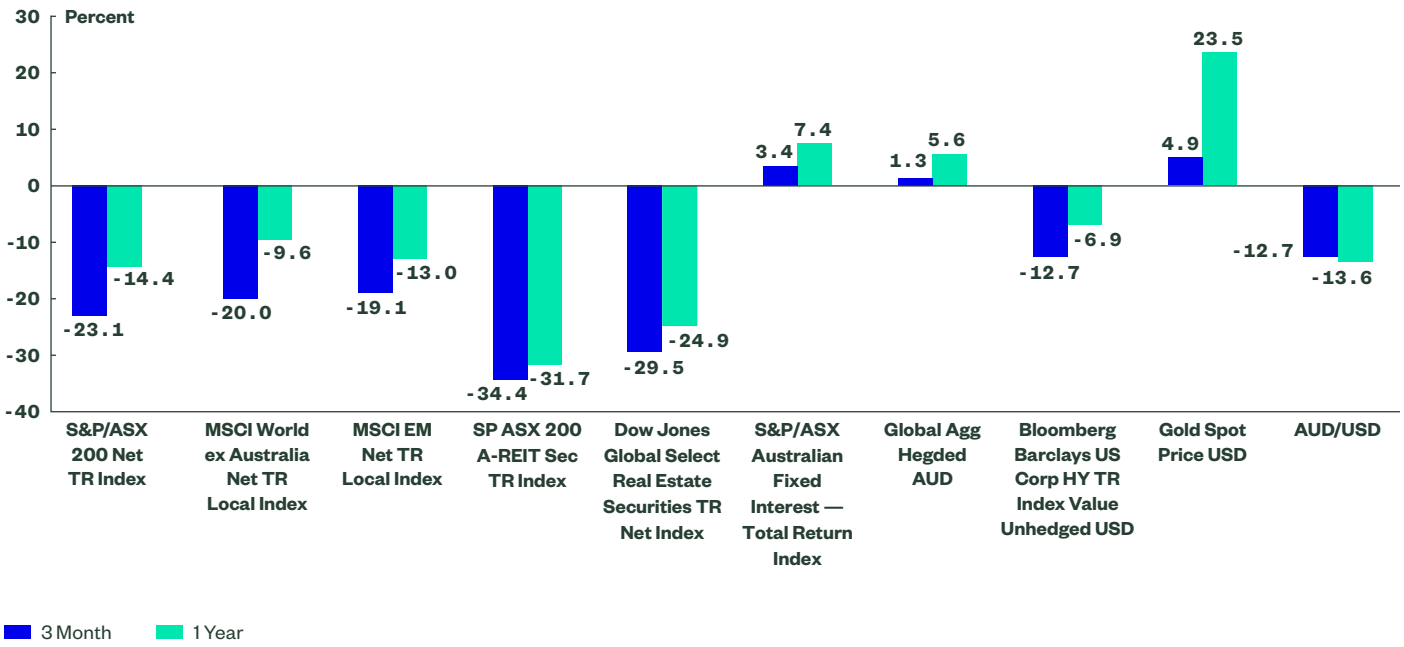
The Australian Equity market was no exception to the COVID-19 concerns, it underperformed when compared to its global peers. Australian equities lagged both the US and European equities market, with its high exposure to financials, and resources this lead to materially negative returns for Australian Equities.

Looking ahead, the global economic recovery will be determined by the collective ability of the world to control the outbreak of COVID-19. Specifically, how quickly the world can return to normal with the easing of social restrictions and the return to normal economic conditions. Supporting this recovery is the unprecedented globally coordinated fiscal and monetary response with a clear purpose to support the economy until it's back on its feet. As such, we believe the market downturn will be temporary and that over the medium term it is expected risky assets could deliver positive returns albeit in an environment with ongoing heightened market volatility.

Asset Class Performance[2]

- **US equities** had a negative quarter, down -12.6%[3]
- **Asia-Pacific** were also negative, down -13.2%[4]. Japan was a relatively positive influence this quarter on Asia's overall performance, experiencing a negative return of 'only' -10.5%[5]
- **Europe** delivered negative returns and were down -18.6%[6] for the quarter
- **Australian equities** were negative for the quarter, down -22.6% and underperformed Europe, Asia-Pacific and the US[7]
- **Emerging markets** were negative for the quarter down -11.3%[8]
- **Global bonds** experienced marginally positive returns over the quarter[9]
- **Australian bonds** experienced positive returns over the quarter with yields moving lower over the quarter[10]
- Investors experienced negative returns in global **corporate bonds** with spreads widening significantly over the quarter[11]
- **Cash** in the Australian money market returned a stable 0.3% for the quarter[12]

Figure 1
Major Asset Class Performance (%)



Source: As of 31 March 2020, Bloomberg Finance L.P, MSCI. Index returns are unmanaged and do not reflect the deduction of any fees or expenses. The index returns reflect all items of income, gain and loss and the reinvestment of dividends and other income. Past performance is not a reliable indicator of future performance.

Positioning and Hypothetical Model Portfolio Performance*

The State Street ETF Model Portfolios are designed with varying objectives to deliver strong risk-adjusted returns over the long term through multi-asset allocation.

State Street Moderate ETF Model Portfolio

The moderate model portfolio seeks to provide optimal capital efficiency over a long-term horizon. The portfolio is designed to generate a moderate amount of capital growth along with some income with exposures to both defensive and growth assets. With growth assets performing negatively during the quarter, specifically Australian Equities the portfolio delivered negative returns. The portfolio's global equity allocation to the multi factor SPDR® MSCI World Quality Mix Fund (QMIX) positively impacted overall performance. For the quarter, QMIX and its balanced exposure across the value, low volatility and quality factors has outperformed the broad market by over 1%.

Overall performance of the hypothetical model portfolio for the quarter was negative and was down -8.5%.

State Street Balanced ETF Model Portfolio

The balanced model portfolio seeks to provide optimal capital efficiency over a long-term horizon. The portfolio is designed to provide capital growth while taking a modest amount of risk with exposures across both defensive and growth assets although more heavily weighted to the latter. With growth assets performing negatively during the quarter, specifically Australian Equities the portfolio delivered negative returns. The portfolio's global equity allocation to the multi factor SPDR® MSCI World Quality Mix Fund (QMIX) positively impacted overall performance. For the quarter, QMIX and its balanced exposure across the value, low volatility and quality factors has outperformed the broad market by over 1%.

Overall performance of the hypothetical model portfolio for the quarter was negative and was down -10.4%.

State Street Growth ETF Model Portfolio

The growth model portfolio seeks to provide optimal capital efficiency over a long-term horizon. The portfolio is designed to predominantly focus on capital growth with exposures weighted to growth assets although it does have exposures to defensive assets. With growth assets performing negatively during the quarter, specifically Australian Equities, the portfolio delivered negative returns. The portfolio's global equity allocation to the multi factor SPDR® MSCI World Quality Mix Fund (QMIX) positively impacted overall performance. For the quarter, QMIX and its balanced exposure across the value, low volatility and quality factors has outperformed the broad market by over 1%.

Overall performance of the hypothetical model portfolio for the quarter was negative and was down -12.3%.

State Street Target Income ETF Model Portfolio

The income model portfolio is designed with the objective to generate a target income of 4% utilising a broadly diversified portfolio of low cost ETFs. With mixed performance across the portfolio's investments, the portfolio delivered a negative total return over the quarter. The portfolio's 50% allocation to income generating equities significantly decreased the portfolios overall performance for the first quarter of 2020. With defensive and stable dividend paying companies generally classified as Consumer Discretionary, Financials and Real Estate. This negatively impacted performance as all three sectors suffered significantly from the COVID-19 pademic. The income proportion of total return for the quarter was positive 0.43%, supporting the portfolios primary objective, generating income.

Overall performance of the hypothetical model portfolio for the quarter was negative and was down -14.2%.

Model Portfolio Performance presented is hypothetical and has been provided for illustrative purposes only, it does not reflect the results of the actual trading of any account or group of accounts and actual results could differ substantially.

The hypothetical State Street ETF Model Portfolio Total Returns are the sum of Growth Return and Distribution Return, and reflect the investment strategy decisions made by State Street's investment professionals for each performance period presented. Returns greater than one year are annualized. The hypothetical model portfolio performance was achieved by mathematically combining the actual performance data of the underlying ETFs multiplied by the hypothetical model portfolio weights allocated to each ETF on a monthly basis. The performance assumes that all dividend distributions paid by the underlying ETFs were reinvested and is calculated gross of trading fees but does not reflect spreads or broker commissions for the hypothetical sale and purchase of the underlying ETFs or any other fees which would be charged by the product provider.

State Street has chosen to use the actual historic performance of the underlying ETFs rather than the underlying ETFs index performance to ensure that the model portfolios reflect as closely as possible of any actual investments that follow the model portfolio strategy, by reflecting differences such as tracking error of the underlying ETFs relative to the underlying ETFs indices.

Limitation of hypothetical results: Hypothetical results have inherent limitations because they do not reflect actual trading by State Street during the period described and may not reflect the impact that material economic and market factors might have had on State Street's decision-making if it was actually managing clients' money pursuant to the strategies. There is no guarantee that any of the investment strategies will be successful and investors should be aware that they can lose money investing assets in accordance with the strategies.

Endnotes

1 According to MSCI World ex Australia Net Total returns in AUD. Index returns reflect capital gains and losses, income, and the reinvestment of dividends.

2 All returns as at 31 December 2019. 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. The index returns reflect all items of income, gain and loss and the reinvestment of dividends and other income. Past performance is not a reliable indicator of future performance.

3 Source: MSCI USA Net Total return Local Index.

4 Source: MSCI Pacific Net Total return Local Index.

5 According to MSCI Japan Net Total Return in AUD.

6 Source: MSCI Europe Net Total Return Local Index.

7 Source: S&P/ASX 200 Net Total return Index.

8 Source: MSCI EM Net Total return Local Index.

9 Source: Bloomberg Barclays Global Aggregate Total Return Hedged AUD Index.

10 Source: S&P/ASX Australian Fixed Interest — Total Return Index.

11 Source: Bloomberg Barclays Global High Yield Total Return Index Value Unhedged index.

12 Source: Bloomberg AusBond Bank Bill Index.

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