Sector & Equity Compass

Q3 2022

Ready for Everything

STATE STREET GLOBAL ADVISORS SPDR®

Themes & Outlook: Ready for Whatever the Quarter Throws at Us

Likelihood of Recession May Not be Known for a While

We believe the extreme volatility across asset classes is unlikely to end in the next few months. The tussle between killing off inflation and not causing economic recession continues to cause extreme market moves. It is possible that equities in general are at the same level at the end of this year, with further legs down followed by further buy-the-dip phases.

High dispersion between sector returns usually lends itself to alpha generation. This quarter, we suspect that investors could be more keen to use sectors for diversification, to reduce risk, and to avoid unwanted exposure. Given the continued interest in thematic investing, we also see how sectors could help with thematic exposure, with industrials serving as an example.

In an aim to reduce volatility, it helps to identify relatively uncorrelated assets among sectors and regions. Japan, with its differentiated central bank policy, is an example at the regional level. In sectors, we have seen interest in the barbell strategy of holding health care with energy as a potential answer to stagflation.

Position for More Than One Scenario

In Q2 2022, it helped to focus on exposures that traditionally benefit from inflation and/or can perform well during economically challenging periods. We favour this approach again in Q3, particularly with the barbell mentioned above. Nevertheless, it is unlikely that just one scenario will work all quarter, and we see value in also positioning for a soft landing, which may mean that some of the markets that have been hit the hardest, such as emerging markets, become relatively attractive.

Key Considerations for Q3 2022

1 **Inflation sensitivity is still important**

While year-on-year CPI figures may start to fall soon, we believe that the problems caused by inflation, including input price pressures, will remain all year. Energy remains an effective way to play inflation, as whatever benefits the sector's profitability is harmful to other sectors. The only other grouping that comes close is mining (in the materials sector). An overweight exposure to natural resources is one reason to stay with UK equities in Q3.

2 **Rising rates call for investors to stick with value**

Rising rates will be with us until the end of the year at least. In this environment, we still prefer value, which can be found in all of our regional picks. Rising rates also benefit banks, albeit coming with a steepening of the yield curve is even better. We find Europe financials both well positioned and good value. We are also more positive on European equities in general, relative to the US, owing to improved valuations compared with local bond yields.

Even though the growth sectors of technology, consumer discretionary and communication services have fallen significantly year to date, they are still relatively highly rated, making them vulnerable in a fragile market. One reason that we are not including US equities is the high proportion of market cap for which these sectors account.

3 **With volatility still high, low beta, dividends and defensives still have their uses**

The flows in recent months show investors' appreciation for assets with defensive characteristics. Health care remains our favourite defensive sector. UK equities may also provide a degree of protection, being overweight in defensive sectors. Finally, Dividend Aristocrats offer a mix of value and quality, which may provide some downside protection.

4 **Earnings becoming more important**

After months of reopening activity, which resulted in positive earnings surprises and forecast upgrades, we are now witnessing net downgrades. Energy is the only sector still seeing net upgrades across all regions. We worry that even though Q2 earnings reports could meet or beat expectations, many company outlooks could be negative. Among the factors that have recently hit earnings forecasts are margin pressure from input costs, overstocking, changing consumer sentiment, and continued supply chain problems. Our picks for Q3 have given consideration to earnings risk.

5 **Consumer sentiment vulnerable**

We expect fears of recession and lower real incomes to feed through in consumer behaviour. In particular, we are wary of consumer sectors and communication services, which could suffer from trading down and lower demand.

Sector Picks This Quarter

SPDR Sector Picks reflect challenges such as inflation and the implications of the war in Ukraine. As always, we take into account top-down considerations including the State Street Global Advisors economic outlook, the fundamentals of each sector, momentum and investor behaviour (as visualised by the flows and holdings data that follows in this document).

	World	US	Europe
Industrials	✓	✓	
Financials			✓
Health Care	✓	✓	✓
Energy	✓	✓	✓

Equity Regions in Focus

Our reasoning for favouring the following regions is discussed later in the document. These themes take into account many of the considerations above as well as the views of State Street Global Advisors.

Europe: MSCI Europe Index, MSCI EMU Index and FTSE All-Share Index

Emerging Markets: MSCI Emerging Markets Index and MSCI EM Asia Index

Japan: MSCI Japan Index

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Sector and Equity Performance

World Sectors

Q2 2022 (%)		YTD 2022 (%)	
Energy	-5.1	24.0	Energy
Cons Staples	-6.4	-6.2	Utilities
Healthcare	-7.2	-9.8	Cons Staples
Utilities	-7.5	-10.3	Healthcare
Real Estate	-14.7	-17.5	Financials
MSCI World NR	-16.2	-17.5	Materials
Financials	-16.2	-19.7	Real Estate
Industrials	-16.7	-20.5	MSCI World NR
Comm Services	-19.4	-21.8	Industrials
Materials	-19.6	-27.8	Comm Services
Tech	-21.8	-29.7	Tech
Cons Disc	-23.8	-31.9	Cons Disc

US Sectors

Q2 2022 (%)		YTD 2022 (%)	
Cons Staples	-4.2	31.0	Energy
Utilities	-5.3	-1.0	Utilities
Energy	-5.5	-5.6	Cons Staples
Healthcare	-6.0	-8.6	Healthcare
Industrials	-14.9	-17.0	Industrials
Real Estate	-14.9	-18.1	Materials
Materials	-16.0	-19.0	Financials
S&P500 NR	-16.2	-20.1	S&P500 NR
Financials	-17.6	-20.4	Real Estate
Tech	-19.7	-26.6	Tech
Comm Servs	-20.9	-29.9	Comm Servs
Cons Disc	-25.6	-32.6	Cons Disc

Europe Sectors

Q2 2022 (%)		YTD 2022 (%)	
Energy	2.5	21.2	Energy
Comm Services	-0.9	0.2	Comm Services
Cons Staples	-2.1	-3.1	Healthcare
Healthcare	-3.9	-8.1	Cons Staples
Utilities	-8.1	-11.1	Utilities
MSCI Europe NR	-9.0	-12.2	Financials
Financials	-9.5	-13.8	MSCI Europe NR
Cons Disc	-9.7	-15.4	Materials
Industrials	-15.2	-24.4	Cons Disc
Materials	-15.7	-24.8	Industrials
Tech	-20.1	-29.9	Real Estate
Real Estate	-26.0	-32.1	Tech

Source: State Street Global Advisors, Bloomberg Finance L.P., as of 30 June 2022. Past performance is not a guarantee of future results. The reference indices are in the MSCI World, S&P Select Sectors, and MSCI Europe. Index returns are unmanaged and do not reflect the deduction of any fees or expenses. Index performance is not meant to represent that of any particular fund. Index performance is net total return. This information should not be considered a recommendation to invest in a particular sector or to buy or sell any security shown. It is not known whether the sectors or securities shown will be profitable in the future.

Equity Performance by Region	Q2 2022 (%)	YTD 2022 (%)
Japan Equities	-4.4%	-5.9%
UK Equities	-5.0%	-4.6%
Europe Equities	-9.0%	-13.8%
Asia Emerging Markets	-9.3%	-17.2%
Eurozone Developed	-10.5%	-18.7%
Global Emerging Markets	-11.4%	-17.6%
Global Equities	-15.7%	-20.2%
US Equities	-16.2%	-20.1%

Source: Bloomberg Finance L.P., as of 30 June 2022. Past performance is not a guarantee of future returns. Returns are net total returns. Reference indices are: UK Equities — FTSE All Share Index; Global Equities — MSCI ACWI (All Country World Index) Index; Asia Emerging Markets — MSCI EM (Emerging Markets) Asia Index; Eurozone Developed — MSCI EMU Index; Global Emerging Markets — MSCI Emerging Markets Index; Europe Equities — MSCI Europe Index; Japan Equities — MSCI Japan Index; US Equities — S&P 500 Index. Index returns are unmanaged and do not reflect the deduction of any fees or expenses. Index Performance is not meant to represent that of any particular fund. Index returns reflect all items of income, gain and loss and the reinvestment of dividends and other income as applicable.

Sector and Equity ETF Flows

Sector ETF Flows	European-Domiciled ($mn)		US-Domiciled ($mn)	
	Q2 2022	YTD 2022	Q2 2022	YTD 2022
Communication Services	10	5	-319	-1,170
Consumer Discretionary	-89	-569	-3,247	-7,260
Consumer Staples	402	912	2,676	5,592
Energy	-227	1987	-3,384	1,384
Financials	-3118	-2208	-15,022	-12,668
Health Care	778	453	5,391	9,123
Industrials	218	423	-2,999	-2,917
Materials	-251	235	-803	985
Real Estate	-255	-404	-1,557	-2,822
Technology	297	902	2,178	7,335
Utilities	373	88	2,538	4,537

Source: Bloomberg Finance L.P., State Street Global Advisors, as of 30 June 2022. Flows shown above are as of the date indicated, are subject to change, and should not be relied upon as current thereafter. This information should not be considered a recommendation to invest in a particular sector or to buy or sell any security shown. It is not known whether the sectors or securities shown will be profitable in the future. **Methodology** We collect and aggregate flow figures for all sector and industry ETFs domiciled in the US and include ETFs invested across all regions (including US, Europe and World). They are calculated as the net figure of buys minus sells. **The green boxes signify the two highest flow figures for each period, while the red boxes signify the two lowest flow figures.**

Equity ETF Flows by Region	European-Domiciled ($mn)			US-Domiciled ($mn)	
	Q2 2022	YTD 2022		Q2 2022	YTD 2022
Global	8,493	24,035	**US**	43,993	150,296
US	3,114	16,786	**Global**	3,202	6,844
Europe	-922	382	**International — Developed**	10,999	27,391
UK	670	1,303	**International — Emerging Markets**	7,222	17,694
Other Region	262	595	**International — Region**	-7,457	-4,576
Single Country	1,827	-1,612	**International — Single Country**	2,743	9,224
EM	1,674	8,799	**Currency Hedged**	351	255
Total	15,118	50,288	**Total**	61,054	207,128

Source: Bloomberg Finance L.P., as of 30 June 2022. Flows shown above are as of the date indicated, are subject to change, and should not be relied upon as current thereafter. Single Country exposures are those that include securities from one country of domicile.

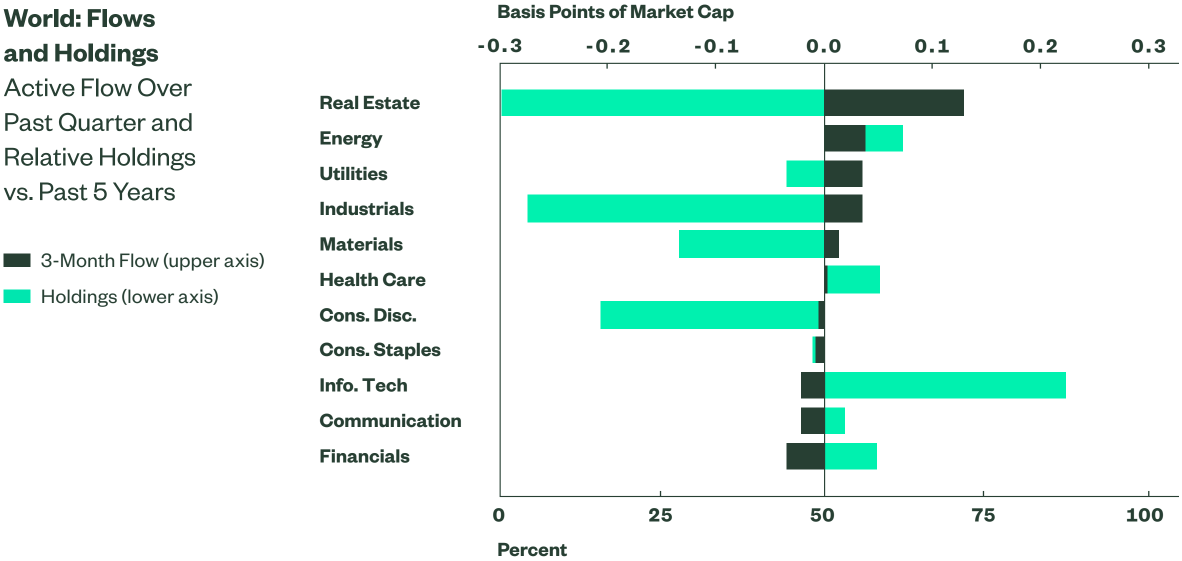
Investor Behaviour Overview

Flows were much more defensive in Q2. This was particularly evident in ETFs, where the traditionally defensive sectors of health care, consumer staples and utilities all received net inflows. After many months of large inflows, June saw net outflows from energy. However, the standout figures were the continuing huge outflows from banks and financials ETFs, which resulted in negative figures overall for European-domiciled and US-domiciled sector ETFs.

Looking at the insights generated from State Street custody data, we saw institutional investors become risk averse across all asset classes during the quarter. One of the manifestations of this, within equities, was investors moving closer to their benchmarks. This can be seen over the three months with relative buying of UK equities and real estate from large underweight positions versus selling of the relatively large overweight in technology on a global basis. Interestingly, the large underweight in energy one year ago has now been closed and active flows remained relatively positive against the other sectors throughout the quarter (see lower chart).

World: Flows and Holdings

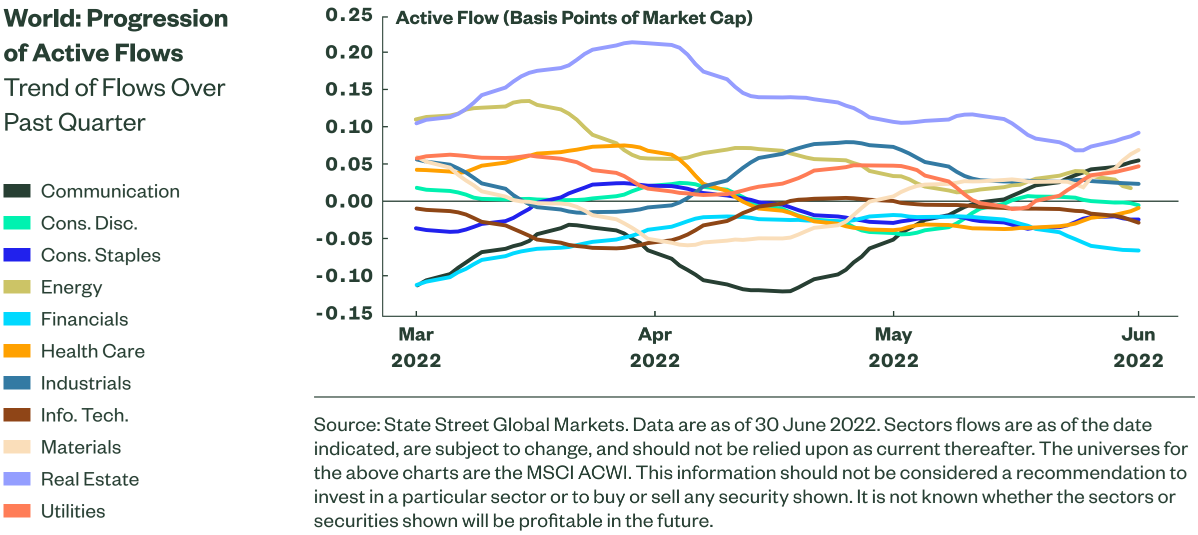
Active Flow Over Past Quarter and Relative Holdings vs. Past 5 Years



Source: State Street Global Markets. Data are as of 30 June 2022. Sectors flows are as of the date indicated, are subject to change, and should not be relied upon as current thereafter. This information should not be considered a recommendation to invest in a particular sector or to buy or sell any security shown. It is not known whether the sectors or securities shown will be profitable in the future. An explanation of methodology can be found on page 23.

World: Progression of Active Flows

Trend of Flows Over Past Quarter



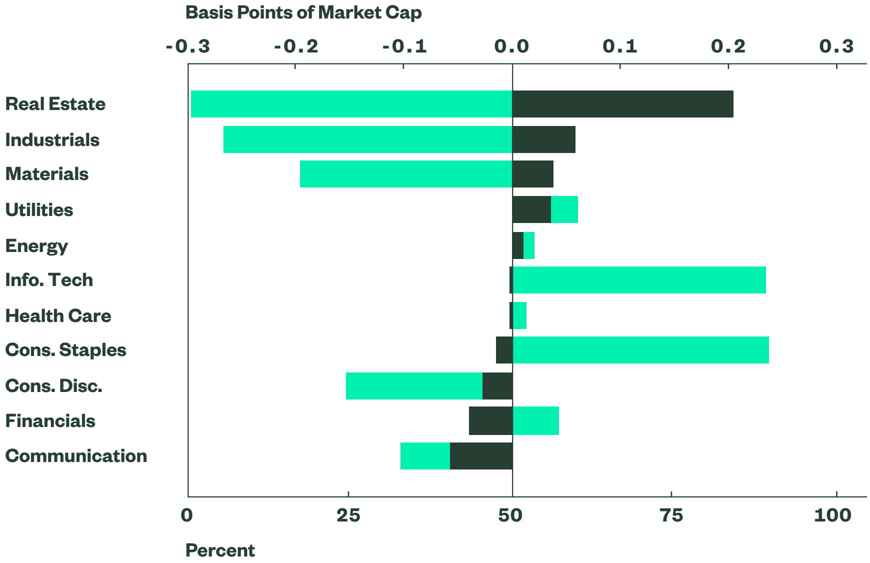
Source: State Street Global Markets. Data are as of 30 June 2022. Sectors flows are as of the date indicated, are subject to change, and should not be relied upon as current thereafter. The universes for the above charts are the MSCI ACWI. This information should not be considered a recommendation to invest in a particular sector or to buy or sell any security shown. It is not known whether the sectors or securities shown will be profitable in the future.

US: Flows and Holdings

Asset Flow Over Past Quarter and Relative Holdings vs. Past 5 Years

3-Month Flow (upper axis)

Holdings (lower axis)



Source: State Street Global Markets. Data are as of 30 June 2022. Sectors flows are as of the date indicated, are subject to change, and should not be relied upon as current thereafter. This information should not be considered a recommendation to invest in a particular sector or to buy or sell any security shown. It is not known whether the sectors or securities shown will be profitable in the future.

US: Progression of Active Flows

Trend of Flows Over Past Quarter

Communication

Cons. Disc.

Cons. Staples

Energy

Financials

Health Care

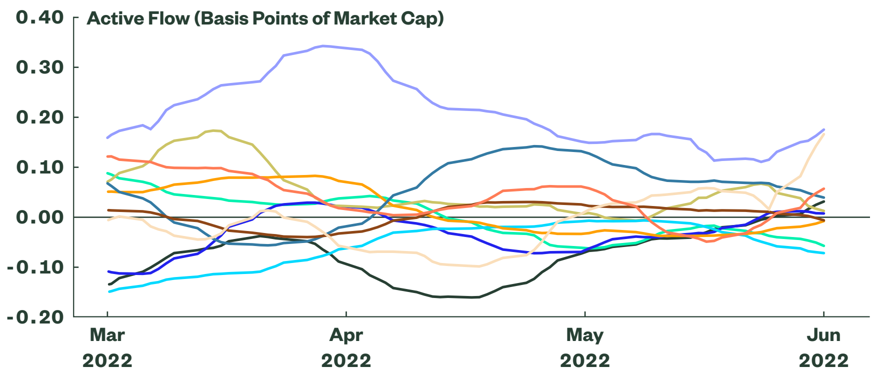
Industrials

Info. Tech.

Materials

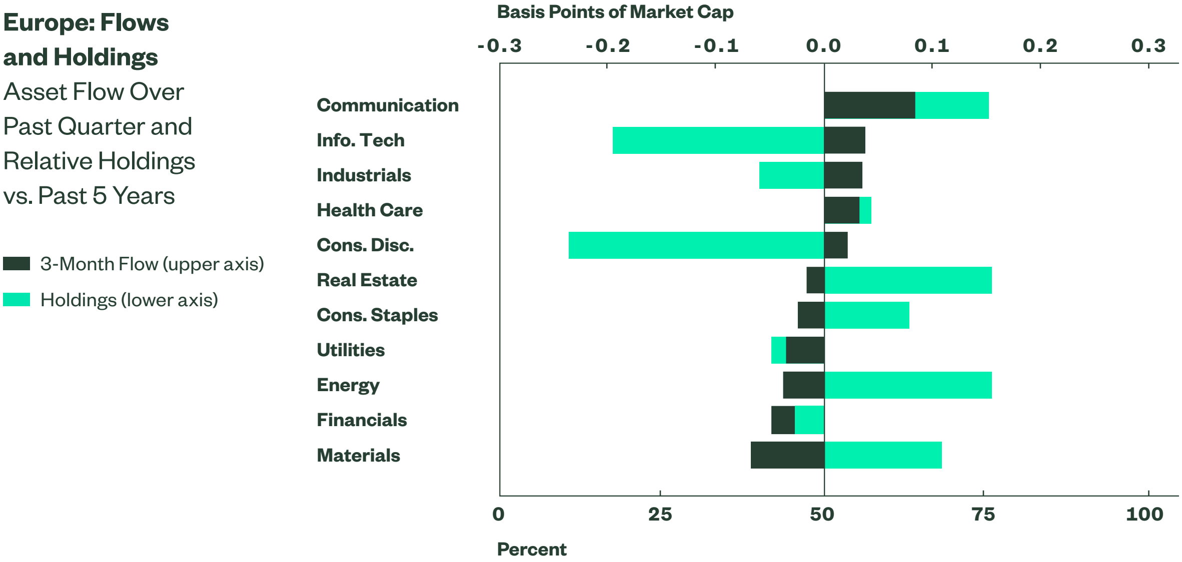
Real Estate

Utilities



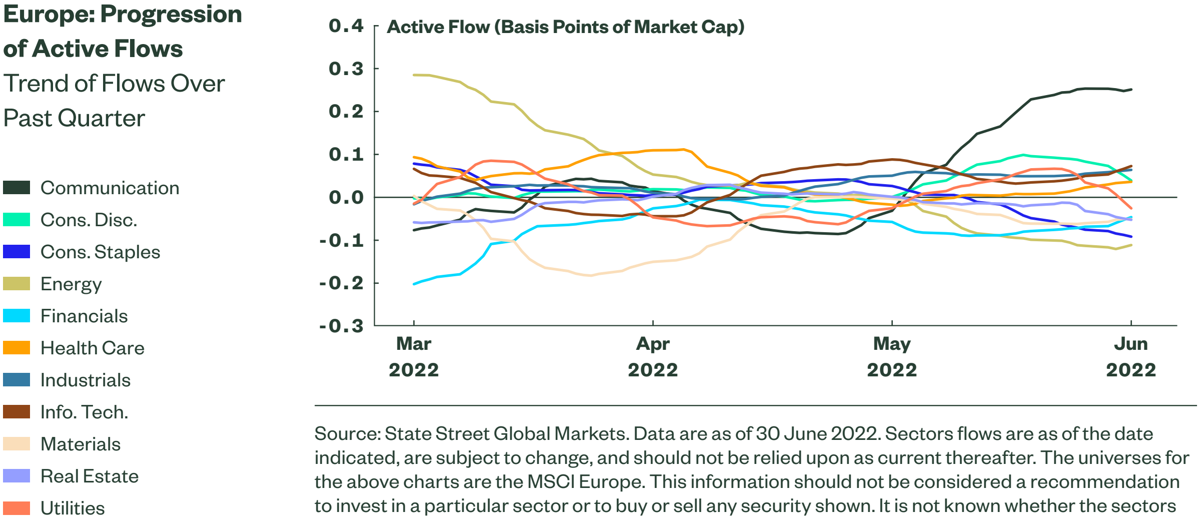
Source: State Street Global Markets. Data are as of 30 June 2022. Sectors flows are as of the date indicated, are subject to change, and should not be relied upon as current thereafter. The universes for the above charts are the MSCI US. This information should not be considered a recommendation to invest in a particular sector or to buy or sell any security shown. It is not known whether the sectors or securities shown will be profitable in the future.

Europe: Flows and Holdings
Asset Flow Over Past Quarter and Relative Holdings vs. Past 5 Years



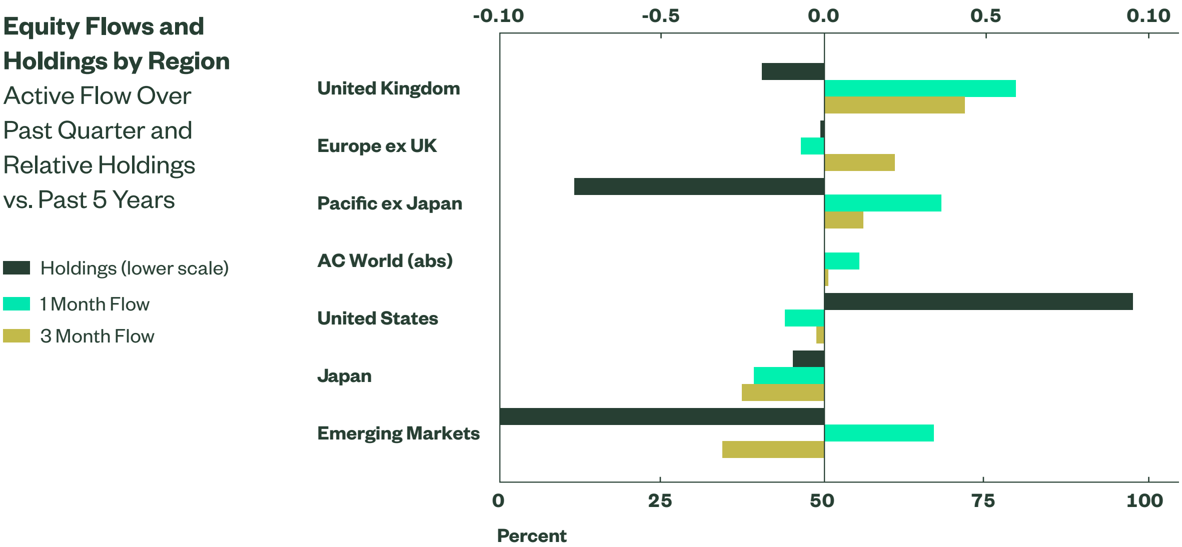
Source: State Street Global Markets. Data are as of 30 June 2022. Sectors flows are as of the date indicated, are subject to change, and should not be relied upon as current thereafter. This information should not be considered a recommendation to invest in a particular sector or to buy or sell any security shown. It is not known whether the sectors or securities shown will be profitable in the future.

Europe: Progression of Active Flows
Trend of Flows Over Past Quarter



Source: State Street Global Markets. Data are as of 30 June 2022. Sectors flows are as of the date indicated, are subject to change, and should not be relied upon as current thereafter. The universes for the above charts are the MSCI Europe. This information should not be considered a recommendation to invest in a particular sector or to buy or sell any security shown. It is not known whether the sectors or securities shown will be profitable in the future.

Equity Flows and Holdings by Region
Active Flow Over Past Quarter and Relative Holdings vs. Past 5 Years



Source: State Street Global Markets, Thomson Datastream, as of 30 June 2022. Flows are as of the date indicated, are subject to change, and should not be relied upon as current thereafter. This information should not be considered a recommendation to invest in a particular sector or to buy or sell any security shown. It is not known whether the sectors or securities shown will be profitable in the future.

Industrials

Seeking Security

World	US	Europe
✓	✓	

Structural Growth Themes

Sectors can offer a way to play growth themes. We see several themes that have been enhanced since the start of the war in Ukraine, can be accessed via the industrials sector.

Defence spending often rises as a result of war. This is particularly true in Europe, given the aggressions on the edge of the region and previous under-spending, leaving some countries under-resourced in key equipment such as attack helicopters, airlift capabilities and missile systems. A recent announcement from the UK government stated that it will seek to increase its budget in support of supplying equipment to Ukraine.

Energy security and demand for new equipment will rise with the construction of new power generation facilities, particularly renewable energy projects, including nuclear power stations, wind energy and hydroelectric plants. Heavy LNG cap ex and continuing electrification are also drivers. There is a wealth of expertise from engineering and construction companies and industrial conglomerates.

Re-shoring of manufacturing capability predated the war, with disruptions around COVID lockdowns and trade tariffs spurring action to secure supply and build more resilient supply chains. Expect to hear more from manufacturers of products such as phones, cars, batteries, chips and medical equipment. The automation and digitalisation skills of electrical equipment and machinery manufacturers are relevant.

Raw materials and high prices are likely to induce oil producers to lift demand for drilling equipment for offshore oil and fracking, enabled by less stringent government and investor restrictions, thus bringing orders to equipment producers and associated transportation. Meanwhile, a desire to secure supply for metals and materials essential to clean energy and new technologies could raise demand for mining machinery.

Agricultural machinery could see higher demand. Elevated crop prices, partly caused by significant disruption to wheat and corn supply from Russia and Ukraine, could extend the agricultural cycle, bringing new demand for equipment.

Earnings outlook. PMI figures for the US and across Europe show lower figures but are still greater than 50, indicating growth, which is important to general cap ex. This is one sector where earnings results are keenly awaited. So far there has been mixed evidence among industrials companies of the ability to pass on pricing pressures to their customers.

We Favour US Exposure in This Sector

US industrials has the highest exposure to defence and aerospace. Its engineering, construction and equipment companies are most likely to win any infrastructure contracts awarded by the US government and domestic industrial production may remain stronger than in countries geographically closer to the war in Ukraine.

World industrials has a large exposure to Japanese manufacturers including important transportation providers, defence contractors and digital products suppliers. Certain companies from these areas performed well last quarter and theoretically could see benefits to their exports from a weak yen.

Financials

Big on Value

World	US	Europe
		✓

New, Contrarian Sector Pick for Q3

It is challenging to buy financials given the potential for economic recession; however, the extremely low valuations of the European sector already discount a significantly tougher time and large balance sheet damage. While the P/E rating is near an all-time low, the sector's returns are still rising.

The Europe financials sector is seeing earnings upgrades, which is rare in the current environment, and next year has the highest growth forecast after the technology sector. Strong bank and insurance company balance sheets and cash flow support relatively attractive dividend growth, share buybacks and M&A.

Investors have been large sellers this year through ETFs and individual shares given economic concerns, risk aversion and concerns over the impact of the war in Ukraine. We see this as a contrarian opportunity.

Rates & Earnings

The upward direction of yields globally is a key support for financials, in particular banks. The net interest income margin of European banks is driven by the interest rate policy of the ECB, Bank of England and Federal Reserve. The latter two have already started tightening, with the ECB expected to start with a 25bp hike this month (July), followed by 50bp in August, at which point the target rate would go above zero. In the meantime, rising yields among government bonds in the eurozone (e.g. the key five-year rate has risen from -0.46% to 0.89% YTD) are allowing higher loan charges, while a steepening of the short end of the curve gives a greater margin over deposit rates.

Bank balance sheets appear sound in terms of loan-to-deposit rates and this leaves the sector better able to weather difficult economic times. Net performing loans are at less than half their rate of five years ago. Furthermore, many of the banks have not written back their pandemic provisioning, providing another cushion. Insurance companies also have healthy solvency ratios, enabling expansive activity.

The Whole Sector

The banking industry is always the newsworthy element of the sector, accounting for 46% of market cap. Banks are by far the most leveraged to rates and have strong value, but have a less volatile exposure when combined with insurance (31% of market cap), which offers quality aspects in terms of returns and less cyclicality and has been the stronger performer over most time periods since the Global Financial Crisis. The impact of rates on insurance is mixed across the categories of life, property and reinsurance but is generally positive.

The diversified financials industry (23% of market cap) has a strong structural growth element among its asset managers. Volatility trading has been driving revenue at exchanges. The capital markets players have not had an easy time but they represent a much smaller part of the index versus in the US.

The Value of Europe

We favour the European sector for its relatively attractive industry mix and low valuations, particularly when looking at price/book value (0.7x for the sector, less than 0.6x for banks, which is a 25% discount to the US industry). The EU will soon move back into positive interest rates, which should represent a major change for banks' profitability. European government bond yield curves have remained steeper than US Treasury, presenting margin opportunity.

Health Care

Barbell in a Barbell

World	US	Europe
✓	✓	✓

Favourite Defensive

In an expensive equity market, prone to volatility and facing a deteriorating economic background, a defensive sector is highly desirable. Compared with utilities and consumer staples, health care suffers much less from commodity price inflation, and also has potential positive catalysts away from the macro scenario.

The sector's price returns are virtually flat on the year, with strong relative performance in Europe, US and world against large stock market falls. Health care has shown a barbell performance of its own: with pharmaceuticals producing marginal positive returns, benefiting from the their stable earnings, high returns and cash flow, while at the other end, the worst performance has come from companies supplying tools, services and equipment after the post-COVID boom dissipated.

Biotechnology, a closely watched and heavily traded part of this sector, has seen performance between these extremes. The industry has endured a big derating this year, particularly among US-quoted stocks, on the rate outlook impact on growth stocks and fears around funding. Biotech looks particularly ripe for takeovers and, even without that activity, has catalysts in terms of clinical trials, and drug approvals by the FDA and other national bodies.

Despite the recent outperformance, relative valuations remain reasonable given the sector's merits.

Barbell with Energy

The low volatility of health care performance and low correlation with moves in the crude oil price make the sector an excellent choice for a barbell strategy with the energy sector to offer efficient diversification. While the latter moves with value, inflation and often cyclical trends, health care offers a combination of stability and quality not readily available at a reasonable price elsewhere. Whereas energy's relative performance is highly sensitive to inflation, health care is more impacted by economic growth. Our analysis in a recent article shows that adding the two sectors to an equity portfolio has previously increased portfolio returns in high inflation scenarios.

Accessing Health Care in all Three Regions

US health care has better earnings growth, albeit with slowing momentum, than the sector in other regions. Over the past three months, we saw institutional investors add to positions but they are still underweight. Part of the reason for the closing of the exposure is a lightening of the political threat in the US.

Europe health care has produced the best performance (absolute and relative) of the three regions. One of the sector's attractions has always been its global sales base, including the huge potential in emerging markets. Euro weakness in Q2 may have helped sales; results will be reported soon.

World health care is dominated by US companies (71% of market cap) and therefore possesses similar opportunities and threats, albeit with less USD exposure.

Energy

Still Buying Energy

World	US	Europe
✓	✓	✓

Short & Long-Term Story

Despite falling in June, in response to the Fed's commitment to kill off inflation and its possible impact on economic activity, the energy sector retained its performance lead for the quarter and year to date. Flows into energy ETFs were net positive. Institutional investors now have a substantial overweight position compared with the normal case over the past five years.

While most of the narrative has focused on supply and demand for oil and gas, fossil fuel prices and, ultimately, the leveraged impact on energy profits, there is also an interesting long-term story emerging that explains continued investor interest.

In a difficult outlook for equities, the forecast upgrades for energy, extremely low valuations and high free cash flow may be sufficient to support it against sectors without these attractions. Despite a rise of 23% this year (MSCI World Energy NTR), the sector has been relatively derated because of the scale of forecast upgrades. The low correlation between energy and the rest of the equity market could be an advantage when looking to reduce portfolio risk.

Demand for Energy Security

A lack of cap ex in oil and gas exploration and production facilities over the past 10 years, which has been exacerbated by OPEC+ production compliance, has yielded extremely tight fossil fuel supply. This has worsened with Russian moves to limit gas flow and bans on Russian oil, including the EU banning all seaborne deliveries. Nations have become desperate to retain sizeable fossil fuel production or secure supply until clean alternatives are well established. This desire for energy security gives oil and gas companies some breathing room, with maybe a lighter ESG or regulatory touch.

Energy Companies can Help with Transition

In transitioning to net zero, fossil fuels necessarily become a much smaller part of the energy mix. For a few years, nervous investors looked at issues of stranded assets and the need to curtail production as a reason to severely downgrade energy stocks. However, international energy companies have value and experience in complex project management and could be part of the solution.

Today's free cash flow can accelerate the sector's transition into low-carbon projects, such as hydrogen and biofuels, as well as broader carbon management through energy efficiency, and carbon capture and storage. In a tighter financial market, where there is less funding for new or indebted independent power producers, there is more need and incentive for integrated energy companies to act.

Exploring Energy in all Three Regions

US energy has shown better performance relative to its broader regional index year to date given the sector's larger share of upstream activity among quoted companies, giving it greater leverage to oil prices.

Europe energy held up best in June and has a relatively high exposure to natural gas. The more enhanced transition plans of European companies resulted in a significant discount rating, giving greater re-rating potential.

World energy offers a broader operational exposure with the inclusion of Canadian and Australian listings.

Sector Index Metrics

	Fundamental Growth Forecasts & Valuations									
	Est. 2yr EPS Growth (% p.a.)*	3mth Change to 1yr EPS Growth Forecast (%)	Forward Relative P/B**	Forward Relative P/E**	Relative CAPE	Relative CAPE (10yr Avg)	ROE (%)	Debt/ Equity (%)	Est 3-5 Years EPS Growth (%)	12mth Div. Yield (%)***
MSCI World Sector Indices										
MSCI World Index	**7.3**	**3.5**	–	**13.9**	–	–	**14.5**	**136**	**NA**	**2.27**
Comm. Services	2.4	-4.5	0.98	13.5	1.27	1.45	11.3	98	10.22	1.49
Consumer Disc.	12.3	1.5	1.32	15.4	1.12	1.16	11.0	115	18.77	1.50
Consumer Staples	4.8	0.1	1.68	18.3	1.05	1.11	22.1	95	3.74	2.73
Energy	39.2	45.5	0.66	7.7	0.63	0.49	22.8	61	7.75	4.05
Financials	0.5	-5.6	0.44	9.6	0.61	0.62	8.7	241	-2.31	3.51
Health Care	4.4	3.2	1.59	16.1	1.34	1.18	29.6	77	20.52	1.78
Industrials	11.5	7.2	1.08	14.1	1.00	1.08	15.1	91	9.83	2.31
Materials	-1.4	6.7	0.72	10.1	0.78	0.89	29.3	49	16.59	4.41
Real Estate	7.0	3.3	0.62	22.7	1.14	1.22	5.5	83	8.25	3.39
Technology	8.6	2.1	2.40	18.7	1.49	1.34	42.7	59	12.05	1.08
Utilities	7.3	1.8	0.76	16.2	1.00	0.92	11.4	145	7.17	3.60
US S&P Select Sector Indices										
S&P 500 Index	**9.0**	**4.1**	–	**15.3**	–	–	**22.4**	**114**	**NA**	**1.71**
Comm. Services	3.9	-3.7	0.76	12.9	0.99	1.47	15.5	100	10.46	1.01
Consumer Disc.	16.2	2.7	1.96	17.4	1.28	1.26	11.8	219	11.88	1.02
Consumer Staples	5.9	1.4	1.64	19.4	0.87	0.90	33.6	113	3.40	2.61
Energy	44.0	51.8	0.59	8.9	0.75	0.53	22.9	51	9.25	3.57
Financials	-0.5	-6.8	0.39	10.7	0.65	0.61	11.2	149	-0.94	2.30
Health Care	3.4	3.7	1.22	15.8	1.08	1.03	33.8	84	24.65	1.65
Industrials	25.2	14.6	1.22	14.6	0.87	0.95	21.9	139	10.93	1.88
Materials	5.2	8.2	0.71	12.9	0.89	0.97	20.0	62	16.69	2.22
Real Estate	7.8	4.0	0.49	32.8	1.72	1.73	9.0	115	14.84	3.20
Technology	8.2	1.9	1.98	18.4	1.10	1.03	46.6	67	12.42	1.08
Utilities	5.8	1.9	0.64	18.9	1.02	1.01	11.5	146	6.90	3.05
MSCI Europe Sector Indices										
MSCI Europe Index	**9.6**	**7.3**	–	**11.2**	–	–	**11.6**	**176**	**NA**	**3.72**
Comm. Services	8.9	3.8	0.89	13.9	0.78	0.83	6.4	121	9.88	4.21
Consumer Disc.	13.0	7.8	1.00	10.5	1.00	1.41	16.6	86	-7.62	3.24
Consumer Staples	8.3	2.9	1.94	16.9	1.18	1.32	17.3	85	6.81	3.03
Energy	37.9	47.7	0.67	5.7	0.74	0.58	23.2	61	5.51	4.69
Financials	3.2	-4.2	0.45	7.7	0.67	0.66	7.9	343	1.79	5.45
Health Care	10.0	5.0	2.21	15.7	1.42	1.25	25.0	70	8.45	2.46
Industrials	11.8	10.1	1.59	13.4	1.36	1.46	21.5	96	8.52	3.08
Materials	-3.0	5.6	0.93	9.5	1.00	1.09	32.2	46	39.97	6.10
Real Estate	5.8	5.2	0.37	11.9	0.73	1.10	5.4	89	1.19	4.87
Technology	14.2	6.2	2.34	17.4	2.95	3.42	15.0	48	10.50	1.47
Utilities	6.9	2.6	1.03	13.0	0.94	0.76	12.3	153	10.30	5.07

Source: State Street Global Advisors, FactSet, Bloomberg Finance L.P., Morningstar, as of 30 June 2022. Past performance is not a guarantee of future results. The above estimates based on certain assumptions and analysis made. There is no guarantee that the estimates will be achieved.
* Calculated as a 2-year average of consensus forecasts for adjusted EPS using BEst (Bloomberg Estimates).
** Forward estimates refer to 12 months.
*** This measures the weighted average of gross dividend yield of the relevant index and the underlying stocks from the relevant ETF.

Sector Index Metrics (cont'd)

	Macro Sensitivities****			Risk Metrics*****		
	US 10yr Yield Sensitivity (36 Months)	Brent Crude Oil Price Sensitivity (36 Months)	Inflation (5yr–5yr Forward) Sensitivity (36 Months)	Beta (36 Months)	Volatility (36 Months) (%)	Correlation (36 Months)
MSCI World Sector Indices						
MSCI World Index	**0.03**	**0.23**	**0.56**	**1.00**	**18.46**	–
Comm. Services	0.00	0.20	0.46	0.96	19.65	0.93
Consumer Disc.	0.01	0.24	0.75	1.15	22.92	0.95
Consumer Staples	0.02	0.10	0.39	0.53	13.08	0.77
Energy	0.20	0.56	0.81	1.27	36.40	0.66
Financials	0.09	0.34	0.67	1.14	24.20	0.90
Health Care	0.00	0.12	0.31	0.67	15.08	0.84
Industrials	0.05	0.27	0.63	1.06	20.86	0.96
Materials	0.05	0.27	0.71	1.07	22.13	0.92
Real Estate	0.03	0.21	0.52	0.88	18.57	0.90
Technology	-0.02	0.20	0.54	1.07	21.87	0.93
Utilities	0.01	0.12	0.40	0.60	16.21	0.70
US S&P Select Sector Indices						
S&P 500 Index	**0.02**	**0.21**	**0.56**	**1.00**	**18.63**	–
Commun. Services	0.00	0.23	0.50	1.04	21.54	0.92
Consumer Disc.	0.01	0.22	0.72	1.15	23.48	0.94
Consumer Staples	0.03	0.10	0.43	0.53	13.95	0.73
Energy	0.23	0.64	0.92	1.42	43.51	0.62
Financials	0.08	0.33	0.64	1.11	24.27	0.87
Health Care	0.01	0.12	0.36	0.70	15.77	0.85
Industrials	0.07	0.28	0.65	1.04	21.77	0.92
Materials	0.06	0.24	0.72	1.05	22.35	0.90
Real Estate	0.02	0.17	0.45	0.84	19.07	0.84
Technology	-0.02	0.18	0.56	1.04	21.39	0.94
Utilities	0.02	0.08	0.35	0.54	18.29	0.56
MSCI Europe Sector Indices						
MSCI Europe Index	**0.04**	**0.26**	**0.55**	**1.00**	**19.67**	–
Comm. Services	0.06	0.25	0.51	0.77	17.48	0.90
Consumer Disc.	0.05	0.31	0.68	1.13	24.45	0.94
Consumer Staples	0.00	0.11	0.38	0.58	14.68	0.80
Energy	0.15	0.43	0.59	1.14	33.46	0.69
Financials	0.10	0.41	0.71	1.33	29.47	0.92
Health Care	-0.01	0.10	0.23	0.56	14.80	0.76
Industrials	0.04	0.31	0.74	1.16	24.21	0.97
Materials	0.04	0.29	0.65	1.07	23.18	0.94
Real Estate	0.00	0.29	0.74	1.16	25.78	0.91
Technology	-0.01	0.26	0.54	1.14	25.34	0.91
Utilities	-0.02	0.22	0.49	0.86	21.14	0.82

Source: State Street Global Advisors, FactSet, Bloomberg Finance L.P., Morningstar, as of 30 June 2022. Past performance is not a guarantee of future results.
**** Sensitivity is beta to the macro variable, e.g. 10-year Treasury yield, Brent oil, and US 5yr–5yr forward as shown here.
***** Beta and volatility are based on index returns. Correlation is the 36-month correlation to the parent index.

Europe & UK

Too Cheap to Ignore, Despite Challenging Backdrop

European equities, like most regions, suffered severe declines during the first half of the year, losing 13.8% (in EUR terms). The reasons behind the poor performance include global inflation, which triggers monetary tightening, as well as economic slowdown and dependency on Russian oil and gas. While a possible recession is on the horizon and rate hikes are just around the corner, we believe that the increasingly appealing valuations of MSCI Europe more than compensate for that.

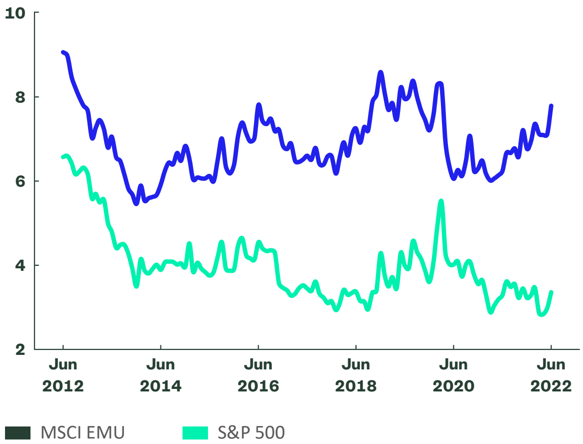
Despite many challenges there are several tailwinds for Europe. The continent may still enjoy some of the reopening dynamics that have now eroded in the US. Consumers' excess savings provide a cushion against rising prices while fiscal transfers from the Next Generation EU fund support investments and growth. Finally, the euro, British pound and Swiss franc have all depreciated against the US dollar year to date, benefitting exporting companies.

As monetary tightening remains the prevailing theme, investors may look for regions with value features built in; MSCI Europe, with a 12-month forward P/E of 11.5x that is below the March 2020 level, certainly represents a value opportunity. Equally low P/E levels are more likely to limit negative performance driven by earnings downgrades, which in our view are likely in both the US and Europe.

MSCI Europe 12-Month Forward P/E

Source: Bloomberg Finance L.P., State Street Global Advisors as of 30 June 2022. 12-Month forward P/E is Bloomberg 12-Month fwd BEST_PE_RATIO.

12-Month Forward Earnings Yield Spread to 10-Year Local Government Bonds yields



Source: Bloomberg Finance L.P., State Street Global Advisors, as of 30 June 2022. Spread for MSCI EMU is against Euro Generic Govt Bond 10-year yield while spread for S&P 500 is against US Generic Govt 10-year yield. Euro Generic curve is created using German and French bonds.

While rate normalisation is a common phenomenon for most developed central banks, the expected quantum of hikes varies significantly. The ECB is expected to remain more dovish relative to the Federal Reserve. This enhances the relative attractiveness of equity valuations, as stocks' earnings yields spread over local bonds for eurozone equities is much more appealing than for the US. In other words, recent derating of eurozone equities more than compensated for rising yields, while for the US this is not necessarily the case.

We have turned more positive on continental equities relative to the US, but we continue to see merit in UK equities given the relatively attractive 12-month forward P/E of 10x. The UK also offers a beneficial sector split in the current environment (overweight in energy, materials, financials and defensives at the expense of technology). Investors could also choose to invest in the whole European complex by buying into MSCI Europe.

Emerging Markets
Timing is Everything

We believe that emerging market equities could serve as an answer to the current challenging backdrop. While global growth is materially slowing, developing economies, led by China, are expected to post decent growth of 3.5% this year and accelerate to 4.1% in 2023, according to economists at State Street Global Advisors.[1] This stands in contrast with the more modest growth of advanced economies. However, the economic growth story was present for a prolonged period and yet over the last year and a half emerging markets underperformed developed markets by a wide margin. Therefore the most important question for emerging market equities is not "if" but "why now."

Answers come from multiple angles and the first source is China, which accounts for 33% of the index. Chinese stocks were beaten down by the Chinese government's zero COVID policy and regulatory crackdown. While both factors remain key risks, China has gradually eased COVID restrictions. The regulatory moves remain unknown but, as the government is increasingly focused on bolstering growth, the situation may at least not deteriorate for the time being.

Indeed, on 31 May 2022, China announced a package of 33 fiscal, financial, investment and industrial policies to revive the economy. Monetary policy is also supportive as the PBOC pledged to continue dovish policy, thus diverging from the majority of developed world central banks. These factors increase the probability that the Chinese economy and Chinese equities may be bottoming out and we start to see it in the data. Official manufacturing PMI increased to 50.2 from 49.6 in May while non-manufacturing PMI rose from 47.8 to 54.7.

Emerging market equities weight heavily to Asia, as APAC countries account for 80% of the MSCI EM Index. This is a growth engine that may answer the challenge of global economic slowdown. India and China are expected to lead the growth but Taiwan and South Korea should also deliver a strong number compared to advanced economies, according to the IMF.

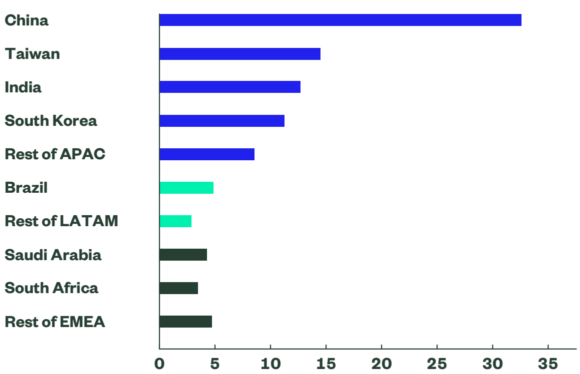
Emerging markets include some commodity-exporting countries such as South Africa, Saudi Arabia, UAE and Mexico. To some extent, this group offsets the negative effect of elevated commodity and energy prices on the EM Asia complex. Many EM countries are ahead of the Federal Reserve in the tightening cycle and therefore may be resilient to the strengthening USD, the main example being Brazil. Valuations remain undemanding, with 12-month price to earnings at 10.9x, which derated close to March 2020 lows.

Real GDP Growth

	Actual	Forecasts	
Country/Region	**2021 (%)**	**2022 (%)**	**2023 (%)**
Developing Economies	**6.4**	**3.5**	**4.1**
China	8.1	4.7	5.2
Taiwan	6.3	3.2	2.9
India	8.9	8.2	6.9
South Korea	4.0	2.5	2.9
Brazil	4.6	0.8	1.4
Advanced Economies	**5.0**	**2.6**	**1.8**
US	5.7	2.3	1.5
Euro Area	5.3	2.8	2.1
World Growth	**5.8**	**3.1**	**3.1**

Source: State Street Global Advisors estimates as of 30 June 2022 except estimates for Taiwan, India, South Korea and Brazil which are sourced from IMF World Economic Outlook April 2022.

MSCI EM Country of Risk Breakdown



Source: FactSet, State Street Global Advisors, as of 30 June 2022.

[1] The above estimates are based on certain assumptions and analyses. There is no guarantee that they will be met.

Japan

BoJ Dovishness and JPY Weakness Remain Intact

Japan equities, in local terms, outperformed the broader market during the challenging first half of 2022, losing 5.9% while global equities, in USD terms, fell 20.2%. The Japanese economy is struggling with the same issues as other countries, such as elevated commodity prices, broken supply chains and slowing growth. However, its resilience to inflation in CPI terms has been remarkable. And while inflation in Japan is ticking up, economists at State Street Global Advisors expect CPI to average 2.8% for 2022, which is well below the high single digit levels expected for other advanced economies.[1]

Resilience to high inflation allowed the Bank of Japan (BoJ) to continue its dovish policy against the hawkish pivot observed elsewhere. Even more importantly, the BoJ appears committed to that dovish stance, keeping local bond yields in check and thus providing support to MSCI Japan in two dimensions: 1) favourable financing conditions for businesses and 2) lower discount rates applied to equity valuations.

Against a challenging macroeconomic backdrop globally, profitability should be a major focus for investors. Japan is one of the least expensive markets, with a 12-month forward P/E of 12.1x, which translates to a generous earnings yield of 8.2%. As monetary policy remains loose in Japan, earnings yield relative to other regions is even more attractive when plotted against local bond yields.

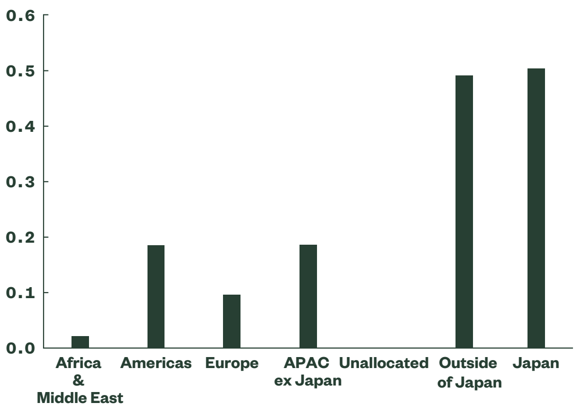
However, the most important consequence of the BoJ policy and the single most important reason behind our bullish stance for MSCI Japan is weak Japanese yen, which, against the US dollar, sits close to a two-decade low. Currency is always a double-edged sword but we believe that, for Japanese equities, weaker JPY represents an opportunity rather than a threat as nearly half of revenue (market cap-weighted) generated by companies within the index comes from outside Japan. This allows exporters to see the positive FX impact already in the top line while global Japanese companies, which generate revenue and bear costs in foreign currencies, may benefit from repatriation of earnings when translated into JPY.

At the same time, while weak JPY is hitting households budgets, government measures (including gasoline subsidies) provide much-needed relief. Lastly, the country is reopening to tourism and this will likely boost spending, particularly on services. In our view, Japan may also be a relatively attractive destination for investors.

USD/JPY Exchange Rate

Source: Bloomberg Finance L.P., as of 30 June 2022.

MSCI Japan Revenue Split by Region



Source: FactSet, State Street Global Advisors. Revenue weighted by index weight of constituents as of 30 June 2022 and revenue split available as of 4 July 2022.

[1] The above estimates are based on certain assumptions and analyses. There is no guarantee that they will be met.

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Methodologies

SPDR Sector Picks Explained Looking out three months, we consider which sectors stand to potentially benefit from a combination of top-down and bottom-up factors. Macroeconomic indicators greatly inform our research, along with aggregated earnings and valuation metrics. We also consider investor flows and positioning. Most importantly, we reflect on the likely drivers of each sector over the forecast period.[1]

Unique Custody Data As part of State Street, we have access to information gleaned from our large global custody business. By aggregating $44 trillion of financial assets, we can observe behavioural trends of this important investor constituent.[2] This includes not only the direction of flows, but also the relative positioning of portfolios. These metrics are generated from regression analysis based on aggregated and anonymous flow data in order to better capture investor preference and to ensure the safeguarding of client confidentiality.

Investor Behaviour Indicators Explained Holdings measure investors' actual positions over and above the neutral positions embedded in their benchmarks. The figures are shown as percentiles and represent the investor holdings at month-end versus the last five years. This approach provides perspective on the size of holdings compared with their historical trends, whereas a single, dollar figure provides less context; 100% represents the largest holding in the last five years whilst 0% is the lowest holding.

Active Flows Indicates the value of net buying by large institutional investors (buys minus sells) expressed in terms of basis points of market capitalisation. These are flows in addition to the purchases or sales driven by shareholders allocating to the benchmark.

Top Chart Records the asset flow over the previous three months (60 trading days) versus the last five years.

Bottom Chart Shows trend of flows over previous three months (60 trading days).

Endnotes

1 Targets such as the type noted above are estimates based on certain assumptions and analysis made by State Street Global Advisors. There is no guarantee that the estimates will be achieved.

2 Source: State Street, as of 31 March 2022.

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Investing in REITs involves certain distinct risks in addition to those risks associated with investing in the real estate industry in general. Equity REITs may be affected by changes in the value of the underlying property owned by the REITs, while mortgage REITs may be affected by the quality of credit extended. REITs are subject to heavy cash flow dependency, default by borrowers and selfliquidation. REITs, especially mortgage REITs, are also subject to interest rate risk (i.e., as interest rates rise, the value of the REIT may decline).

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