Sector Compass

Reopening, Recovery and Rotation

Q1 2021

STATE STREET GLOBAL ADVISORS SPDR®

Themes and Outlook

A summary of the major investment themes influencing sectors, plus an outlook for the quarter ahead.

Reopening, recovery and reopening, but not straightforward

The sector rotation seen in flows and performance in the last two months of 2020 could continue given many investors still hold cash and are underweight the more risky areas. While the outlook for inflation may not be strong enough for a complete growth to value switch, the stretched valuation gap suggests there could be more to come. Thus valuation matters more for our Q1 picks than it has for some time, but when selecting sectors a near-term driver is also needed.

Recovery but Not Instantly

Successful vaccine delivery implies economies will open up and recover, although the return to normal is unlikely to be straightforward.

As we start 2021, we could be seeing peak optimism on vaccine delivery and reopening. Meanwhile, in our personal lives we are reminded of the reality of the large second wave and further restrictions to social mobility. The stock market is looking beyond this worsening virus news, but there is a risk that many of the post-vaccine announcement assumptions may be too positive.

While we favour cyclical sectors for Q1, namely Industrials and Materials, there is still need for caution and selectivity. For example, while manufacturing is for now supported by PMIs, there could be disappointment in how long it takes services to recover. Therefore, investors are likely to want some defensive growth in portfolios, such as Health Care.

Rotation on Reflation Hopes

The current risk-on or reflation trade, which has recently boosted flows into equities in general and riskier sectors specifically, is supported by underweight exposures and valuations. Cash balances and high fixed income positioning imply that investors do not need to sell growth to fund incremental pro-cyclical positions or value sectors such as Financials. This suggests the rotation could continue.

Expectations of higher inflation are rapidly becoming consensus, especially after the results of the Georgia US Senate election run-off, which has raised hopes of stimulus. While we believe that, in the near term, economic reflation (growth and inflation) will result from a post-recession return to normal, there is little reason to expect a longer-term uplift in underlying inflation trends.

Investors wanting to look at sectors that have a higher sensitivity to inflation can look at the data on page 24.

Taking a Break from Technology

Technology was a SPDR Sector Pick for most of 2020. The sector offers various secular growth themes, which have undoubtedly strengthened during the crisis. Strong, sustainable earnings growth should continue to favour the sector, but there are likely to be better opportunities for recovery and relative returns in the coming months.

While interest rates remain very low, long-duration assets are supported and there is no urgency to sell — but the story has moved on. The sector looks expensive in a market that cares more about valuation. Also watch the political attacks on the FAANGs in the US and internationally, which are likely to mainly hit stocks in Communication Services and Consumer Discretionary but could dent sentiment toward tech leaders.

Key Considerations Entering 2021

Entering 2021, it will be important to assess each sector's exposure to economic recovery and the extent to which this is reflected in earnings forecasts. We believe valuations will have much more importance moving forward compared to most of last year.

Many sectors are international in nature and are driven by the same macroeconomic factors and market themes. Nevertheless, sector performance does vary by region, and it is important to consider the relative size of different industries included within the sector.

Among the important factors that we think could impact relative regional sector performance this quarter are exposure to:

- Dollar weakness
- Commodity demand
- Steeper US Treasury yield curve
- Continued economic strength of China
- Income prospects

Sector Picks This Quarter

To inform our choice of sectors, we consider these market themes and relevant macroeconomic factors for the next quarter (such as commodity prices, manufacturing figures, credit markets), alongside earnings and valuation metrics, investor behaviour and the outlook of the largest constituents. The SPDR Sector Picks are those we believe stand to benefit the most from this outlook.

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

Sector Performance and ETF Flows

Regional sector performance highlighting dispersion between top and bottom performance. Flows into sector ETFs split between US and European domicile, worth more than $730 billion in AUM.*

* Source: Morningstar, as of 31 December 2020.

Sector Performance

Performance differentials for Q4 and full-year 2020 narrowed following the sharp rotation in November and December, but were still very wide overall. Notably, the spread between the best and worst performing US sectors in 2020 was the largest since 2000. The gap was not as wide in Europe, partly after Technology weakened on Q3 reporting. The other major regional difference in 2020 was the outperformance of European Utilities on clean energy prospects.

Q4 performance was dominated by the rotation that started following the US presidential election and, more importantly for equity prospects, the game-changing announcements on COVID-19 vaccines. The more defensive and least inflation-sensitive parts of the market, such as Utilities and Consumer Staples, were immediately side-lined, while high beta sectors outperformed.

Value sectors, Energy and Financials turned around quickly from previous weakness. Energy was driven by expectations of increased demand for oil as more normal levels of travel resume. Meanwhile, Financials was seen as a beneficiary of some steepening of the US Treasury yield curve as well as central banks allowing a return to share buybacks (in the US) and dividends (in Europe).

World Sectors

Q4 (%)		2020 (%)	
Energy	26.7	43.8	Tech
Financials	24.0	36.6	Cons Discret
Cons Discret	16.2	23.0	Comm Servs
Materials	15.8	19.9	Materials
Comm Servs	15.6	15.9	MSCI World NR
Industrials	15.3	13.5	Health Care
MSCI World NR	14.0	11.7	Industrials
Tech	12.9	7.8	Cons Staples
Utilities	9.3	4.8	Utilities
Real Estate	8.6	-2.8	Financials
Health Care	6.8	-5.0	Real Estate
Cons Staples	6.4	-31.5	Energy

US Sectors

Q4 (%)		2020 (%)	
Energy	27.7	43.4	Tech
Financials	23.0	29.3	Cons Discret
Industrials	15.5	26.6	Comm Servs
Materials	14.3	19.7	Materials
Comm Servs	13.8	17.8	S&P500 NR
S&P500 NR	12.0	12.8	Health Care
Tech	11.7	10.4	Industrials
Cons Discret	9.6	9.4	Cons Staples
Health Care	7.9	-0.5	Utilities
Utilities	6.3	-2.4	Financials
Cons Staples	5.9	-3.0	Real Estate
Real Estate	4.8	-33.9	Energy

Europe Sectors

Q4 (%)		2020 (%)	
Energy	27.1	14.5	Tech
Financials	22.9	11.7	Utilities
Cons Discret	19.3	9.4	Materials
Real Estate	14.4	6.5	Cons Discret
Materials	13.0	3.7	Industrials
Industrials	12.5	-1.9	Health Care
Utilities	11.4	-3.3	MSCI Europe NR
Comm Servs	10.9	-3.5	Cons Staples
MSCI Europe NR	10.8	-11.6	Real Estate
Tech	7.7	-13.5	Comm Servs
Cons Staples	1.4	-15.6	Financials
Health Care	-2.1	-33.9	Energy

Source: State Street Global Advisors, Bloomberg Finance L.P., as of 31 December 2020. Past performance is not a guarantee of future results. The universes for the above charts are 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. These indices are net total return.

Sector ETF Flows

The use of sector ETFs as a financial instrument did not pick up as much as expected before the US presidential election, but did increase markedly as a means of playing the rotation that started after the vaccine announcements. Investing by sector can offer a quick way to change top-level exposure in a portfolio, and both European-domiciled and US-domiciled ETF ranges saw substantial inflows toward the end of the year.

Financials (including banks ETFs) saw the biggest turnaround in flows, with expectations of a steeper yield curve alongside economic recovery helping to reverse previous fund outflows. Industrials, Materials and Consumer Discretionary were all favoured for their cyclical nature. These Q4 inflows were partly funded by money out of more defensive exposures as well as cash.

Over the full year, Technology ETFs stood out as the most popular sector funds, as a means of accessing earnings growth, but these funds suffered small profit-taking late in the year. The Health Care sector (which also includes biotech ETFs) was also popular earlier in the year, although it lost support around the US election.

	US-Domiciled ($mn)		European-Domiciled ($mn)	
	Q4	2020	Q4	2020
Communication Services	797	3,281	-40	-390
Consumer Discretionary	2,117	4,523	672	822
Consumer Staples	-1,285	-1,451	-651	-212
Energy	3,139	7,431	457	994
Financials	5,206	2,150	2,719	1,858
Health Care	1,160	7,795	-395	2,383
Industrials	3,748	7,334	701	1,832
Materials	3,431	4,326	275	2,350
Real Estate	3,279	-2,230	-85	-656
Technology	1,398	8,497	1,211	5,507
Utilities	-76	519	99	468

Source: Bloomberg Finance L.P., State Street Global Advisors, as of 31 December 2020. Flows shown above are as of the date indicated, are subject to change, and should not be relied upon as current thereafter.
Methodology We collect and aggregate flow figures for all sector and industry ETFs domiciled in the US and Europe. As of October 2020, this set includes approximately $541 billion in AUM invested in US-domiciled funds and $50 billion in AUM invested in European-domiciled funds. The flow figures include ETFs invested across 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.**

Institutional Flows and Positioning

The direction of flows and relative positioning of institutional sector flows, referencing $20 trillion of equity assets under custody.*

* Source: State Street, as of 30 September 2020.

World

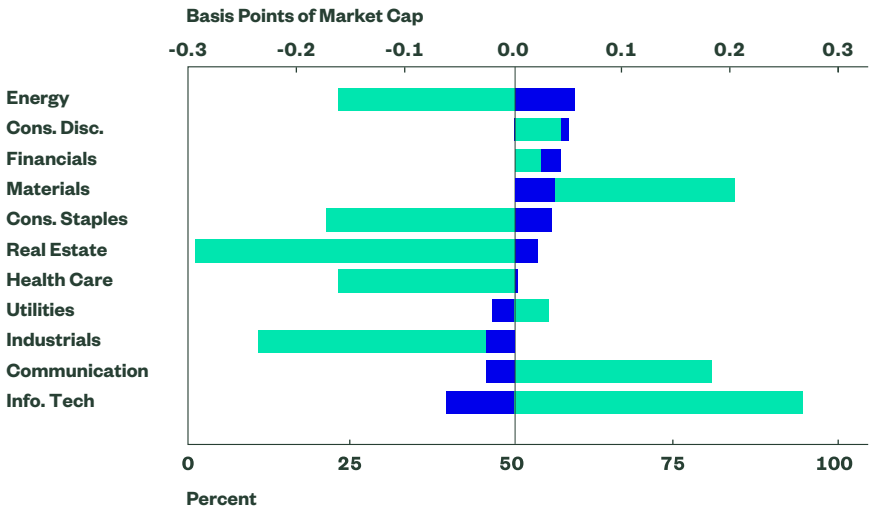
Institutional investors reacted immediately to the better outlook by increasing equity holdings from cash, targeting the areas where they were most underweight and/or with a higher beta.

Most striking were the relative flows into and out of Energy stocks. On average, shareholdings are still highly underweight after years of outflows. But investors reacted quickly to hopes of more social mobility and associated demand for oil following the positive vaccine news, with positive active flows as share prices bounced off of their lows. However, this enthusiasm dissipated within a few weeks as investors remained nervous given high oil inventories, weak product demand and pressure to transition to greener sources of energy.

By contrast, the momentum in buying of Consumer Discretionary exposure increased over Q4, predominantly in autos, and will have included Tesla;* relative inflows were more than twice the level of any other sector in December. Elsewhere in the sector, shares in consumer service stocks (such as restaurants and leisure) remain understandably unpopular and heavily underweight.

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

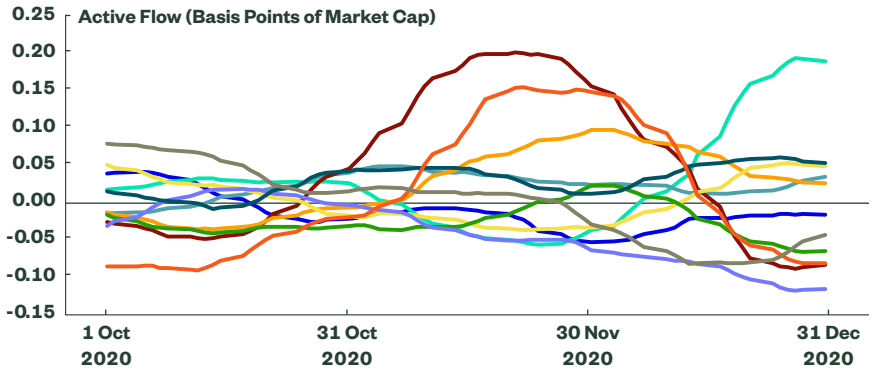
- 3-month flow (upper axis)
- Holdings (lower axis)



Source: State Street Global Markets. Data are as of 31 December 2020. 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.

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



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US

Trends in US-listed stocks were similar to those noted for World, with the same exaggerated moves in active flow for Energy stocks, leaving investor holdings still underweight at the end of the year. Real Estate also saw a sharp turn in popularity during the fourth quarter, from low holdings levels with some buying of real estate management companies, but this did not last.

Buying of Tesla* ahead of the huge S&P 500 index entry saw Consumer Discretionary flows rise sharply in December, adding another large stock to the sector alongside Amazon.* Institutional investors are almost as overweight in this sector as other the FAANG* sectors, Technology and Communication Services. Index investors needed to sell down stocks elsewhere to fund the Tesla trade, as well as dip into cash balances. This explains some of the profit-taking in Technology, which has high holdings levels, and relative outflows from the traditionally defensive Utilities sector.

In general, it appears that the early switch from growth to value lost pace during December, with greater focus on size and cyclicality, such as the mining and chemical companies (in Materials) given hopes for an improved outlook for economic recovery, and less on Financials.

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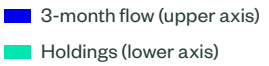
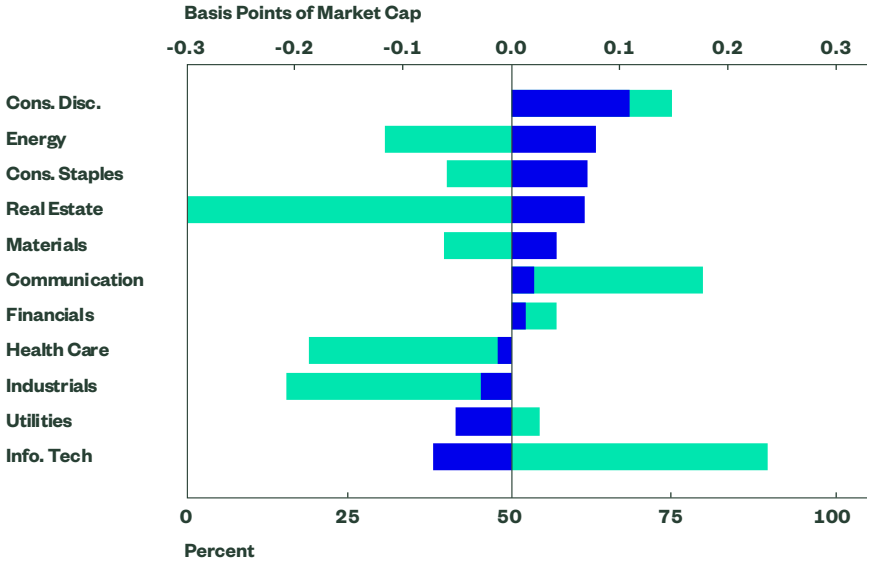
Asset Flow Over Past Quarter and Relative Holdings vs. Past 5 Years





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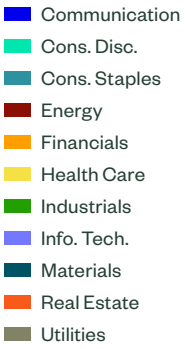

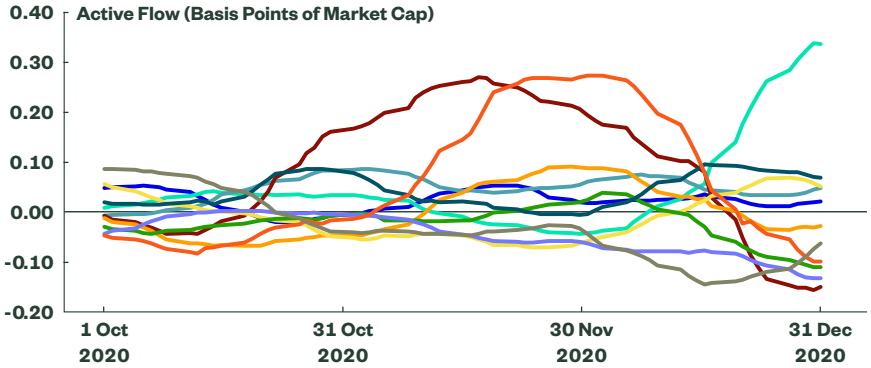

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Europe

The buying of European banks, insurers and diversified insurers started in Q3 and gathered momentum through November, with relative attractions of extreme value and expectations of M&A activity. However, this momentum dried up towards the end of 2020 despite price strength for Financials, presumably on concerns that the ECB would not raise rates for years and the yield curve appears unattractive (unlike in the US). There may have also been concerns of disruption before the Brexit deal was struck, but this also mirrors the pattern of interest in value stocks in other regions.

Compared to the US oil and gas flows, interest in European energy companies was sustained through December, although institutional investors still appear strongly underweight.

Consumer Discretionary exposure was popular in Europe, as elsewhere, but the makeup of the sector is different, with a higher weight to luxury goods, less in online retail and no Tesla.* Nevertheless, auto manufacturers and component makers alongside retailers were added in Q4. Overall, institutional investors are underweight in the European sector, so there may be more buying to come.

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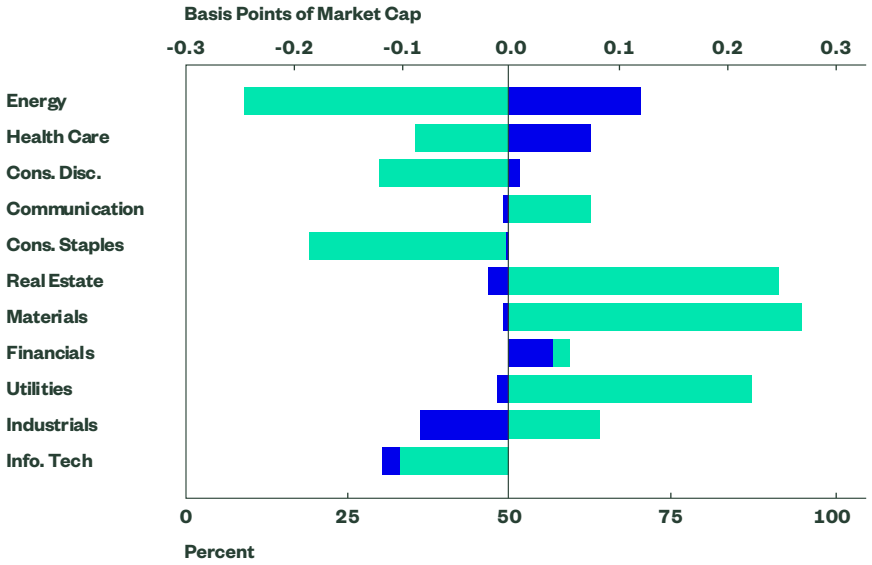
- Holdings (lower axis)



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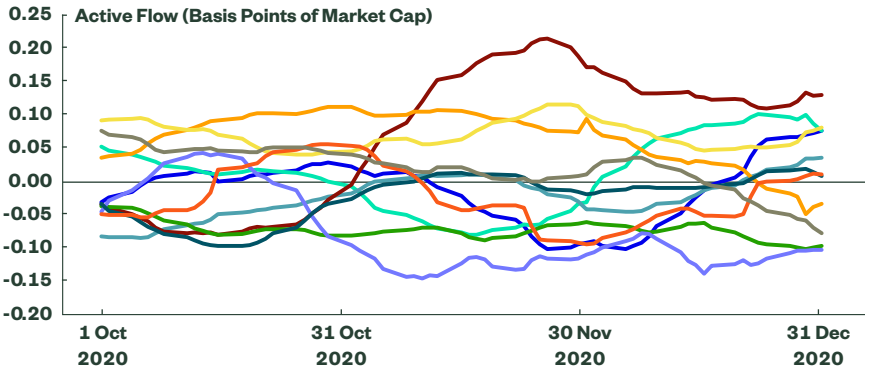

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Sector Picks

Ideas for the quarter ahead based on macroeconomic indicators, aggregated earnings, valuation metrics, flows, holdings and potential drivers for each sector.

Financials

Value and Income Even without Rate Rises

World	US	Europe
	✓	

Macroeconomic Sensitivity

Financials was a SPDR Sector Pick in Q1 2020, which we removed when we saw the damage that the COVID-19 crisis inflicted on businesses and individuals, affecting loan demand and threatening bad debt. Having seen a bottoming of bond yields, some steepening of the US Treasury yield curve, an earnings hit but capital still comfortable, and a high level of financial confidence, we are happy to now reconsider the sector. While share prices have outperformed since the rally inspired by the vaccine news, they are still absolutely lower than at the start of 2020.

Important factors for the sector include:

Interest Rates US discount rates are likely to remain extremely low for the next few years, but further steepening of the yield curve (possibly via a pick-up in yields at the long end, while short-term rates remain anchored to the zero bound by accommodative Federal Reserve policies) may provide some relief for banks' net interest income margins.

Business Sentiment/GDP Growth/Consumer Confidence/Unemployment A better economic background could help bank loan growth and consumer finance activities would also be important for insurance claims. Positive sentiment among US consumers has already produced a strong rise in mortgage bank applications in recent months.

Credit Risk The Federal Reserve's announcement in late December, permitting large banks to resume share buybacks, signals comfort in levels of credit risk, even with higher commercial real estate and card loan losses factored in. Together with a narrowing of credit spreads, this move provides investors with reassurance on bad debts.

Financial Markets Strong equity and bond markets should show through in several parts of the sector, including insurance investment performance (although this may be offset by low interest rates), AUM for asset managers and volume levels for financial exchanges. Volatility in most asset classes has fallen back from its extreme highs reached in March, but is important to watch as an indicator of trading volumes for investment banks.

Regional Choice: US vs. European Banks

Banks in particular represent an interesting proposition for cyclical recovery. Thankfully the COVID-19 crisis did not produce a financial crisis and there should be less overhang than after previous recessions given the scale and speed of loan provisioning. For example, banks retained higher levels of capital and liquidity in 2020 than they did in the last three recessions.

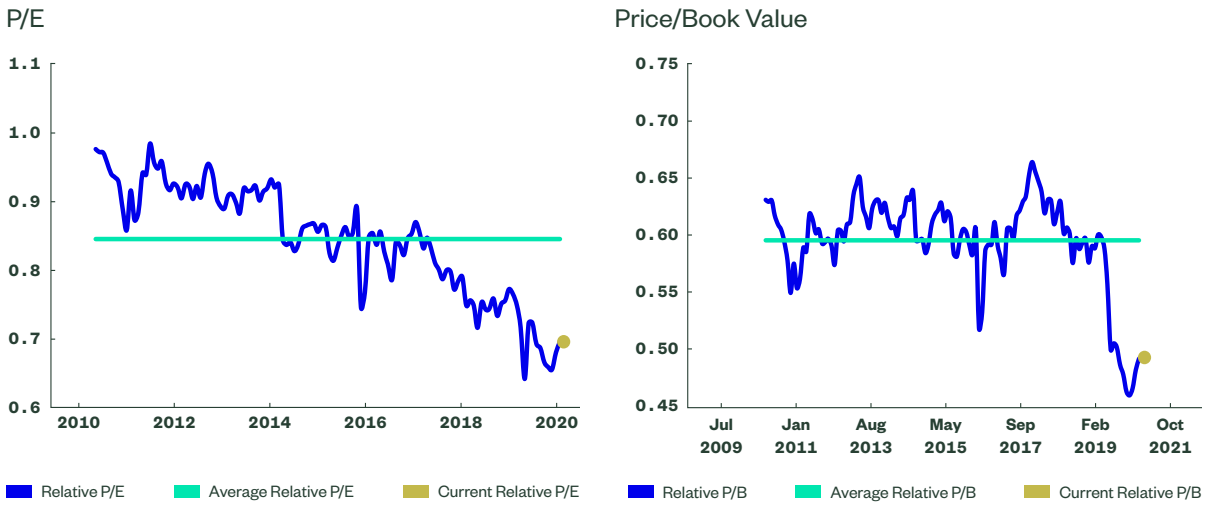
While we have gained confidence in the outlook for US banks, we are not yet as assured on the financial prospects for the European industry. The sector is certainly cheap and there likely will be consolidation, but Europe faces a flatter yield curve and uncertainty given unresolved areas in the Brexit deal (this applies to UK companies in particular). For those reasons, for now we prefer US Financials over Europe or World (which is underweight the US and overweight European Financials exposure).

Relatively Attractive Income and Valuation

Significant upgrades over the last three months give the sector earnings growth forecasts ahead of the broader market, while valuations (across earnings, sales and book value) look relatively attractive against the market and historical medians.

The news came late last year that, following stress tests, the Federal Reserve would allow US banks to resume share buybacks this quarter. Share buybacks typically make up 70% of the money paid out to shareholders, making them an important consideration to investors. JPMorgan Chase* (the largest US bank by assets) and Morgan Stanley* have already announced intentions to buy back $30 billion and $10 billion, respectively. Dividend payments are still capped to an amount based on recent income, but upside remains on payouts to permitted levels.

Relative Valuation of US Financials to S&P 500 Index



Source: State Street Global Advisors, Bloomberg Finance L.P., as of 31 December 2020. Both measures are 12-month forwards and based on Bloomberg's consensus Best figures.

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Materials

Cyclical Growth and Value

World	US	Europe
✓		✓

Ticks the Macro Boxes

Materials works as a top-down story on the following economic points:

- **Exposure to Cyclical Recovery** Experienced through industrial demand for raw materials and chemicals. Products are up-stream in supply chains so should see early pick-up.
- **Major Beneficiary of Stimulus Spending** This would be especially true if we see infrastructure building, which necessitates construction materials as well as other products from the sector.
- **Positive Sensitivity to Inflation** We currently see this in higher metals pricing, particularly copper.
- **Recipient of Growing Chinese Demand** The sector has the second highest exposure to emerging markets, with the Chinese requirement for metals most important.
- **Positive Impact of Weaker Dollar** Often associated with rising commodity prices.

The Materials sector also ticks the thematic boxes given:

- **Valuation** Despite strong recent performance, the sector's P/E is still below the peak and has fallen relatively over recent months as forecasts have risen.
- **Defensiveness** The sector's diversity, with below-average stock correlation and above-average stock dispersion, could be reassuring in an uncertain recovery period.

Metals Pricing

Industrial metals have a stronger relationship with GDP growth (as measured by PMIs) than most other commoditites including crude oil, gas, gold and agricultural commodities. Prices of these metals (zinc, iron ore, aluminimum, lead and copper) rose sharply in the second half of 2020 on the back of demand prospects and supply tightness. These price rises are feeding earnings forecasts upgrades for the sector.

We now see significant investor interest in copper, whose spot price is trading at the highest level in nine years, according to Bloomberg Finance. This interest has been stoked by buoyant end use demand from China, where the rapid V-shaped recovery has benefited building, autos and electronics activity.

Chemicals Outlook

Chemical manufacturers have a broad customer base and end use, with the majority set to recover following COVID-19 disruption.

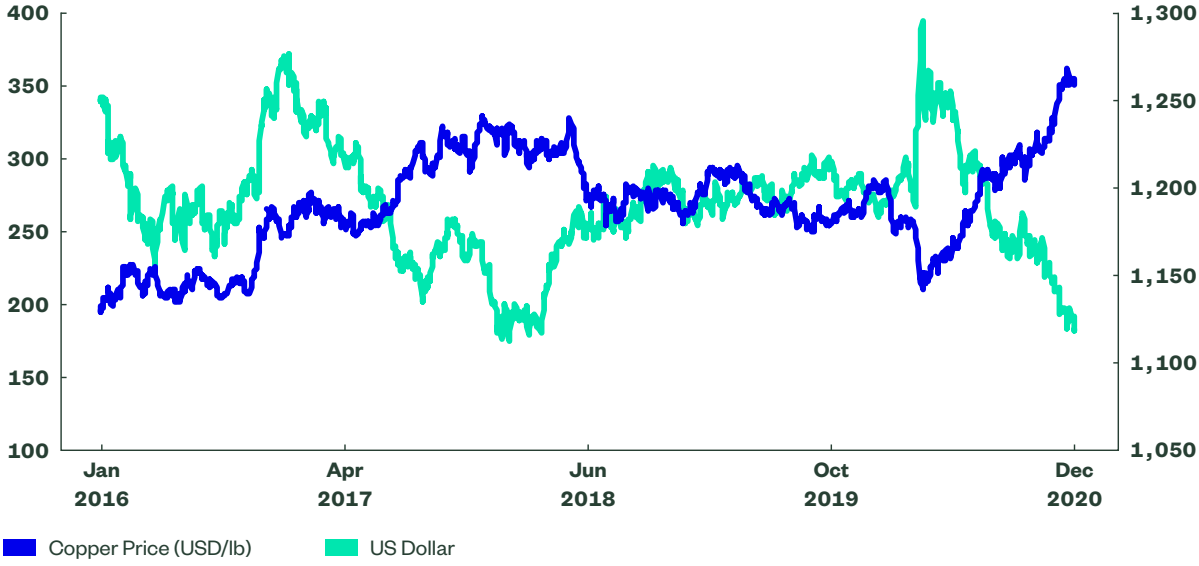
Speciality Chemicals is the largest sub-industry. Its growth products include lithium for batteries, electronic chemicals for semiconductors, and industrial coatings, which could be boosted by autos this year.

Industrial Gas companies have been protected by their food and beverage and health care operations, but still await a pick-up in production and refining of oil and gas.

Basic Chemicals face growing capacity competition but should benefit from cheaper oil input costs. While non-durables use (e.g. household cleaning products) has been steady, upside is forecast in autos and domestic appliances.

Agricultural Chemicals now enjoy an outlook for fertisliers and pesticides that is helped by positive crop pricing.

Inverse Correlation of Copper Price and US Dollar



Source: Bloomberg Finance L.P., as of 31 December 2020. Copper price uses generic first HG Future. US dollar used the Bloomberg Dollar Spot Index.

Regional Choice

The macro-level drivers are compelling across regions, but our Sector Picks favour Europe and World Materials over the US for their higher weighting to mining and speciality chemicals. Location of customer base is another interesting comparison: Europe Materials has the second highest international revenues of any European sector, with over a third of sales in emerging markets. In addition to European and the US constituents, World Materials contains leading companies based in Australia, Canada and Japan. Both these regions trade at a discounted P/E rating to the broader market and have a relatively attractive yield compared with the US sector.

Industrials

Turnaround, Albeit Not Straightforward

World	US	Europe
✓	✓	✓

How and When Will the Sector Rebound?

The Industrials sector was hard hit early in the COVID-19 pandemic, with pain in supply chains and cancellations of customer orders. Now, however, the sector is a leading candidate for turnaround during an economic revival. Industrials has the highest correlation with our Sector Pick of Materials and the same performance drivers related to international trade and cyclicality of demand. Compared with Materials, it possibly has more to gain from recovery, although it could take longer.

A return to normal levels of activity is not guaranteed in the next few months, especially where related to the airline and oil and gas industries, making the timing for this Sector Pick complicated.

Positive drivers for the sector include:

China Resuming Infrastructure Spending Fixed-asset investment has lagged the recovery in retail sales and manufacturing, but is expected to rebuild strongly in 2021 with construction and capital expenditure.

US Fiscal Stimulus Though Traditional Infrastructure While immediate plans relate to paychecks and health care support, further out we expect large-scale transportation improvement plans. Even without federal spending, funding is available from record amounts of ready-to-deploy capital in private infrastructure funds

Europe-Wide Projects The EU recovery plan should kick-start infrastructure projects, including green-building, emphasising political and financial cooperation across the EU bloc.

Benefit of Biden Presidency on Trade A year ago, the US sector suffered from tariffs on Chinese imports of intermediate goods (raw materials, industrial inputs, machine parts) while uncertainty reduced capex on equipment. Although there are no immediate prospects, a more measured tone on trade would help.

Industrials by Industry

This is a diverse sector, with the largest stock, Honeywell*, accounting for less than 3% of the index. Moreover, multi-industrial end markets respond differently during the various stages of the economic cycle.

The outlook for four of the largest segments of the sector break down as follows:

Machinery (by market cap: 19% of World, 20% of US, 19% of Europe sector) Machinery prospects are directly correlated to Manufacturing PMIs worldwide. In general, as factory capacity utilisation rates rise, there will be new orders for the likes of bearings, machine tools and automation equipment. Current bright spots in industry demand are for residential construction and mining equipment.

Aerospace and Defence (by market cap: 13% of World, 19% of US, 12% of Europe sector) Aircraft manufacturers (led by Boeing* and Airbus*), suppliers and engine makers were among the earliest casualties of the COVID-19 crisis as airlines started to demand deferred deliveries and cancel new aircraft orders. Conversely, the rollout of vaccines should start to restore demand for air travel. In the meantime, US airlines may see some relief courtesy of a new stimulus package, which will cover most labour costs in Q1, but European carriers could cut capacity given further lockdown restrictions.

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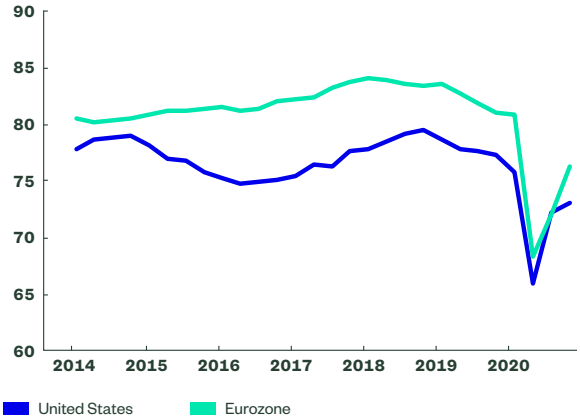
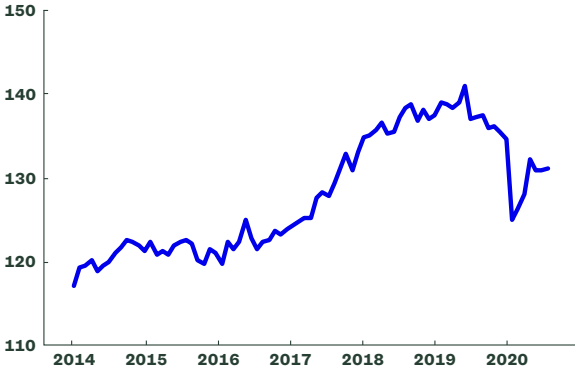
Electrical Equipment (by market cap: 10% of World, 6% of US, 17% of Europe sector) Compared with the US, there is a higher proportion of European and Japanese names in electrical components, industrial automation and power generation, the largest being Schneider Electric*. The quick turnaround expected in demand for such products showed in strong share price performance in December.

Road and Rail (by market cap: 13% of World, 12% of US, not applicable for Europe sector) Prospects are brighter for transportation and logistics providers in 2021, including the largest stock in the industry, Union Pacific*. Volume growth and limited trucking capacity could provide some pricing power for the industry. US and Canadian rail carloads were already posting a quarterly gain in Q4 2020, benefiting from increased demand for consumer durables offsetting lower volumes in oil, coal and cars.

Capital Utilisation (%)



US Dept. of Trade Freight Transportation Services Index



Source: Bloomberg Finance L.P., as of 31 December 2020.

Regional Choice

While the split by industry may favour the European sector, the US sector should benefit from dollar weakness helping overseas sales, which are approximately 70% of the total, according to S&P Dow Jones Industries.

* This information should not be considered a recommendation to invest in a particular sector or to buy or sell any security shown.

Health Care

Inexpensive Defence

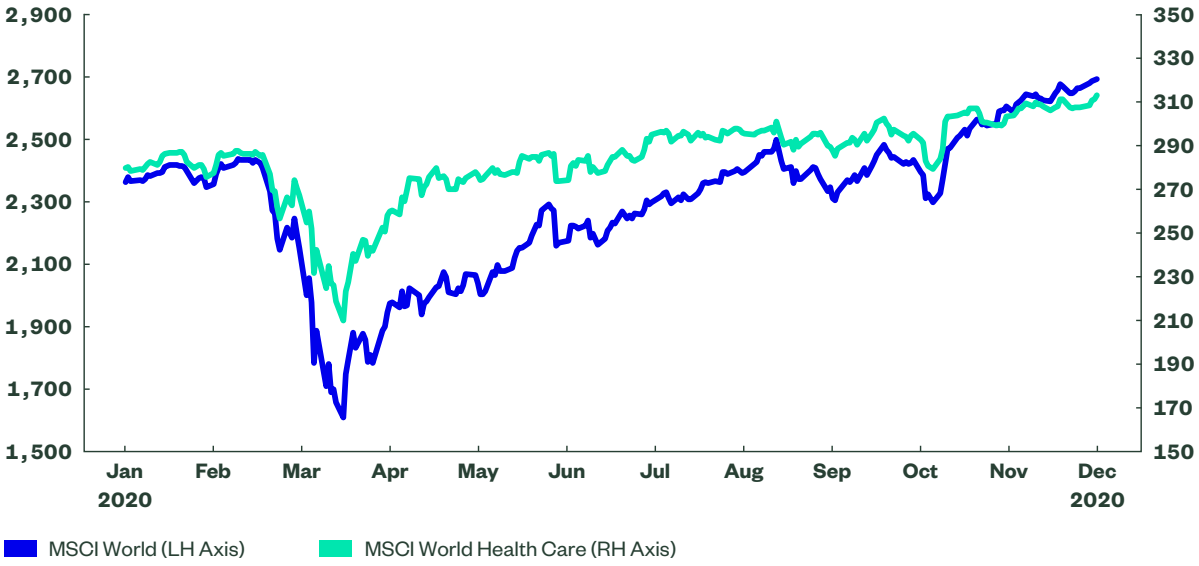
World	US	Europe
✓	✓	✓

The Strangest of Years

In a year dominated by health considerations, the global sector surprisingly failed to match the returns of the market average. The sector traded sideways and did not participate in the surge in equities since the vaccine announcements. Part of this performance can be explained by the Health Care sector's defensive properties, but there has also been concern on disruption to the health care system. This offset what should have been a relief rally following the US presidential election result.

Nevertheless, the defensive aspects of the sector could be important if we see an uneven recovery in the coming months. In the long term, Health Care has one of the best risk-return profiles of all sectors thanks to its secular growth trends and non-discretionary demand.

MSCI World Health Care and MSCI World Indices in 2020



Source: Bloomberg Finance L.P., as of 31 December 2020. 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. Past performance is not a guarantee of future returns.

Vaccine Delivery and Ongoing Benefits

The story has evolved quickly. At the time of writing, there has been emergency licence approval for three COVID-19 vaccines from Pfizer*/BioNTech*, Moderna*, AstraZeneca*/Oxford University. More than 100 other companies were working on vaccines but many of those may now pull their efforts as human trials will becoming increasingly hard to complete. The vaccines are being rolled out at cost or at minimal profit, and thus may not be the payday for pharmaceutical and biotech companies some expected. Perhaps the benefit for the manufacturers, whether they reached the finishing line or not, will be enjoyed longer term through new vaccine platforms and R&D facilities.

The sector also finished 2020 with several COVID-19 drug therapies in use for hospitalised patients, including authorised antibody therapies from Eli Lilly*, Gilead Sciences* and Regeneron*.

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Better Prospects Following COVID-19

While health care activity has not suffered during the crisis as much as other parts of the economy, there was a negative impact.

As the health care system approaches more normal operations, we can hope to see:

- A resumption of elective surgery and treatments with benefit throughout the equipment and services supply chains.
- Some continued growth in new telemedicine and telehealth.
- R&D activity outside of COVID-19 can resume.
- Good news expected in therapeutic areas of Alzheimers, Huntington's disease and immuno-oncology from some of the largest names (e.g. Roche*, Sanofi*).
- All pharmaceutical majors (comprising c. 40% of the sector), except for Bayer*, are forecast to grow annual sales and margins. The fastest revenue growth is expected from AstraZeneca*, with its high-margin cancer drugs and other treatments.

However, we remain aware of pricing headwinds in many regions, caused by new competition or centralised buying programs, which could affect large drugmaker sales by 1–5%, according to Bloomberg Finance. And while the US does not have a large Democrat House majority, which may have challenged the status quo in Health Care, we have seen increasing bipartisan and public support for measures to control drug prices.

Regional Choice

The sector looks relatively attractive on valuation in all regions, with approximately a 20% discount on P/E compared with the long-term premium rating to the market. While the US sector has more of the higher growth companies, including those in the biotech industry, it does have more political risk on pricing. Meanwhile, Europe has a larger underweight positioning of institutional investors.

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Implementing Sector Investing

Sector index metrics to help investors compare sectors.

Sector Index Metrics

	Fundamental Growth Forecasts & Valuations								
	Est. 2yr EPS Growth (% p.a.)*	3mth Change to 1yr EPS Growth Forecast (%)	Forward P/E**	Forward Relative P/B**	Relative CAPE	Relative CAPE (10yr Avg)	ROE (%)	Debt/ Equity (%)	12mth Div. Yield (%)***
MSCI World Sector Indices									
MSCI World Index	**6.8**	**4.9**	**20.3**	**–**	**–**	**–**	**9.5**	**148**	**1.86**
Comm. Services	10.8	4.5	21.3	1.12	1.48	1.42	10.3	102	1.37
Consumer Disc.	9.1	14.2	26.5	1.52	1.31	1.15	-0.8	135	0.87
Consumer Staples	7.3	3.1	19.9	1.47	0.99	1.13	20.9	107	2.68
Energy	-5.7	-27.5	20.6	0.42	0.33	0.55	-2.8	73	5.80
Financials	2.5	8.2	13.0	0.40	0.56	0.60	4.1	246	2.93
Health Care	13.5	3.9	17.4	1.45	1.24	1.12	26.7	86	1.73
Industrials	3.6	-3.3	22.1	1.16	1.02	1.09	4.9	111	1.65
Materials	11.5	10.5	17.6	0.79	0.91	0.95	9.2	62	2.51
Real Estate	-4.2	-1.9	26.2	0.50	0.99	1.23	4.6	86	3.24
Technology	12.0	6.4	28.0	2.95	1.68	1.30	60.3	75	0.87
Utilities	5.3	1.0	17.5	0.67	0.88	0.93	10.8	143	3.56
US S&P Select Sector Indices									
S&P 500 Index	**8.1**	**5.5**	**22.1**	**–**	**–**	**–**	**21.3**	**122**	**1.54**
Comm. Services	14.6	6.5	22.0	0.91	1.33	1.50	15.1	93	0.86
Consumer Disc.	6.5	15.8	30.7	2.52	1.57	1.19	-26.7	261	0.78
Consumer Staples	7.6	3.6	20.3	1.47	0.79	0.93	32.6	136	2.68
Energy	-8.8	13.9	31.5	0.35	0.28	0.62	-1.3	63	5.91
Financials	3.5	8.6	14.8	0.34	0.55	0.56	6.6	147	2.11
Health Care	13.1	5.2	16.3	1.06	1.00	1.01	29.4	93	1.59
Industrials	5.5	-0.2	23.7	1.25	0.85	0.97	5.8	163	1.56
Materials	13.4	7.5	21.0	0.74	0.90	1.01	8.6	73	1.80
Real Estate	-9.2	-1.2	47.7	0.43	1.35	1.74	6.0	123	3.01
Technology	14.1	7.7	26.3	2.45	1.22	1.03	64.4	86	0.95
Utilities	6.6	0.0	18.7	0.53	1.35	1.74	10.7	144	3.26
MSCI Europe Sector Indices									
MSCI Europe Index	**0.5**	**-0.3**	**17.0**	**–**	**–**	**–**	**3.4**	**196**	**2.74**
Comm. Services	-1.0	-2.5	14.7	0.76	0.72	0.86	5.0	156	4.04
Consumer Disc.	0.7	-1.4	19.9	1.21	1.18	1.48	6.1	117	1.12
Consumer Staples	1.5	-0.7	18.6	1.70	1.15	1.39	16.1	98	2.88
Energy	-5.4	-21.4	14.4	0.50	0.46	0.64	-4.0	79	5.66
Financials	-2.9	5.5	11.4	0.43	0.65	0.62	2.6	346	3.72
Health Care	7.2	-3.1	16.9	2.00	1.24	1.24	26.4	76	2.67
Industrials	0.8	-9.5	22.0	1.83	1.51	1.46	-2.5	127	1.94
Materials	4.0	8.3	16.5	1.13	1.16	1.13	6.3	62	3.15
Real Estate	-5.4	-1.9	18.0	0.56	1.00	1.12	5.2	87	3.30
Technology	6.1	3.2	29.4	2.71	3.94	3.33	12.2	69	0.88
Utilities	5.0	-1.0	17.2	1.02	1.04	0.73	11.4	141	4.13

Source: State Street Global Advisors, FactSet, Bloomberg Finance L.P., Morningstar, as of 31 December 2020. 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	**0.11**	**0.27**	**0.75**	**1.00**	**18.53**	–
Comm. Services	0.10	0.23	0.76	0.85	17.64	0.92
Consumer Disc.	0.13	0.31	0.95	1.14	22.26	0.97
Consumer Staples	0.04	0.14	0.39	0.57	12.71	0.86
Energy	0.21	0.50	1.15	1.55	33.39	0.88
Financials	0.18	0.34	0.95	1.18	23.84	0.94
Health Care	0.06	0.14	0.45	0.70	15.53	0.85
Industrials	0.14	0.32	0.83	1.11	21.79	0.97
Materials	0.13	0.30	0.77	1.05	21.19	0.95
Real Estate	0.04	0.23	0.51	0.75	17.18	0.83
Technology	0.11	0.29	0.78	1.04	21.41	0.93
Utilities	0.03	0.14	0.26	0.45	12.94	0.66
US S&P Select Sector Indices						
S&P 500 Index	**0.11**	**0.26**	**0.76**	**1.00**	**18.79**	–
Commun. Services	0.12	0.29	0.84	0.99	20.84	0.92
Consumer Disc.	0.12	0.30	0.89	1.11	22.37	0.96
Consumer Staples	0.05	0.13	0.44	0.61	14.27	0.82
Energy	0.24	0.57	1.36	1.77	39.70	0.86
Financials	0.18	0.32	0.93	1.14	23.90	0.93
Health Care	0.07	0.13	0.51	0.72	16.49	0.85
Industrials	0.15	0.32	0.89	1.15	23.59	0.94
Materials	0.12	0.28	0.73	1.03	21.34	0.93
Real Estate	0.01	0.19	0.37	0.63	16.56	0.74
Technology	0.11	0.28	0.79	1.03	21.37	0.93
Utilities	0.02	0.10	0.18	0.33	13.93	0.45
MSCI Europe Sector Indices						
MSCI Europe Index	**0.12**	**0.29**	**0.69**	**1.00**	**19.48**	–
Comm. Services	0.11	0.23	0.63	0.83	19.80	0.84
Consumer Disc.	0.17	0.37	0.93	1.17	24.37	0.96
Consumer Staples	0.02	0.15	0.36	0.57	13.67	0.83
Energy	0.18	0.39	0.82	1.28	30.95	0.83
Financials	0.21	0.41	1.06	1.39	29.33	0.95
Health Care	0.02	0.12	0.28	0.55	14.08	0.78
Industrials	0.15	0.37	0.87	1.15	23.71	0.97
Materials	0.14	0.34	0.76	1.06	22.58	0.94
Real Estate	0.10	0.35	0.77	0.99	23.24	0.86
Technology	0.11	0.34	0.68	1.04	22.60	0.92
Utilities	0.03	0.25	0.39	0.75	18.84	0.80

Source: State Street Global Advisors, FactSet, Bloomberg Finance L.P., Morningstar, as of 31 December 2020. 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.

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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]

Access to 15% of World's Tradeable Securities[2] As part of State Street, we have access to information gleaned from our large global custody business. By aggregating $20 trillion of equity assets, we can observe behavioural trends of this important investor constituent. 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 30 September 2020.

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ID382856-1990314.51.1.GBL.INST 0121
Exp. Date: 30/04/2021