

Investing in uncertain times

Public and Taft-Hartley Pension Plans

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Insights for public and Taft-Hartley defined benefit plans



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Welcome to the latest edition of *Insights for public and Taft-Hartley defined benefit plans*. The financial markets during the first half of 2025 have been anything but predictable. We've seen sharp declines in the stock market and all-time highs—all in the space of a few months. And we've seen Treasury rates drop precipitously and spike strongly over the course of a few weeks' time.

For any investor, these uncertain market environments are difficult to navigate. For public and Taft-Hartley pension plans, they've posed unique challenges. One key challenge is the risk that volatile markets will impact liquidity. After all, maintaining liquidity is crucial as plans face recurring benefits payments, especially as many plans continue to increase their allocations to relatively illiquid private market investments.

In these types of uncertain and volatile environments, it's crucial for plans to think about their overall strategic

asset allocation. Consider the issue of funding ratios: For public pension plans, strong investment returns have pushed funding ratios higher. But while plans have benefited, some may find themselves overexposed to the risk-on assets that drove much of that growth in recent years. Meanwhile, for Taft-Hartley plans, declines in funding ratios can have serious regulatory implications, including requirements to take action to address funding shortfalls.

A thoughtful asset allocation strategy can help plans minimize the impulse to make tactical changes in response to volatility. In recent months, we've seen CIOs and investment consultants in the public pension space communicate about the importance for plans to stay the course rather than attempting a portfolio pivot in the face of market volatility. A focus on asset allocation also can help plans identify strategies to dampen volatility, which in turn will help ensure sufficient liquidity to make regular benefit payments.

In this quarter's newsletter for public and Taft-Hartley pension plans, we cover several important and timely topics for plans navigating today's uncertain market environment.

- Dane Smith, head of Investment Strategy and Research, explains how a renewed focus on diversification is a key step in helping public and Taft-Hartley plans manage market uncertainty.
- Francois Pellerin, CFA, CERA, FSA, State Street Investment Management's new head of US Defined Benefit Investment Strategy, discusses why Taft-Hartley plans need to be thinking about how to manage their funding ratios amid rising volatility.
- Jake Brown, CFA, head of US Client Portfolio Management—Fixed Income, weighs in on several strategies and tactics to enhance diversification and return in fixed income portfolios.
- Ben Goldberg, CFA, Client Portfolio Manager—Systematic Equity, discusses what plans need to consider before divesting from China.

Finally, we're pleased to present a Q&A with Francois, who joined State Street Investment Management in March. We spoke with Francois about his experience in the defined benefit space, the factors that drew him to State Street, and his innovative vision for how State Street's public plan work will continue to evolve.

As always, this edition of *Insights for public and Taft-Hartley defined benefit plans* is designed to keep you informed and prepared to navigate the complexities of pension management. Read on to learn more about managing public and Taft-Hartley retirement solutions in today's unique market environment.

Diversification: The answer for volatile markets



Dane Smith

Head of Investment
Strategy and Research

Throughout the first half of the year, investors had to contend with a rise in protectionist measures, threats of significant tariffs, an escalating global trade war, and mounting worries over economic growth.

A “what’s next?” feeling among investors fueled big swings in the stock and bond markets. The S&P 500 Index shed more than 4% in the first quarter. During a two-week stretch in March and April, yields on 10-year Treasuries fell roughly 50 basis points before rocketing more than 70 points higher. Stocks roared back in the second quarter as investors had more clarity on the economic impact of US-imposed tariffs. What was a decidedly risk-off market suddenly turned risk-on.

These types of uncertain economic and market environments are tough for any investor. For public and Taft-Hartley pension plans with looming liability payments and long-term funding ratios to consider, worries about “what’s next?” can be especially acute. While it may be tempting to quickly pivot to safety during volatile and uncertain environments, another

option for public and Taft-Hartley plans is to get back to the basics—including making sure their plan is appropriately diversified.

Indeed, after years of benefiting from a concentrated market environment, investors today need to recognize the critically important role of diversification. A well-diversified portfolio strategy not only softens the impact of volatile markets but also affords more flexibility to take advantage of the opportunities these environments can produce.

Volatility is never far away

The factors driving today’s market environment are certainly unique, but these periods of uncertainty and volatility aren’t uncommon.

Consider the events of the past three years. During the post-COVID recovery period in 2022, rising interest rates and inflation caused sharp sell-offs in both the equity and fixed income markets. In that environment, institutional investors with strong cash positions were able to seek the safety of TIPS and real assets such as gold without needing to sell underperforming assets.

As markets rebounded in 2023, plans that rotated out of safe havens likely benefited from strong equity returns. Those that maintained a diversified approach, however, also benefited from the continued strength of TIPS and gold—even as the path of inflation continued to trend lower. In fact, in the two years through early July, gold spot prices have risen more than 70%, handily outpacing the S&P 500.

Last year, investors wrestled with several bouts of volatility, including a particularly sharp spike in equity market volatility in early August. That episode was fueled by worries about restrictive monetary policy, a deteriorating labor market, and the looming potential for higher tariffs from a new presidential administration.

Public and Taft-Hartley plans that stuck with a risk-on approach likely felt the pain of that volatile period, as the S&P 500 tumbled 6% in three trading days through August 5, while the index's tech stocks fell 8%. By contrast, plans that pivoted to a more defensive posture may have diluted their exposure to a rebound in which the S&P rose over 14% between August 5 and the end of the year, led by a more than 34% gain from consumer discretionary stocks.

The power of planning

Improving sentiment around equities has led many institutional investors back to a risk-on stance. But this is precisely the time when plans should be thinking about how to handle the next bout of market volatility.

The first step in building an all-weather plan involves carefully evaluating the plan's asset allocation with an eye toward diversification. Do plan managers understand what every exposure in their portfolio is delivering to the plan's overall risk and return profile? Are there gaps in those exposures or areas of overconcentration?

Cash also should be an important area of focus: Institutional investors that do well in uncertain markets often have the ability to allocate to cash—and have a well-laid plan to manage that cash. That allocation can support strategic portfolio moves without the need to sell other assets. And as exposure to private market assets continues to rise among public and Taft-Hartley plans, sources of liquidity such as cash can help plans manage challenging market environments.

Plans may also want to consider strategies to add diversification through fixed income investments. This might include systematic active fixed income strategies that can deliver potential alpha, low benchmark tracking error, and low correlations to fundamental active strategies. Meanwhile, emerging market debt can not only provide attractive yield opportunities but also add a layer of diversification due to the different set of economic risks and opportunities emerging markets face compared to US debt.

In reviewing asset allocation strategies, it's critical for plans to be aware of their investment time horizon. For instance, it may make sense to take a more defensive approach if a plan has specific short-term liabilities or obligations. Plans with longer-term horizons may have more appetite for risk even in uncertain markets. That said, liquidity still matters: Without it, for example, plans have less latitude to take advantage of buying opportunities when growth assets dip.

You can't predict when volatility will reappear, but you can plan for its inevitable return. At State Street Investment Management, we have deep experience partnering with public and Taft-Hartley plan clients to consider key questions around portfolio positioning, asset allocation, and diversification. The goal is to identify strategies that give their plans the flexibility to manage risk and embrace opportunities in uncertain and volatile markets.

How Taft-Hartley plans can manage funding ratios amid volatility



Francois Pellerin, CFA, CERA, FSA
Head of US Defined Benefit
Investment Strategy

Many Taft-Hartley plans ended 2024 in a strong financial position. The average plan's funding ratio hit 97%¹ in December 2024, an eight-point increase from the previous year, lifted by strength in the equity market and financial assistance through the American Rescue Plan Act of 2021. Funding likely remained high in the first half of 2025, as bond yields stayed elevated and stocks posted strong gains despite sometimes severe volatility.

Whether these constructive market dynamics can continue is an open question, given concerns about government policy, economic growth, inflation, and other key factors. Taft-Hartley sponsors may want to consider strategies to preserve the gains they have made in recent years.

Staying above funding thresholds

The need to protect funding ratios may be especially acute for plans with below-average ratios. ERISA defines funding thresholds that affect how Taft-Hartley plans must be funded and managed. For some sponsors, the volatile market environment may trigger worries about falling below ERISA funded status thresholds.

A plan with funding status below 80% is classified as *endangered*. This designation may require a plan to outline improvement or take actions to address the shortfall, such as increasing contributions and/or reducing benefits.

The unique multiemployer nature of Taft-Hartley plans can make these types of changes extremely challenging. For example, unions may be reluctant to reduce plan participant benefits, while companies funding multiemployer plans may be reluctant to increase contributions when already faced with difficult operations and economic headwinds. Plans confronting these constraints may look first to investment strategy to minimize the chances of falling below funding thresholds.

Strategies for managing unpredictable markets

Strategic asset allocation is the first line of defense against volatile markets. Many plans also employ tactical asset allocation to reduce exposure to riskier assets during periods of high volatility. Those that feel the need to boost funding ratios, whether to stay above thresholds or for other reasons, may be tempted to adjust allocations in pursuit of stronger returns—but this approach typically is hard to pull off and can pose considerable risks.

Plans can take other strategic and tactical steps to manage the uncertainty presented by volatile markets, including:

Defensive equity strategies

Defensive, low-volatility equity strategies may help plans harness equities’ potential growth while managing downside risk. These investment approaches typically use in-depth fundamental analysis to focus on high-quality companies with relatively stable earnings, strong cash flows, healthy balance sheets, powerful competitive advantages, and prudent management. The strategies also may emphasize sectors with lower sensitivity to economic cycles, such as health care, utilities, and consumer staples.

Defensive equity strategies may give up return versus more aggressive approaches during risk-on periods. That said, their downside protection in volatile markets may prove more valuable over a full market cycle.

Use of derivatives

Derivatives can enable Taft-Hartley plans to hedge against both decreases in assets and increases in liabilities. For example, equity options can reduce the impact of stock market downturns, while interest rate swaps can help protect the plan in the event falling interest rates cause liabilities to rise. Since derivatives typically require relatively small capital outlays, plans can secure meaningful protection without having to liquidate long-term assets, helping improve their flexibility and capital efficiency.

Short-term derivatives and physical assets work together to help pension plans maintain stable funding levels. For example, a Taft-Hartley plan teetering toward endangered status could use a short-term derivatives program to increase the likelihood that its funded ratio won’t slip below a certain level.

Splitting the plan by participant status

Separating a pension plan into separate groups of active and retired participants can provide greater clarity around the best ways to manage its assets, making it easier to align investment strategies with each cohort’s risk profile and liquidity requirements. Retirees’ liabilities become more visible and predictable, better positioning the plan’s managers to match those liabilities with bonds that provide corresponding cash flows. Assets for active participants—who generally have longer time horizons and higher risk tolerance—can be invested more aggressively to pursue growth.

This strategy offers strategic advantages as well as trade-offs:

| Advantage | Trade-off |
|---|---|
| Tailored investment strategies. Allows for separate growth-oriented portfolios for active participants and income-focused, lower-risk strategies for retirees. | Administrative complexity. Increases governance and operational demands. |
| Improved risk management. Isolates the impact of market volatility on retirees, who are more vulnerable to drawdowns. | Cost implications. May lead to higher administrative fees, especially if retirees remain in the plan. |
| Enhanced funding clarity. Provides better visibility into the financial health of each group, aiding in more precise funding and risk management decisions. | Investment design challenges. Balancing the differing needs of actives and retirees can complicate portfolio construction. |

The value of guidance

Recent years' market conditions have helped many Taft-Hartley plans improve their funding ratios. These plans may be well positioned to put measures into place that prepare them for potential volatility in both assets and liabilities. As they consider an uncertain future, plans can look beyond simply trying to maximize assets and instead consider a range of options that may help maintain and improve funding levels, including defensive equity strategies, the use of derivatives, and splitting the plan into groups of active and retired participants.

At State Street Investment Management, our goal is to be your trusted advisor—partnering with you to understand your plan's current status, specific needs, and challenges. We aim to deliver customized, high-performing, and cost-effective solutions that help you meet your objectives and strengthen the overall health of your pension plan. Please contact your [relationship manager](#) to learn more about options for protecting a Taft-Hartley plan's funding ratio.

How fixed income can (still) provide an anchor to windward

A variety of strategies and tactics can help public and Taft-Hartley plans enhance diversification and return in fixed income portfolios



Jake Brown, CFA
Head of US Client
Portfolio Management—
Fixed Income

The financial markets' turbulence this year has been well chronicled. (See the [State Street Investment Management Insights page](#) for our ongoing thoughts on the matter.) In addition to concerns about ongoing changes in trade policy, immigration rules, and government spending, investors and business leaders are worried about the overall lack of clarity and stability in policy—including difficulty discerning which pronouncements represent genuine intentions versus negotiating tactics.

Both equity and bond markets have been exceptionally volatile:

- The S&P 500 nearly entered bear market territory, dropping 19% between February 19 and April 8, as the VIX spiked to levels last seen in the early days of the COVID-19 pandemic. The benchmark equity index subsequently recovered and in July reached a new all-time high.²
- The yield on the 10-year US Treasury note swung from a closing high of 4.62% on February 12 to a low of 3.99% on April 4, then rose back to 4.60% in late May before once again retreating.²

US Treasuries historically helped stabilize portfolios during periods of turbulent equity markets. Many public and Taft-Hartley pension plans are trying to determine how they can use fixed income to play this

role today, when sources of volatility seem to shift daily. Meanwhile, plans are searching for ways to improve their funding ratios without meaningfully increasing the risk in their portfolios. We have several ideas for fixed income strategies and tactics that may help manage risk and improve diversification, and have the potential to generate additional return as well.

Systematic active fixed income

Active management can help enhance a fixed income allocation's returns without sacrificing the qualities that help it stabilize a broadly diversified portfolio—namely regular income payments and low correlations to other asset classes.

Systematic active fixed income (SAFI) strategies use a quantitative approach that emphasizes specific investment factors. SAFI strategies seek to add a level of excess return similar to that of traditional fundamental active strategies. Because systematic and fundamental strategies derive alpha from different sources, the two approaches' excess returns can have low correlations to each other, providing the potential to enhance diversification in the overall fixed income allocation (Figure 1).

Adding a systematic approach to an allocation otherwise composed of fundamental strategies can help enhance diversification while maintaining the incremental return offered by active management.

Figure 1: SAFI has produced low correlations to fundamental active strategies

| | Bloomberg US IG Corp Index | SAFI US IG Corp Backtest | Western US IG Credit Plus | Loomis IG Corp Credit | Western US IG Credit | Invesco US Corp Credit | GSAM US IG Credit | PIMCO IG Corp | Voya IG Credit |
|----------------------------|----------------------------|--------------------------|---------------------------|-----------------------|----------------------|------------------------|-------------------|---------------|----------------|
| Bloomberg US IG Corp Index | 1.00 | | | | | | | | |
| SAFI US IG Corp Backtest | 0.53 | 1.00 | | | | | | | |
| Western US IG Credit Plus | 0.84 | 0.56 | 1.00 | | | | | | |
| Loomis IG Corp Credit | 0.85 | 0.52 | 0.84 | 1.00 | | | | | |
| Western US IG Credit | 0.82 | 0.55 | 0.83 | 0.82 | 1.00 | | | | |
| Invesco US Corp Credit | 0.70 | 0.59 | 0.72 | 0.69 | 0.53 | 1.00 | | | |
| GSAM US IG Credit | 0.77 | 0.51 | 0.66 | 0.79 | 0.77 | 0.56 | 1.00 | | |
| PIMCO IG Corp | 0.44 | 0.50 | 0.61 | 0.47 | 0.45 | 0.64 | 0.44 | 1.00 | |
| Voya IG Credit | 0.50 | 0.31 | 0.65 | 0.59 | 0.43 | 0.49 | 0.31 | 0.46 | 1.00 |
| Mean | 0.68 | 0.51 | 0.70 | 0.67 | 0.63 | 0.60 | 0.58 | 0.51 | 0.46 |

Fundamental Active US Credit Managers with AUM > \$20B Sources: State Street Investment Management, eVestment, Bloomberg Finance, L.P. As of December 31, 2024. Analysis is conducted on the largest fundamental active credit managers by AUM as of June 30, 2024, using monthly excess returns vs. manager preferred benchmarks from December 2010 to December 2024. Credit index excess returns are defined as excess returns over like-duration Treasuries for the Bloomberg US Investment Grade Corporate Bond Index. Manager returns are gross of fee. Performance is calculated based on monthly total returns for the back-tested model portfolio with assumed transaction costs based on Barclays Liquidity Cost Score (LCS) measure, which is a widely used liquidity model in the investment industry. LCS represents a bond-level transaction cost expressed as a percentage of a bond's price, and measures the cost of an immediate, institutional-size, round-trip transaction. Total returns for the Bloomberg US Investment Grade Corporate Index do not take into account transaction costs. Back-tested performance is the result of applying a State Street Investment Management model to market data that predates the model in order to yield results that predate the model's inception (i.e., all data is back-tested) OR the results of a State Street Investment Management model, some of which predates model inception and some of which was generated after model inception. Analysis is done on back-tested performance based on State Street Investment Management's Model Portfolio Optimization process, taking factor inputs from QPS Indices. The back-tested performance presented herein reflects the output of the State Street Investment Management Model Portfolio Optimization process portion of the Systematic US Investment Grade Corporate strategy only and does not reflect or incorporate any potential deviations from the model portfolio at the time of implementation. The data displayed is a hypothetical example of back-tested performance, is for illustrative purposes only, and is not indicative of the past or future performance of any State Street Investment Management product. Back-tested performance does not represent the results of actual trading but is achieved by means of the retroactive application of a model designed with the benefit of hindsight. Actual performance results could differ substantially, and there is the potential for loss as well as profit. Back-tested performance may not take into account material economic and market factors that would impact the advisor's actual decision-making. The performance reflects transaction costs but does not reflect management fees and other fees and expenses a client would have to pay, which reduce returns. State Street Investment Management does not yet manage actual assets to this strategy. A complete list of the firm's composites and their descriptions is available upon request.

What's more, fees often are lower for systematic active strategies than for fundamental active strategies, helping to reduce cost drag on investors' portfolios.

Broad exposure to investment-grade debt—public and private

Many core-plus fixed income strategies are pegged to the bond market's standard benchmark, the Bloomberg US Aggregate Bond Index, with additional out-of-benchmark exposure to higher-yielding, higher-credit-risk public bonds, such as below-investment-grade high yield bonds. In addition, focusing exclusively on public fixed income effectively ignores large swaths of the debt markets. Core-plus strategies that incorporate private credit may provide public and Taft-Hartley plans with higher yields without meaningfully greater credit risk.

Many investors associate private credit with the roughly \$2 trillion middle market direct lending market. In fact, the full scope of private credit is much larger, in the realm of \$40 trillion. It includes direct lending to large investment-grade companies that are willing to pay somewhat higher interest than on publicly issued debt in exchange for greater speed, certainty, and flexibility in the lending process. The private debt markets also encompass a diverse universe of private, investment-grade, asset-backed securities backed by an enormous range of collateral, from real estate and aviation equipment and machinery to music royalties, consumer receivables, and more. Pairing public debt exposure with high-quality private credit from these sources has the potential to generate significantly higher yield than public-only core-plus strategies without a commensurate boost in credit risk.

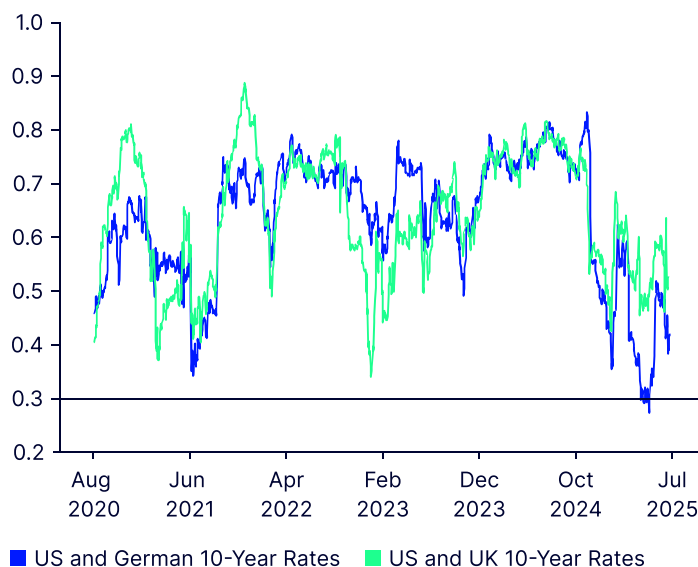
This investment thesis is at the foundation of the SPDR SSGA IG Public & Private Credit ETF (PRIV) launched in 2025 through a relationship between State Street Investment Management and Apollo Global Management. PRIV's combination of actively managed public and private exposures offers access to the full breadth of the investment-grade debt markets, potentially helping public and multiemployer plans meet the need to balance returns and stability.

International opportunities

The United States is the epicenter of today's turbulence, and shock waves are emanating outward from US markets. The diversification provided by exposure to other bond markets could help mute their impact.

The current trade war represents an escalation of a trend toward deglobalization that picked up steam amid COVID-related supply chain disruptions. Deglobalization has a silver lining for fixed income investors: As countries pull back on foreign relationships to varying degrees, we expect economies to experience divergent growth, inflation, and policy trends. Those differences will affect bond markets, likely leading to a wider range of opportunities for return and diversification. For example, US 10-year Treasury rates' correlations with UK and German sovereign rates fell immediately following the US presidential election, partially recovered, then plunged again following the announcement of tariff policies in April 2025 (Figure 2).

Figure 2: Correlations between US treasury rates and other sovereign bond rates have fallen



Rolling 60-day correlation between US, German, and UK 10-year interest rates. Source: Bloomberg, as of July 9, 2025.

Indexed leveraged loan exposure

Public and Taft-Hartley plans can add another dimension of diversification by allocating to assets with lower interest rate risk than the broad fixed income universe. Leveraged loans—also known as senior loans or bank loans—can play this role.

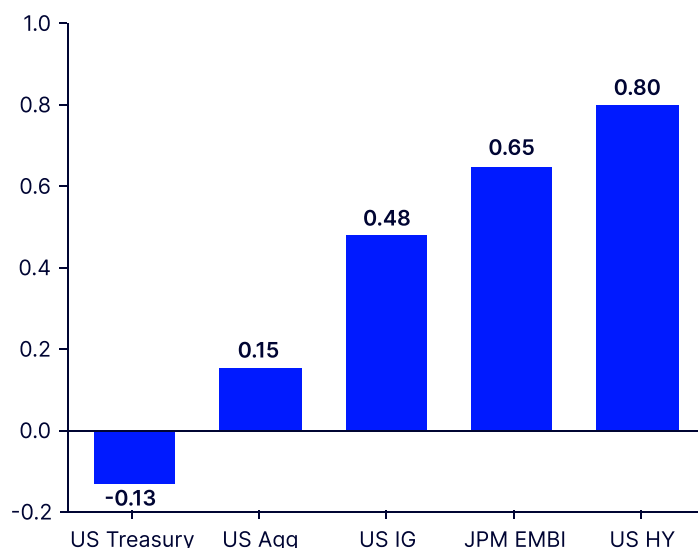
Leveraged loans have floating rates, resulting in effective durations close to zero and helping provide a degree of diversification in a rising rate environment. In addition, leveraged loans have a historical correlation of just 0.15 to the Bloomberg US Aggregate Bond Index (Figure 3). And loans often are both callable (a feature that caps their upside) and secured (which can reduce losses), contributing to a relatively stable return profile over time.

The loans market has expanded and evolved considerably in recent years. It is now possible to index exposure to leveraged loans, which can help improve the efficiency and liquidity of allocations to this unique asset class.

Balancing growth and stability is a primary focus for public and Taft-Hartley plans. That balancing act becomes especially challenging amid volatile, fast-shifting market environments. Plans can manage the challenge by capitalizing on the fixed income markets' breadth and depth, which can provide the diversification and range of opportunities they need to help navigate rough seas.

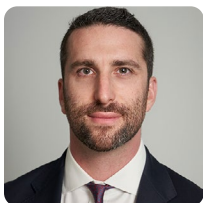
Please contact your [relationship manager](#) to learn more about how you can make the most of your fixed income allocation.

Figure 3: Leveraged loans have low correlations to other fixed income sectors



Source: Morningstar, Bloomberg, as of March 31, 2025. Correlations represented are for the 10 years through March 31, 2025. Leveraged loans represented by Morningstar LSTA Leveraged Loan Index; US Agg represented by Bloomberg Barclays Aggregate; US IG represented by Bloomberg US Corporate Index; US Treasury represented by Bloomberg US Treasury Index; US HY represented by Bloomberg US High Yield Index; JPM EMBI is the JP Morgan Emerging Market Bond Index.

What to know if your pension plan has to divest from China



Ben Goldberg, CFA

Client Portfolio Manager—
Systematic Equity

Eliminating exposure to Chinese stocks has complicated implications for public pension plans.

As the relationship between the United States and China evolves, some politicians and policymakers are expressing concerns about public pension plans' investments in Chinese stocks. In late 2024, treasurers from more than a dozen states cosigned a letter that strongly urged their states' pensions to divest from China, including Hong Kong and Macau.

The prospect of divesting from China presents pension plans with a variety of challenges. The country has the second-largest economy in the world and makes up large portions of global equity indexes. As a result, any plan that eliminates China from its portfolio will meaningfully alter its balance of risk exposures, potentially undermining its diversification and growth potential.

Nevertheless, public plans may feel they have no choice but to divest. For those plans and others that want to eliminate China-domiciled companies from their equity portfolios, State Street Investment Management offers a range of ex-China investment strategies.

The challenges and complications of divesting from China

China is a massive player in the global economy. Its gross domestic product in 2023 was larger than the rest of the East Asia/Pacific region combined and almost four times as large as the next-largest economy, Germany.³

The country's weight in financial markets is similarly outsized. Mainland China makes up more than 30% of the market capitalization of emerging markets (EMs), based on the MSCI EM Index, and Hong Kong is included in many international developed-market benchmarks.

Figure 1: Weight of China and Hong Kong in key indexes

| Index | Weight of China and Hong Kong |
|---|-------------------------------|
| MSCI Emerging Markets | 31.3% |
| MSCI All Country World ex-US | 10.4% |
| MSCI All Country World | 3.7% |
| MSCI All Country World Investable Market | 3.5% |
| MSCI Europe, Australasia, Far East (EAFE) | 2.0% |
| MSCI World ex-US | 1.7% |

Source: FactSet, MSCI, as of March 31, 2025.

A plan divesting from China can take one of two approaches with its EM allocation:

- **Eliminate China exposure and reduce its EM allocation commensurately.** Say a plan's strategic allocation prior to divesting called for holding 15% of the equity portfolio in EMs. The plan might invest in an EM ex-China strategy and reduce its EM allocation by 30%—China's weight in the EM index—decreasing the total EM allocation to 10.5% of the equity portfolio. In effect, the plan would remove China while maintaining steady allocations to other individual

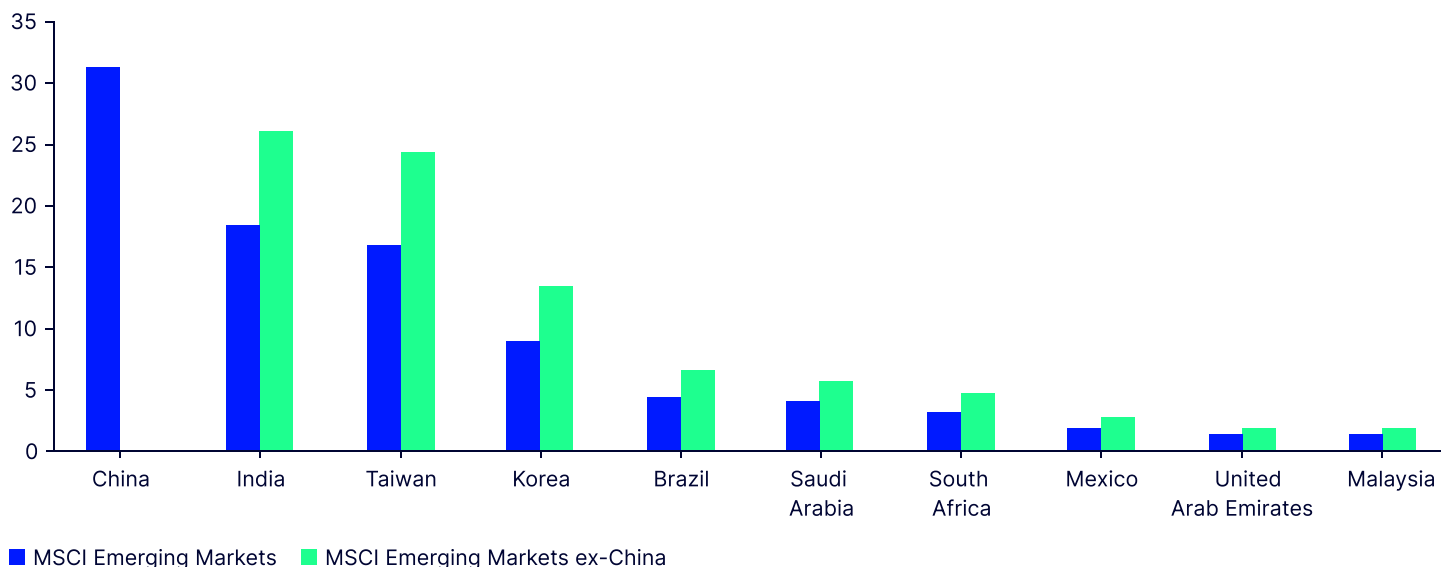
EMs, and it likely would increase the allocation to developed-market equities by 4.5 percentage points.

- **Keep the EM allocation steady but eliminate China.** In this scenario, the hypothetical plan would shift from investing 15% of its equity portfolio in EMs including China to investing 15% in EM ex-China. This move would boost allocations to other individual EMs—particularly India, Taiwan, and South Korea, which together make up more than 64% of the EM ex-China index.

Sector exposures would change, too. For example, shifting from the broad EM benchmark to EM ex-China would reduce the EM allocation's weight in consumer discretionary stocks by more than half, from 14.6% to 6.5%—decreasing exposure to potential growth related to the rise of EM consumers, among other changes. Meanwhile, the information technology weighting of the EM portfolio would rise by almost a third, from 22% to 28%, and would be dominated by a relatively small number of Taiwanese and Korean semiconductor firms, presenting greater concentration risk.

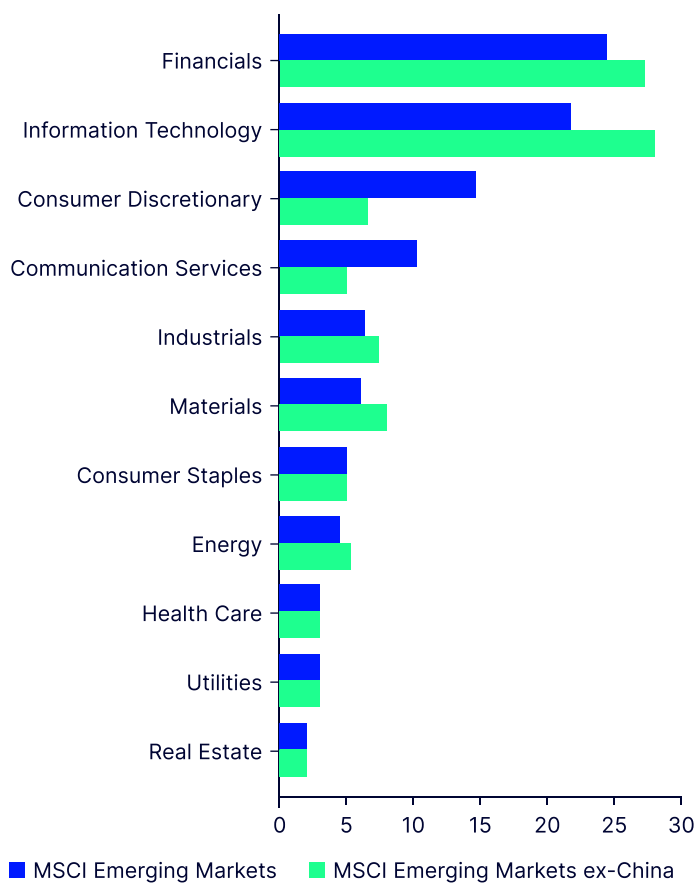
The information illustrated in figures 2 and 3 is based on companies' country of domicile, as defined by MSCI. Rather than eliminating exposure to shares of companies domiciled in China and its territories, some

Figure 2: Top 10 EM country weights with or without China



Source: FactSet, MSCI, as of March 31, 2025.

Figure 3: Sector weights in MSCI EM vs. MSCI EM ex-China



Source: FactSet, MSCI, as of March 31, 2025.

plans may consider trying to eliminate exposure to shares of firms that generate revenues there. Although this move may be technically possible, it is likely to prove impractical and of questionable value. Data on revenue exposure is not reliably precise, so plans could not be sure they had truly divested from companies that derive revenues from China. And divesting from companies with Chinese revenues or that source Chinese parts in their supply chain would reduce plans' investable universe to a very small subset of the global equity markets, exacerbating the difficulty of reaching return targets and managing risks.

Even removing exposure to companies domiciled in China and its territories would alter a portfolio's risk-and-return profile meaningfully. As you can see in

figure 4, the EM and EM ex-China indexes posted very different calendar-year performance over the five years through 2024. During that time, the ex-China index posted both higher volatility (standard deviation) and higher risk-adjusted return (Sharpe ratio). Moreover, the EM ex-China index had a significantly higher correlation to the US equity market than the broader EM benchmark did over the 10 years through March 2025.

Figure 4: Returns, risk, and correlations differ between EM and EM ex-China

| | MSCI EM | MSCI EM ex - China |
|----------------------------------|---------|--------------------|
| Annual returns | | |
| 2024 | 7.50% | 3.56% |
| 2023 | 9.83% | 20.03% |
| 2022 | -20.09% | -19.26% |
| 2021 | -2.54% | 10.03% |
| 2020 | 18.31% | 12.55% |
| Risk Metrics | | |
| Standard Deviation (5 - year) | 16.70 | 17.08 |
| Sharpe Ratio (5 - year) | 0.38 | 0.60 |
| 10 - Year Correlation to S&P 500 | 0.68 | 0.75 |

Source: MSCI, as of March 31, 2025. Correlations based on net returns.

Given the differences between the EM and EM ex-China indexes, plans divesting from China should expect increases in tracking error relative to their current benchmarks. For example, a plan that uses the MSCI ACWI IMI Index as its policy benchmark should expect to incur approximately 84 basis points of tracking error as a direct result of divestment from China and Hong Kong.⁴ Divesting plans need to understand and consider this outcome. They may choose to change their policy benchmark to an ex-China index that is better aligned with their investable universe.

Another challenge: Liquidating China holdings en masse may be expensive. Divesting plans are effectively forced sellers of potentially large positions in a market where trading can be inefficient. For large plans, these transactions could trigger trading costs that run into the millions of dollars. Where possible, plans should work with asset management partners to minimize transaction costs.

Considerations when divesting from China

Divesting from China is a complex undertaking. Any plan for the process is likely to include many steps, potentially including:

- Cataloging China exposures
- Identifying strategies the plan needs to eliminate
- Determining alternate ex-China strategies
- Understanding the potential impacts eliminating China would have on the overall portfolio's risk exposures, potential return, and tracking error
- Creating a plan that makes the shift away from China while seeking to minimize cost and disruption to diversification
- Considering whether the plan should revise its investment policy statement and potentially change its benchmark to reflect the new ex-China investment universe

How State Street can help

State Street offers a variety of ex-China strategies, including ex-China EM strategies and ex-Hong Kong developed-market international and global strategies. (Avoiding shares of mainland- and Hong Kong-based firms effectively eliminates exposure to Macau as well.)

- MSCI Emerging Markets ex-China Index Strategy
- SPDR® S&P Emerging Markets ex-China Index Strategy
- MSCI ACWI IMI ex-China ex-Hong Kong Index Strategy

- MSCI EAFE ex-Hong Kong Index Strategy
- Emerging Markets ex-China Active Strategy
- Emerging Markets ex-China Enhanced Strategy
- Emerging Markets Small Cap ex-China Active Strategy
- Customized strategies

Our investment experts can help you understand the ways shifting to these strategies would affect your plan's balance of risk exposures, and they can work with you to adjust the portfolio accordingly in light of its liabilities, restrictions, and objectives.

Our investment and trading experts also can help your plan minimize transition costs, capitalizing on our position as one of the largest participants in global financial markets. At State Street, we manage over \$130 billion in EM equity assets. Our three global trading desks executed \$41 billion in EM equity trades in 2024, with average commissions 11% lower than those at similar-sized peers. Our passive strategies routinely reduce client expenses through the use of a technique called crossing, in which we minimize transaction costs by matching selling clients with buying clients, whether they are trading individual securities or asset classes. In 2024, crossing reduced trading costs for our clients by an estimated 17 basis points, as less than a quarter of our EM equity order flow was traded on the open market.

Make the most of a difficult situation

Public pension plans that have to divest from China find themselves between a rock and a hard place: They need to maximize the potential of their financial assets to meet liabilities and fiduciary responsibilities, even as their investment universe is constricted in ways that make it harder to do so. State Street's strategies and experts are here to help you navigate this tricky terrain so your plan can achieve its mission.

Contact your [relationship manager](#) to learn more about State Street Investment Management's ex-China strategies.

Meet Francois Pellerin, State Street's new head of US Defined Benefit Investment Strategy



Francois Pellerin, CFA, CERA, FSA

Head of US Defined Benefit
Investment Strategy

Francois Pellerin joined State Street in March. We sat down with him recently to ask about his career to this point, what drew him to his current role, and his vision for State Street's work with defined benefit (DB) plans.

How did you come to work in defined benefit pensions?

I was good with numbers as a child, and I enjoyed resolving problems. When it came time to go to college, I was told that actuaries got paid to help clients solve complex problems using math. That seemed like a good fit! So I got a degree in actuarial sciences in Quebec, where I grew up, and got a job as a retirement actuarial associate in Montreal.

I came to the United States in 1999, looking to live the American Dream. A large actuarial consulting firm hired me, even though I didn't speak English when I

first arrived. There I realized that developing solutions to complex problems was only half of the fun—the other half was interacting with clients to explain and implement those solutions. Eventually I wanted to solve broader problems, so in 2003, I attended the Haas School of Business at Berkeley and earned my MBA.

Over the last 27 years, I have had the fortune to help DB clients solve business challenges from actuarial consulting, investment banking, and asset management standpoints. In my most recent role prior to joining State Street, I implemented a wide array of custom outsourced CIO (OCIO) solutions to help DB sponsors manage risk. People who know me refer to me as a “solutions guy”—I find it rewarding and interesting to take a challenge and figure out how to solve it by leveraging a team of investment and actuarial subject matter experts.

What drew you to State Street?

I specifically sought a company that would give me access to a broad, deep array of tools that I could use

to design and implement DB solutions. That's State Street. Here, our team can truly adopt a product-agnostic consultative approach. For example, our open-architecture framework allows us to provide clients with best-in-class investment ideas, regardless of the asset class.

Because best execution is critical in our line of business, I was also looking for a firm that had a strong track record of successfully implementing durable and flexible solutions for clients. My interaction with the OCIO group quickly put me at ease on that front. State Street has a solutions engine that can tackle almost any problem you can throw at it. State Street has had OCIO mandates since 1994—about as far back as OCIO goes. That was very appealing. Being solution-oriented at State Street is not lip service, it's part of the culture.

Last and certainly not least is the sheer size of State Street's DB book of business—second largest in the US with over \$400 billion. This is a testament to State Street's strength in retirement investing. No firm can achieve such market share by accident. It is the result of State Street's ability to act as clients' trusted advisor by providing products and solutions that fit their needs.

What are you most looking forward to working on as State Street's new head of US Defined Benefit Investment Strategy?

Strategically, I'm excited about growing our DB footprint by further leveraging our broad resources. Specifically, the alignment of our fixed income, OCIO, independent fiduciary, public policy, PRT, alternatives, and distribution capabilities will allow State Street to expand its ability to improve client outcomes. In addition, very few firms have the DB/DC capabilities we have. This competitive advantage positions us to help clients increase the efficiency and reduce the cost of their overall retirement programs.

I am also excited about specific ways to connect DB sponsors' needs and State Street's core competencies. For example, we have over 17 hedging vehicles that third-party investors can use to hedge virtually any liability profile. And we are about to launch an offering

for well-funded frozen plans that want to lock in their surplus, either as a bridge to an upcoming PRT or as a long-term, low-cost, low-risk solution.

What is your vision for State Street's work in public plans?

We will continue innovating to develop strategies and solutions that can help public DB plans produce better risk-adjusted returns. In addition, we plan to leverage our actuarial expertise to help clients solve strategic and operational challenges. For example, we can help mature, underfunded public plans solve liquidity issues stemming from negative cash flows, or we can explore how public and multiemployer plans may be able to use custom LDI solutions to reduce risk for a portion of their plans, capitalizing on certain actuarial or reporting rules.

Strategically, we can help public and Taft-Hartley sponsors think about how they can use investment solutions to minimize regulatory risks. For Taft-Hartley plans specifically, we can help design solutions to manage the risk of becoming "critically underfunded," which could force the sponsors to provide notices to participants, cut back benefits, or contribute more money to the plan.

About Francois Pellerin

Francois Pellerin is a managing director at State Street Investment Management and head of DB Investment Strategy. In this role, Francois leads State Street's efforts in growing its market share from US DB plans by working to align the firm's capabilities and market positioning with the needs of US DB investors.

Francois was most recently at Fidelity, leading the Multi-Asset Class Solutions business, where he was responsible for growing their LDI, OCIO, and pension risk transfer offerings. Prior to Fidelity, Francois was the head of UBS' Asset Liability Investment Solutions group, where he was responsible for leading the firm's North American pension risk management business. Francois also worked at the Investment Banking divisions of JPMorgan and Citi, as well as at Towers Perrin. Francois started his career in the investments industry in 1995 as an actuary at Morneau Sobeco Ernst & Young in Montreal.

Francois earned his bachelor's degree in actuarial sciences at Université Laval and his MBA from the University of California at Berkeley. He is a Fellow of the Society of Actuaries, a Chartered Enterprise Risk Analyst, and a member of the CFA Institute.

Join the conversation on defined benefit innovation

We invite you to join us as Francois Pellerin leads State Street's defined benefit group into the future. Connect with us to learn more about how the DB investment strategy landscape is shifting, share your perspectives, and discover how our expertise can support your organization. Reach out today to start a conversation.

To learn more, contact us at
InstitutionalUS@ssga.com.

Endnotes

- 1 Source: Milliman, Multiemployer Pension Funding Study: Year-end 2024, February 20, 2025.
- 2 Source: Bloomberg.
- 3 World Bank Group.
- 4 Axioma, March 31, 2025.

About State Street Investment Management

At State Street Investment Management, we have been helping to deliver better outcomes to institutions, financial intermediaries, and investors for nearly half a century. Starting with our early innovations in indexing and ETFs, our rigorous approach continues to be driven by market-tested expertise and a relentless commitment to those we serve. With over \$5 trillion in assets managed*, clients in over 60 countries, and a global network of strategic partners, we use our scale to create a comprehensive and cost-effective suite of investment solutions that help investors get wherever they want to go.

* This figure is presented as of June 30, 2025, and includes ETF AUM of \$1,689.83 billion USD of which approximately \$116.05 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 Investment Management are affiliated. Please note all AUM is unaudited.

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Equity securities may fluctuate in value and can decline significantly in response to the activities of individual companies and general market and economic conditions.

Bonds generally present less short-term risk and volatility than stocks, but contain interest rate risk (as interest rates rise, 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.

International Government bonds and corporate bonds generally have more moderate short term price fluctuations than stocks but provide lower potential long-term returns. Investing in high yield fixed income securities, otherwise known as "junk bonds", is considered speculative and involves greater risk of loss of principal and interest than investing in investment grade fixed income securities. These Lower-quality debt securities involve greater risk of default or price changes due to potential changes in the credit quality of the issuer.

Currency Risk is a form of risk that arises from the change in price of one currency against another. Whenever investors or companies have assets or business operations across national borders, they face currency risk if their positions are not hedged.

Generally, among asset classes, stocks are more volatile than bonds or short-term instruments. Government bonds and corporate bonds generally have more moderate short-term price fluctuations than stocks, but provide lower potential long-term returns. U.S. Treasury Bills maintain a stable value if held to maturity, but returns are generally only slightly above the inflation rate.

Diversification does not ensure a profit or guarantee against loss.

Asset Allocation is a method of diversification which positions assets among major investment categories. Asset Allocation may be used in an effort to manage risk and enhance returns. It does not, however, guarantee a profit or protect against loss.

Investing in high yield fixed income securities, otherwise known as “junk bonds”, is considered speculative and involves greater risk of loss of principal and interest than investing in investment grade fixed income securities. These Lower-quality debt securities involve greater risk of default or price changes due to potential changes in the credit quality of the issuer.

Foreign investments involve greater risks than U.S. investments, including political and economic risks and the risk of currency fluctuations, all of which may be magnified in emerging markets.

Availability of internal crossing at State Street Global Advisors may be affected by your asset class, vehicle type, jurisdiction, or other factors.

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.

Equity securities may fluctuate in value in response to the activities of individual companies and general market and economic conditions.

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Market Risk: The Fund’s investments are subject to changes in general economic conditions, general market fluctuations and the risks inherent in investing in markets. Investment markets can be volatile, and prices of investments can change substantially due to various factors including, but not limited to, economic growth or recession, changes in interest rates, inflation, changes in the actual or perceived creditworthiness of issuers, and general market liquidity

ETFs trade like stocks, are subject to investment risk, fluctuate in market value and may trade at prices above or below the ETFs net asset value. Brokerage commissions and ETF expenses will reduce returns.

The Fund is actively managed. The Adviser’s judgments about the attractiveness, relative value, or potential appreciation of a particular sector, security, commodity or investment strategy may prove to be incorrect, and may cause the Fund to incur losses. There can be no assurance that the Adviser’s investment techniques and decisions will produce the desired results.

Debt Securities: The values of debt securities may increase or decrease as a result of the following: market fluctuations, changes in interest rates, actual or perceived inability or unwillingness of issuers, guarantors or liquidity providers to make scheduled principal or interest payments or illiquidity in debt securities markets; the risk of low rates of return due to reinvestment of securities during periods of falling interest rates or repayment by issuers with higher coupon or interest rates; and/or the risk of low income due to falling interest rates.

Privately issued securities are securities that have not been registered under the Securities Act and as a result are subject to legal restrictions on resale. Privately-issued securities are not traded on established markets and may be illiquid, difficult to value and subject to wide fluctuations in value. Limitations on the resale of these securities may have an adverse effect on their marketability, and may prevent the Fund from disposing of them promptly at reasonable prices. **Private credit** can range in credit

quality depending on a variety of factors, including total leverage, amount of leverage senior to the security in question, variability in the issuer’s cash flows, the size of the issuer, the quality of assets securing debt and the degree to which such assets cover the subject company’s debt obligations. In addition, there can be no assurance that the Adviser will be able to secure all of the investment opportunities that it identifies for the Fund, or that the size of an investment opportunity available to the Fund will be as large as the Adviser would desire, on account of general economic conditions, specific market developments, or other circumstances outside of the Adviser’s control

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Counterparty Risk: The Fund will be subject to credit risk with respect to the counterparties with which the Fund enters into derivatives contracts, repurchase agreements, reverse repurchase agreements, and other transactions. If a counterparty fails to meet its contractual obligations, the Fund may be unable to terminate or realize any gain on the investment or transaction, or to recover collateral posted to the counterparty, resulting in a loss to the Fund. If the Fund holds collateral posted by its counterparty, it may be delayed or prevented from realizing on the collateral in the event of a bankruptcy or insolvency proceeding relating to the counterparty.

Valuation Risk: Some portfolio holdings, potentially a large portion of the Fund’s investment portfolio, may be valued on the basis of factors other than market quotations. This may occur more often in times of market turmoil or reduced liquidity. There are multiple methods that can be used to value a portfolio holding when market quotations are not readily available. The value established for any portfolio holding at a point in time might differ from what would be produced using a different methodology or if it had been priced using market quotations. Portfolio holdings that are valued using techniques other than market quotations, including “fair valued” securities, may be subject to greater fluctuation in their valuations from one day to the next than if market quotations were used. In addition, there is no assurance that the Fund could sell or close out a portfolio position for the value established for it at any time, and it is possible that the Fund would incur a loss because a portfolio position is sold or closed o

The Fund may hold securities that have not been registered for sale to the public under the U.S. federal securities laws. There can be no assurance that a trading market will exist at any time for any particular restricted security. Limitations on the resale of these securities may have an adverse effect on their marketability, and may prevent the Fund from disposing of them promptly at reasonable prices. The Fund may have to bear the expense of registering the securities for resale and the risk of substantial delays in effecting the registration. Also, restricted securities may be difficult to value because market quotations may not be readily available, and the securities may have significant volatility.

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