

# A Letter From Our CIO

## Indexed Fixed Income Update

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Global Fixed Income, Currency & Cash

Recent markets have been a rollercoaster for fixed income investors. After a gloomy 2022, bond markets were on the road to recovery in the first half of 2023, only to see volatility surge back this past summer.

What a difference six months make. In my last letter, we were coming off a dismal 2022 where central banks roiled global markets with aggressive rate hikes in an attempt to quell stubbornly high inflation. And while 2023 has not come without its own headlines — March's banking crisis and a close call with a US Treasury default in May come to mind — in general, bond investors were able to breathe easier this year.

Overall, ultra aggressive bank policy has worked — we have seen a decline in global inflation, though the readings are still higher than central banks' target ranges. In the US, we have neared (or, depending whom you ask, reached) peak policy rates while the EU and UK central banks are lagging, with more hikes expected given persistently strong jobs and wage growth data. Bond markets were on the path to recovery after 2022's carnage, with all major indices posting positive returns for the first half of 2023. However, volatility returned in July and August amid strong economic data, a US downgrade, and a weakening Chinese economy.

Figure 1  
**Fixed Income Index  
Total Returns**

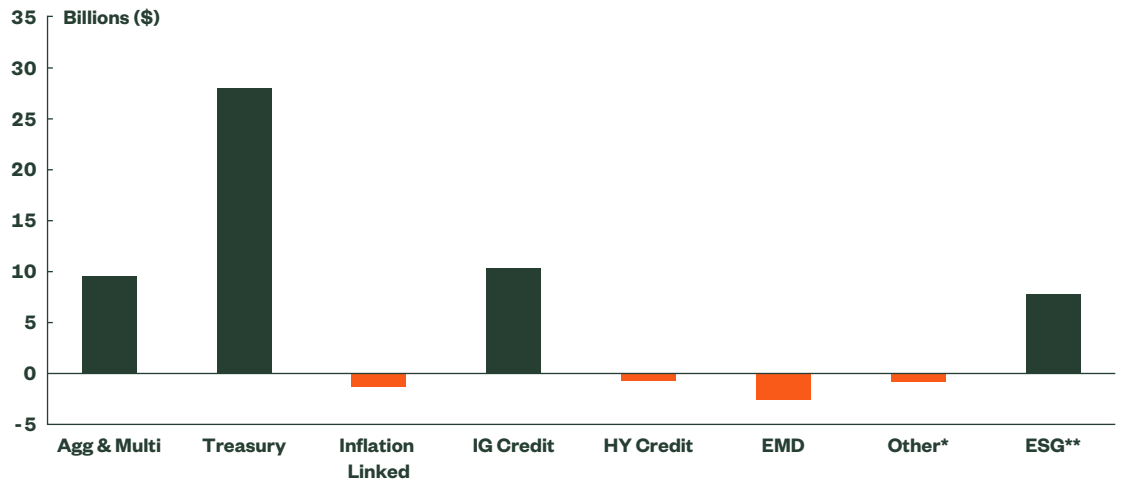
Index	YTD 2023	1H 2023	2022
US Aggregate	1.37	2.09	-13.01
US Treasuries	0.70	1.59	-12.46
US Credit	2.70	3.13	-15.26
US High Yield*	7.25	5.42	-11.21
Euro Corporate	3.54	2.18	-13.65
Euro High Yield	6.45	9.84	-11.13
Global Aggregate	0.74	1.43	-16.25
Global Sovereign	-0.48	0.57	-17.47
EMD Hard Currency**	4.61	4.25	-17.78
EMD Local Currency**	7.92	7.79	-11.69

Source: Bloomberg, ICE BofA, JPMorgan Chase & Co. as of August 31, 2023. All indices listed are Bloomberg unless otherwise noted.

\*ICE BofA Index and \*\*JPM Index.

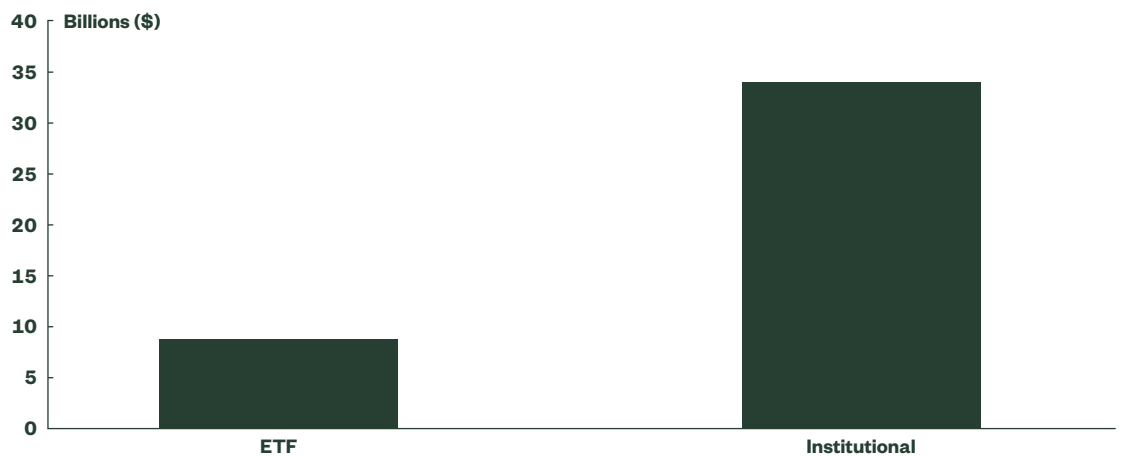
Our indexed fixed income assets under management increased almost 11% over the first eight months of the year, ending the period at \$566 billion. The increase was driven by more favorable markets as well as strong client inflows totaling \$42 billion. Trends in flows were largely a continuation of those we had seen in 2022, namely de-risking within nominal Treasuries and global sovereigns (+\$28 billion) as well as broader multi-sector and aggregate strategies (+\$10 billion). Since the first quarter, we have seen increased interest in investment grade credit (+\$10 billion) as investor sentiment improved, recessionary risks receded further, and markets shifted to a more risk-on nature. Inflation-linked strategies and emerging markets saw outflows amid falling inflation and a difficult macroeconomic backdrop, respectively. However, we do see interest in emerging markets picking back up for the second half of the year as exhibited by a strong pipeline of new institutional mandates with hard currency in particular focus, given improved valuations and low allocations.

Figure 2a  
**2022 Fixed Income Indexing Flows by Sub Sector**



Source: State Street Global Advisors as of August 31, 2023. \*\*Other\* includes securitized, municipals, and convertibles. \*\*ESG not included in total.

Figure 2b  
**2022 Fixed Income Indexing Flows by Channel**



Source: State Street Global Advisors as of August 31, 2023.

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## The Future of Fixed Income

Historically, the fixed income market has been less organized and more fragmented than equity markets, hampering progress seen in other asset classes from advancements and innovations, but thankfully this is quickly changing. Post the Global Financial Crisis (GFC), we have seen improved pricing transparency for investors through the proliferation of electronic trading, which enables more efficient and reliable implementation of fixed income strategies, thereby accelerating the adoption of indexing while paving the way for new approaches such as systematic active fixed income. This alignment of transparency and technology is behind a major consideration among investors on how to best access, construct, and implement their fixed income exposures today.

One key trend gaining traction on the heels of these improved implementation efficiencies is the disaggregation of traditional core/aggregate strategies into their underlying sectors and maturity buckets as discrete building blocks. Increasingly, we are seeing investors “dis-aggregating the Agg” and reconstructing it to better deliver on their various investment objectives for fixed income. This often involves adopting two different, but complementary approaches that can solve for competing objectives such as alpha vs. beta, liquid vs. illiquid, growth vs. matching, public vs. private, etc. Clearly, no manager can be the best at all of these strategies, so we see investors employing specialist active managers as satellites, that are complemented by a reliable, transparent index manager for their core. At State Street Global Advisors we have been designing and delivering this building block approach to fixed income exposure management since launching our first aggregate strategy back in 1995. Today, we have over 100 sub-strategies/building blocks ranging from liquid Treasuries, to more complex sectors such as high yield and emerging market debt. Our success to date is built on delivering these benefits to our investors consistently over many years, and now as more investors come to appreciate and rely on this more outcome-oriented approach, we believe that we are well positioned to partner with them and help achieve their desired outcomes.

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## Closing Thoughts

As always, we value your business and look forward to our continued partnership in 2023 and beyond. Should you have any additional questions surrounding your investments or the markets, please do not hesitate to reach out to your client relationship manager.

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- 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 29 offices around the world, and a firm-wide conviction that we can always do it better. As a result, we are the world's fourth-largest asset manager\* with US \$3.8 trillion<sup>†</sup> under our care.

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\* Pensions & Investments Research Center, as of December 31, 2022.

<sup>†</sup> This figure is presented as of June 30, 2023 and includes approximately \$63 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. Please note all AUM is unaudited.

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