

Active Defensive Equities

Capturing Growth and Managing Risk in the Disruptive AI Era

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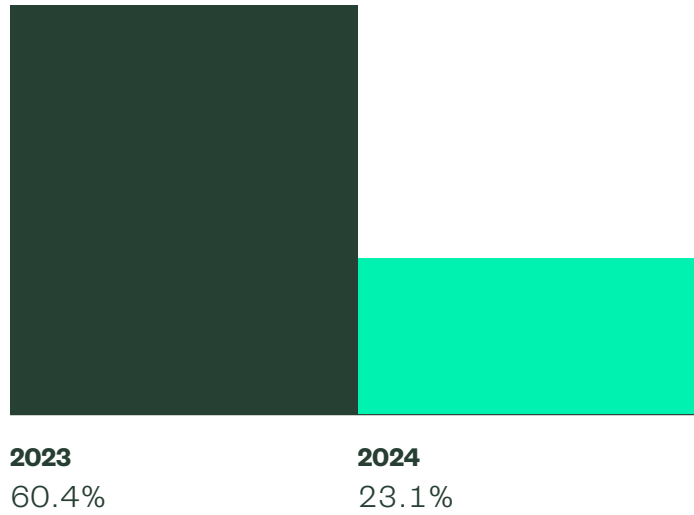
Managing Director, Systematic Equity

It has been a chaotic start to the year, with a flurry of policy changes in the US and fast-moving technological developments. With that in mind, we present a timely update on our Global Defensive Strategy and our strategy outlook for the year ahead.

Overall, the Global Defensive Strategy's performance in 2024 was a vast improvement over the prior year. Although the Strategy did end up with an underperformance versus the market, it participated adequately on the market upside for most the year. For a defensive, low-beta portfolio, the Strategy's upside participation of 84% was above our expectations, given the mostly pro-risk market environment of 2024. In fact, as we approached Q4, the Strategy was ahead of the market — only to see significant underperformance in Q4 as the post-election risk rally took centerstage.

The market developments in 2024 were consistent with our expectations when we penned our annual update a year ago. After the strong risk rally in 2023 that saw a historic level of high beta outperformance, we expected to see an expansion of the base market rally in 2024 that would reduce the low beta headwinds. Performance headwinds for low beta did moderate in 2024. (See Figure 1.)

Figure 1
**Performance Spread
 (High Beta Return
 Minus Low Return)**

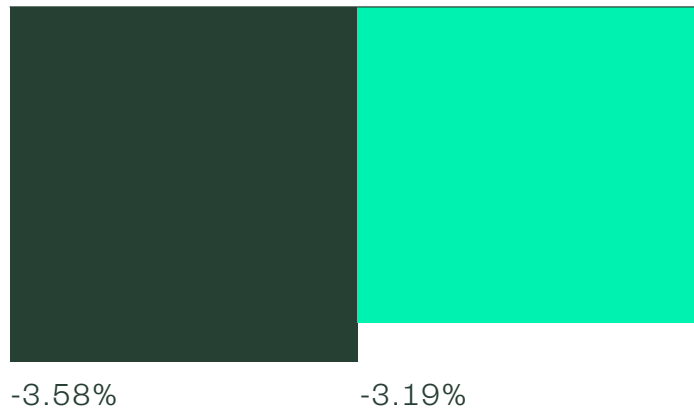


Source: Axioma Solutions, FactSet, as of December 31, 2024.

What's more, we also saw an expansion of the base of the market rally that significantly improved the value added from our stock selection model. Quantitative models operate on the law of large numbers; therefore, a market rally that was not concentrated on just a few mega-cap stocks naturally favored better efficacy for the models. Great stock selection performance partially offset some of the headwind for low beta from being underweight expensive, high-growth themes such as the AI chips rally. As shown in Figure 2, not owning Nvidia alone accounted for most of the short fall of the portfolio versus the market in 2024.

Figure 2
**An Underweight to Nvidia
 Dampened Returns**
 Nvidia Contribution in
 GDE — FY 2024
Underweight of -3.89%

■ Total Excess Return
 ■ Nvidia



Source: State Street Global Advisors, MSCI, as of December 31, 2024. The performance shown is of a composite consisting of all discretionary accounts using this investment strategy. The above information is considered supplemental to the GIPS presentation for this Composite, which is available upon request. Past performance is not a reliable indicator of future performance. Performance returns for periods of less than one year are not annualized. Returns are expressed gross of management fees. Some members of the composite may accrue administration fees. The performance includes the reinvestment of dividends and other corporate earnings and is calculated in US dollars. Index returns reflect capital gains and losses, income, and the reinvestment of dividends. The calculation method for value added returns may show rounding differences.

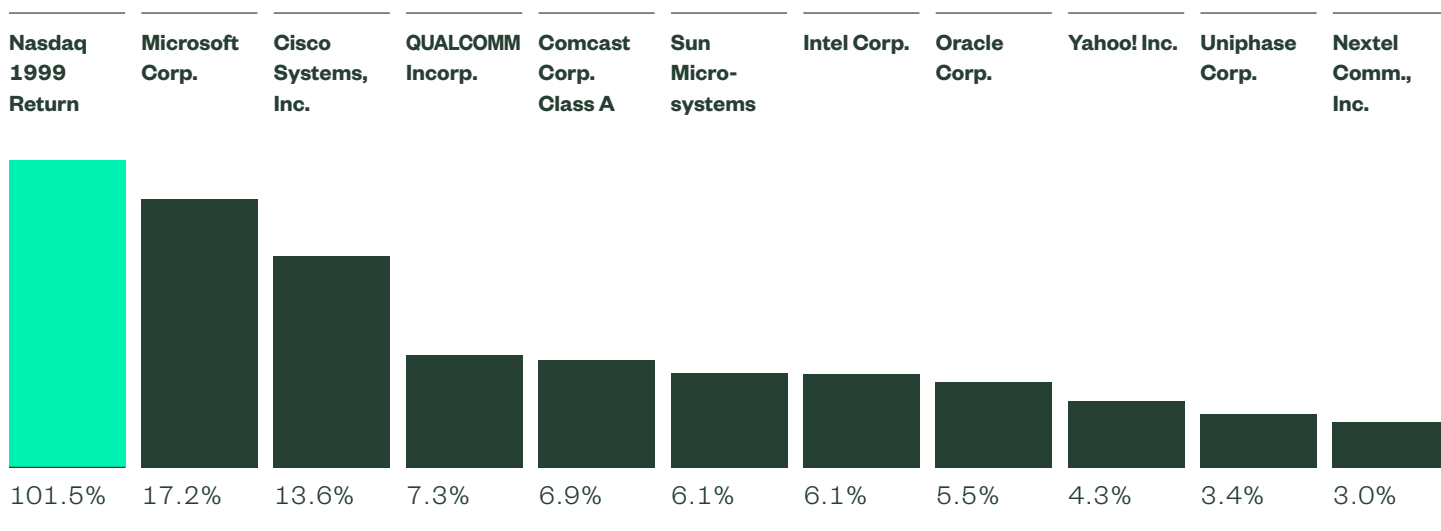
Since the beginning of 2025, as various risk factors came to dominate the market and as the euphoria of the US election started to wear off, risk sentiment has subsided and the Strategy has seen sizable outperformance year-to-date (as of the time of this writing). The key risks dominating sentiment this year have been the stubborn, elevated levels of US long term interest rates and the threat of a global trade war as the new US administration ramped up its deployment of tariffs.

Strategy Outlook

In our view, the headwind for the Strategy over the past two years was consistent with the nature of all disruptive innovation cycles. We could derive similar observations from the internet and mobile computing cycles, where the early stages tended to be capital-intensive, resulting in very narrow breadth and concentrated rallies akin to the Magnificent 7 performance observed over the past two years. Essentially, only the big, well-capitalized companies get to participate in the infrastructure build-up phase of the cycle — for example, the internet era saw the dominance of AOL, Intel, and Cisco.

In Figure 3 below, we see during the internet boom an attribution of the top 10 contributors in the early years versus broader participation for the entire market. The top 10 contributors accounted for approximately 72% of the total return of the Nasdaq for that year (101.5%).

Figure 3
**Top 10 Nasdaq
 Contributors, 1999**



Source: FactSet, as of March 5, 2025.

However, as the technology becomes more mature and available, the beneficiaries of the innovation broaden. The expansion and continuous improvement of the internet exponentially lowered the cost of bandwidth and expanded use cases, which paved the way for new players like Amazon, Google, Netflix etc. circa the mid-2000s — thus the circle of value creation increased significantly.

We are seeing the beginning of the same dynamics playing out in AI. Deepseek's unveiling of more efficient AI inference and training approaches may have ushered in the beginning of the shift in the AI innovation cycle. With cheaper, powerful Chain of Thought models that are less demanding on inference computing, we will see the expansion of AI use cases and large-scale application development. The new application-dominant cycle should broaden the number of beneficiaries of the AI theme to more players across different sectors and segments beyond semiconductor and core technology players. Innovative companies, big or small, can now play in this new AI playground.

Over the past year, we have already seen how the expansion of AI infrastructure creates new demand for energy infrastructure, and as a result, benefits utilities companies that are core holdings in our portfolio. Our expectation is the democratization of AI will expand value creation to many more industries outside of the big tech/chip players and will bring productivity growth to many more companies.

What Role Does Active, Defensive Equity Play in This New Era?

In our view, for investors with long investment horizons and the ability to tolerate short-term deviations from market performance, the investment process underpinning the Global Defensive Equity Strategy is particularly well suited for this new era of explosive innovation. First and foremost, we believe the disruptive nature of AI will create few winners and potentially many losers, an environment where an active approach such as the Strategy can be more effective at capturing value. More specifically, the interaction between our **Value** and **Sentiment** factors can be effective at that value capture: Sentiment drives investment into new trends, while valuation anchors the Strategy with the discipline of not over-investing in unsustainable trends.

Our **Quality** and **Catalysts** factors provide further diversification by evaluating balance sheet qualities, as well as avoiding excessive leverage. The deeply disruptive nature of AI could lead to complacent incumbents getting dethroned by more efficient, more innovative players. However, the deployment of powerful technologies requires thoughtful implementation and transitions to different levels of workforce skills via retraining and new recruits etc. Over the years, we have expanded our Quality and Catalyst metrics to cover both traditional and alternative data that would be required to assess the resiliency of companies to withstand transformational change to their business. These metrics are critical to differentiate those that have both the capital and culture to adapt. Companies with good reputations and the ability to retain and acquire new talent are more likely to succeed.

When combined, we believe our active approach is better-positioned to capture the selective value creation over the next era of explosive technological change and disruption. Over the past two years, we have seen a consistent value-add from our diversified approach.

The Bottom Line

Prudent Risk Management Remains Critical

After two consecutive years of high double-digit returns for the stock market, it is perhaps not surprising that it was priced for perfection. Optimism remained in good supply, with analyst expectations for the calendar year growth topping 10%.¹ In fact, consistent with our expectation for wider industry participation in the value creation cycle, we are seeing a broader base of healthy growth rates across a larger set of industries and sectors for 2025. In our view, if corporations were to deliver on these growth expectations, there may be some more fuel left in the tank for the current bull run.

However, hovering above this optimism on AI and innovation, is an ever-present cloud of uncertainty. Geopolitical competition could turn into escalating trade conflicts. The deep impact of these highly disruptive technologies could have unintended societal and economic impacts that are hard to mitigate. Even as society as a whole reaps the benefits from the advancement of AI, there could be a nascent rise in market risk that requires thoughtful management. Outside of technological disruptions, we are also entering an era of drastic demographic, economic and geopolitical shifts and the confluence of all these forces of change could yield unanticipated risks to the bullish market setup. The market has had the good fortune of an abundance of returns and low risk over the past decade. Both post-GFC and post-Covid fiscal and monetary policies have helped stabilize markets. However, investors should not be overly complacent that the low-risk market setup will be sustainable over the next decade amid the cross current of all the disruptive forces.

Our active defensive strategy is designed with the specific objective of executing the dual mandate of higher active returns and lower total portfolio risk versus the market. The active component seeks to capture return opportunities, while the portfolio risk management component actively lowers portfolio risk through greater portfolio diversification and risk factor mitigation. Our goal with this approach is to deliver long-term sustainable returns with lower drawdowns and lower total risk than the market. As we have highlighted in this article, there are exciting opportunities ahead with the promises of AI. There are also risks associated with the disruptive nature of the technology as well as other emerging forces that can and will drive market risk higher. In our view, the dual mandate approach of our defensive strategy deserves due consideration as investors ponder the challenging task of investing in the rapidly evolving market landscape ahead.

The authors would like to thank Amruth Davuluri, Portfolio Specialist for Systematic Equity-Active, for the data assistance.

Endnote

1 [Style Source: The S&P 500 is expected to return 10% in 2025 | Goldman Sachs](#).

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* Pensions & Investments Research Center, as of December 31, 2023.

[†]This figure is presented as of December 31, 2024 and includes ETF AUM of \$1,577.74 billion USD of which approximately \$82.19 billion USD in gold 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. Please note all AUM is unaudited.

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This document provides summary information regarding the Strategy. This document should be read in conjunction with the Strategy's Disclosure Document, which is available from SSGA. The Strategy Disclosure Document contains important information about the Strategy, including a description of a number of risks.

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