

# Sector & Equity Compass

Hoping for  
a One-Way  
Road to  
Recovery

## Q2 2021

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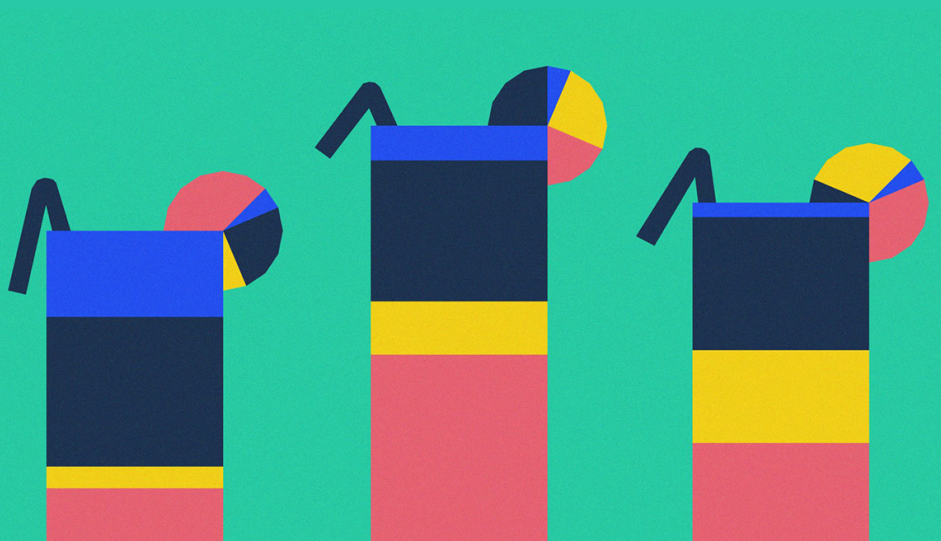
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# Themes and Outlook

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

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## Reopening, recovery and reflation continue

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Most countries have started on the road to recovery, with economies opening and people regaining mobility freedoms. Disappointment may arrive in the form of vaccination supply issues or new COVID variants, but hopefully any letdowns take the form of speed bumps and the direction of travel remains one-way. Our Sector Picks reflect that the themes we adopted last quarter, of reopening and recovery and the associated rotation of sectors, are largely unchanged.

This quarter, we have extended this publication to include broader equity flow information, using the same unique data set and insights that we utilise for sector strategy.

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### Performance Dispersion Creating Opportunities

Significant dispersion between the returns of each sector has continued to create major investment opportunities for those investing in sectors on a three to six-month basis. Sector investing has proven a favoured means of profiting from the current environment, but different geographical exposures and smart beta factors could also be used to play current market themes.

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### Reasons for Rotation to Continue

Equity markets have seen a sizeable rotation since the start of November 2020 but we believe there are reasons for the risk-on trade to continue. Not least among the support is large underweight positioning in some sectors seeing large investor flows. Institutional investor positioning data, courtesy of the State Street global custody business (see page 10) shows heavy underweight positions on average in Energy across all regions, contrasted with large overweight positions in Information Technology stocks.

There also continues to be a large valuation dispersion between growth sectors such as Tech and Communication Services, home to most of the FAANG stocks, and value sectors such as Financials. This dispersion was reinforced by surprisingly positive Q4 2020 results and the direction of earnings forecasts since then, with cyclical and value sectors enjoying much higher upgrades helped by the uplift in GDP estimates for 2021. These newly revived sectors now have momentum behind them and thus could become a 'pain trade' for investors left behind.

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## Inflation

CPI forecasts for 2021 are being driven up by a combination of supply factors, such as the supply chain dislocation caused by COVID lockdowns and commodity pricing, and demand factors as a consequence of an expected bounce-back in consumer spending. This is more the case in the US than in Europe.

Given the impact of eroding pricing power, spending (retail or capex) is often pulled forward ahead of expected periods of higher inflation. This could positively affect sellers of goods and services but, in some cases, the benefits will be negated by higher input costs. Thus the net result by sector is determined by a combination of factors such as elasticity of demand or availability of product.

To learn more about inflation and the impact on sectors, please read our recent Insights article, **5 Sectors that Could Benefit or Suffer from Inflation**.

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## Varied Opportunities: US vs. Europe

There are risks to the rosy scenario painted, not just from roadblocks to recovery but around expectations and the risk of disappointment if companies do not deliver improved results with their Q1 2021 reports. Europe is cheaper, less well owned, more tilted to the value style and exports, but the vaccination race has not been won yet, new lockdowns will push domestic recovery into Q3 2021 and fiscal response lags behind the US.

Going into results season, US companies are better placed to report near-term uplift particularly in response to consumer spending, but equally have higher expectations. European stocks and sectors may look more interesting thereafter given the much lower expectations, which have resulted from less stimulus and a slower vaccine roll-out. Despite lacking a sharp pickup in domestic manufacturing or services demand this quarter, many of the sectors with large international exposure could benefit from US or Chinese orders.

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## Recognising the Climate Change Agenda

We are now just seven months away from COP26, which will have an impact across financial markets. Although sectors do not neatly sit along good/bad ESG lines (apart from Energy), it is worth noting where some of the clean energy and sustainable solutions themes fit and in which regions. Although China has monopolised many of the battery and other renewable energy solutions, there are European, Japanese and US trailblazers in some of the new growth areas.

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## 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
<b>Financials</b>	✓	✓	
<b>Materials</b>	✓	✓	✓
<b>Industrials</b>	✓	✓	✓
<b>Consumer Discretionary</b>			✓

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# Performance and ETF Flows — Sectors

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**Regional sector performance highlighting dispersion between top and bottom performance. Flows into sector ETFs split between US and European domicile, worth more than \$855 billion in AUM.\***

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\* Source: Morningstar, as of 31 March 2021.

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## Sector Performance

“Reopening, Recovery, Rotation” was the title of the SPDR Sector Compass for Q1 and these factors indeed dominated, with value sectors relatively outperforming growth sectors. Performance dispersion remained high on both a three-month and six-month basis.

Inflation came into focus, and sectors that benefit from higher commodity prices stood out, as seen with Energy and Materials. Sensitivity to interest rates was also important last quarter. Long-duration sectors suffered, such as Technology, which is expected to generate higher cash flows in the future. Meanwhile, the Financials sector posted outperformance, where banks benefitted from higher bond yields and a steepening curve.

After a surprisingly positive Q4 2020 results season, earnings growth revision trends became very important. This helped Energy as well as cyclical sectors, including Industrials and Materials, to produce higher returns than defensive sectors.

World Sectors				US Sectors				Europe Sectors			
Q1 2021 (%)		Q4 2020 (%)		Q1 2021 (%)		Q4 2020 (%)		Q1 2021 (%)		Q4 2020 (%)	
Energy	21.8	26.7	Energy	Energy	30.2	27.7	Energy	Energy	15.1	27.1	Energy
Financials	13.2	24.0	Financials	Financials	15.8	23.0	Financials	Financials	14.2	22.9	Financials
Industrials	7.8	16.2	Cons Discret	Industrials	11.3	15.5	Industrials	Materials	11.4	19.3	Cons Discret
Comm Services	6.8	15.8	Materials	Materials	8.9	14.3	Materials	Cons Discret	11.3	14.4	Real Estate
Real Estate	6.0	15.6	Comm Services	Real Estate	8.8	13.8	Comm Services	Technology	10.9	13.0	Materials
Materials	5.7	15.3	Industrials	Comm Services	8.7	12.0	S&P500 NR	Comm Services	10.4	12.5	Industrials
MSCI World NR	4.9	14.0	MSCI World NR	S&P500 NR	6.1	11.7	Technology	Industrials	10.4	11.4	Utilities
Cons Discret	3.6	12.9	Technology	Cons Discret	4.6	9.6	Cons Discret	MSCI Europe NR	8.4	10.9	Comm Services
Technology	1.4	9.3	Utilities	Health Care	3.0	7.9	Health Care	Cons Staples	2.2	10.8	MSCI Europe NR
Health Care	0.7	8.6	Real Estate	Utilities	2.5	6.3	Utilities	Health Care	1.8	7.7	Technology
Utilities	0.5	6.8	Health Care	Technology	2.1	5.9	Cons Staples	Utilities	0.0	1.4	Cons Staples
Cons Staples	-0.6	6.4	Cons Staples	Cons Staples	1.4	4.8	Real Estate	Real Estate	-2.2	-2.1	Health Care

Source: State Street Global Advisors, Bloomberg Finance L.P., as of 31 March 2021. 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

Sector ETFs saw significant net inflows in Q1 2021 as investors used the vehicle to access wide sector dispersion and recovery plays. The difference in flows between cyclical and defensive sectors, as well as value versus growth flows, was extremely wide.

Throughout Q1 2021, Financials (mainly those based in the US and World) experienced the largest inflows in light of improving financial conditions for banks and a healthy outlook for insurers and other financial services providers. Energy flows responded positively to the rise in crude oil prices, which fed through to a significant increase in earnings forecasts.

There were outflows from more defensive sectors, particularly Consumer Staples, as investors rotated into other sectors. But overall, most flows came from new assets moving into sector investing rather than flows between sectors.

	US-Domiciled (\$mn)		European-Domiciled (\$mn)	
	Q1 2021	Q4 2020	Q1 2021	Q4 2020
Communication Services	-82	797	178	-40
Consumer Discretionary	2,986	2,117	209	672
Consumer Staples	-3,176	-1,285	-144	-651
Energy	9,506	3,139	2,994	457
Financials	15,507	5,206	4,484	2,719
Health Care	-1,871	1160	345	-395
Industrials	5,005	3,748	476	701
Materials	2,314	3,431	667	275
Real Estate	2,507	3,279	-133	-85
Technology	1,627	1,398	1,531	1,211
Utilities	-114	-76	447	99

Source: Bloomberg Finance L.P., State Street Global Advisors, as of 31 March 2021. 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 — Sectors

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**The direction of flows and relative positioning of institutional sector flows, referencing \$39 trillion of financial assets under custody.\***

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\* Source: State Street, as of 31 December 2020.

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# Flows Overview: World, US and Europe

Rotation into Energy, from large underweight positioning, was the standout in all three regions featured. The active flows chart reveals that this was at its peak in relative terms at the end of January, which was when large earnings upgrades were seen. Relative flows into US and global Consumer Discretionary exposure reversed after Tesla entered the S&P 500 index in December 2020.

Utilities gained in popularity at the end of Q1 2021, particularly US Utilities, where investors have been underweight for a long period. Large inflows into Materials dissipated last month following price gains. We see investors still adding to miners but reducing exposure to chemical manufacturers, which make up the largest part of the sector.

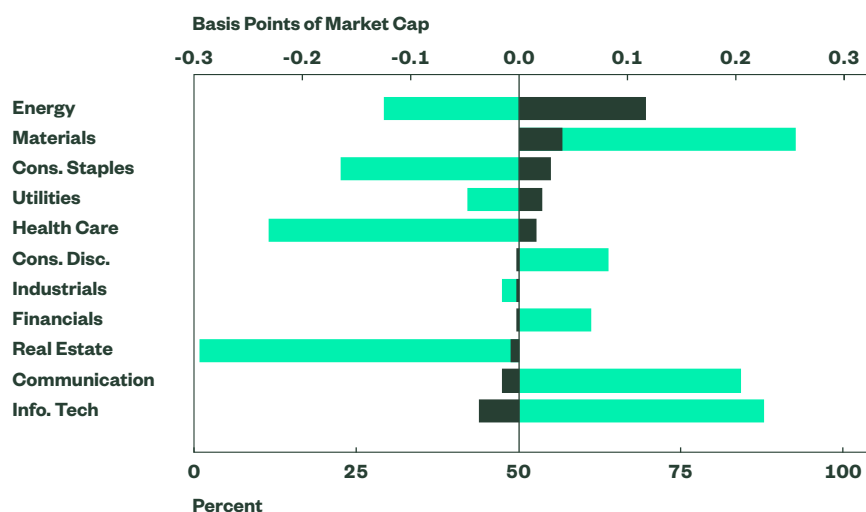
Flow trends are broadly similar across US and European stocks. However, there is a notable difference in Financials, with relative outflows from institutional investors in US Financials, which contrasts with high sector ETF inflows and institutional inflows into European Financials in February and March 2021.

Health Care remains very underweight in all three regions we cover here, partly due to concerns about future US policy. There were small additions to holdings in the past quarter, possibly after there were no immediate plans on health care provision or pricing announced by president Biden.

## World: Flows and Holdings

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

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

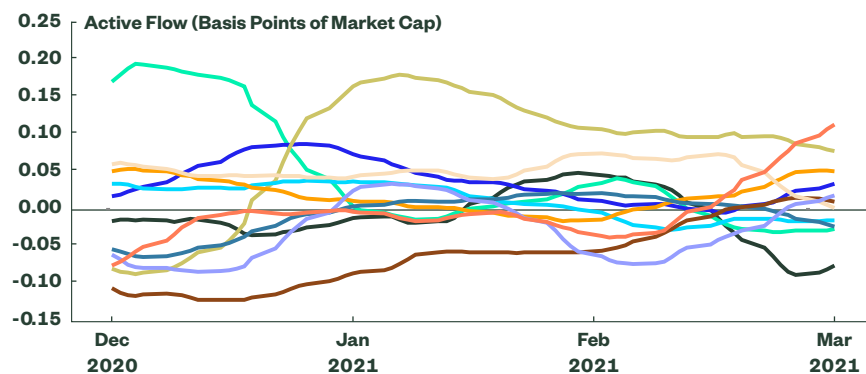


Source: State Street Global Markets. Data are as of 31 March 2021. Sectors flows are as of the date indicated, are subject to change, and should not be relied upon as current thereafter. This information should not be considered a recommendation to invest in a particular sector or to buy or sell any security shown. It is not known whether the sectors or securities shown will be profitable in the future.

## World: 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

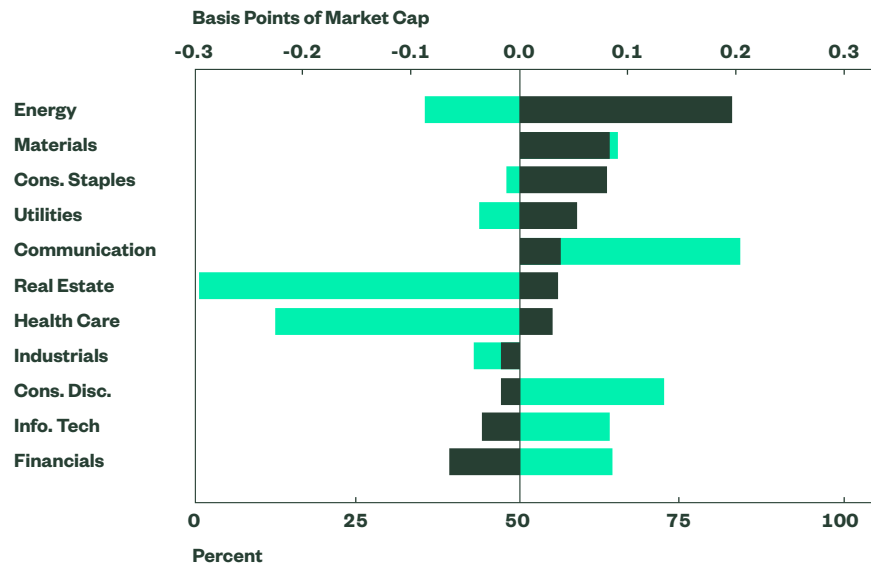


Source: State Street Global Markets. Data are as of 31 March 2021. Sectors flows are as of the date indicated, are subject to change, and should not be relied upon as current thereafter. The universes for the above charts are the MSCI ACWI. This information should not be considered a recommendation to 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)

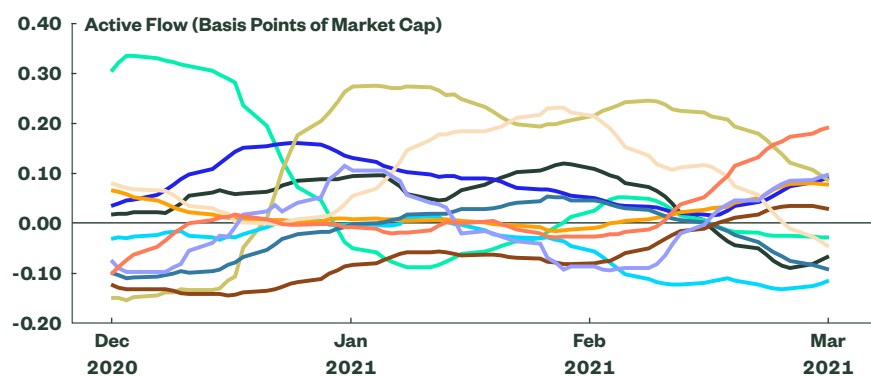


Source: State Street Global Markets. Data are as of 31 March 2021. Sectors flows are as of the date indicated, are subject to change, and should not be relied upon as current thereafter. This information should not be considered a recommendation to invest in a particular sector or to buy or sell any 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

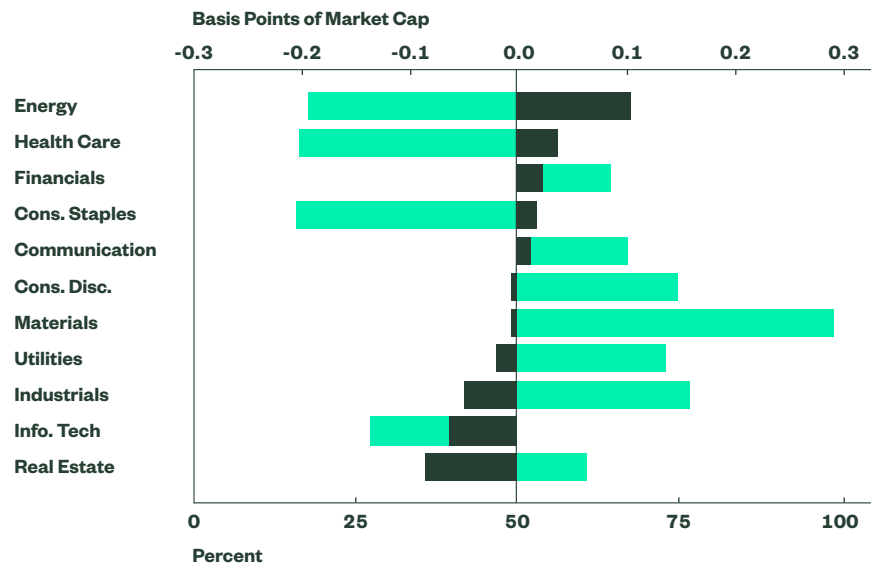


Source: State Street Global Markets. Data are as of 31 March 2021. Sectors flows are as of the date indicated, are subject to change, and should not be relied upon as current thereafter. The universes for the above charts are the MSCI US. This information should not be considered a recommendation to 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

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

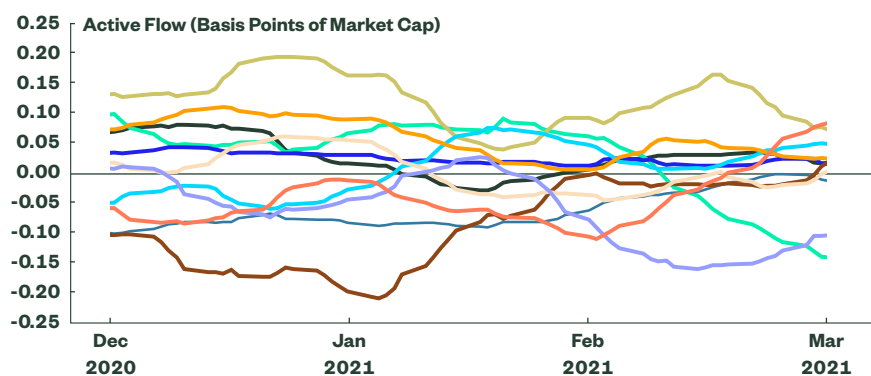


Source: State Street Global Markets. Data are as of 31 March 2021. Sectors flows are as of the date indicated, are subject to change, and should not be relied upon as current thereafter. This information should not be considered a recommendation to invest in a particular sector or to buy or sell any 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

■ 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 31 March 2021. 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.

# Sector Picks

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

## Financials

### Beneficiary of Value and Cyclical Themes

World	US	Europe
✓	✓	

#### Sticking with Financials

We made US Financials a Sector Pick in Q1 2021 based on its sensitivities to an improving macroeconomic outlook, including the outlook for rates, better business and consumer sentiment, lower credit risk and strong financial markets. Recently, the sector has benefitted from value and cyclical themes during the rotation. We believe that these factors will continue to drive the sector in the coming months. In terms of regional exposure, we prefer the US to Europe.

#### High Inflation Beta

Financials have a high sensitivity to inflation (see page 25). Rather than specific demand-pull or supply-push factors, this sensitivity comes mainly from what happens to interest rates historically during periods of faster rising prices.

The sector's high beta to bond yields (second only to Energy over the last 36 months, as shown in the chart on next page) is among the reasons why investors have added to their holdings via ETFs in Q1 2021. Figures on page 8 show that net inflows in Financial sector ETFs (including bank industry ETFs) were 50% higher than the next most popular sector.

We expect a continued bear steepening of the US Treasury yield curve, with the front end anchored by the Federal Reserve's reluctance to increase rates until employment has recovered. This stance is balanced against inflation risks from continued accommodative monetary policies plus fiscal stimulus and upbeat growth prospects, which are putting upward pressure on longer-term interest rates.

#### Higher and Steeper Yield Curve Tends to Benefit Whole Sector

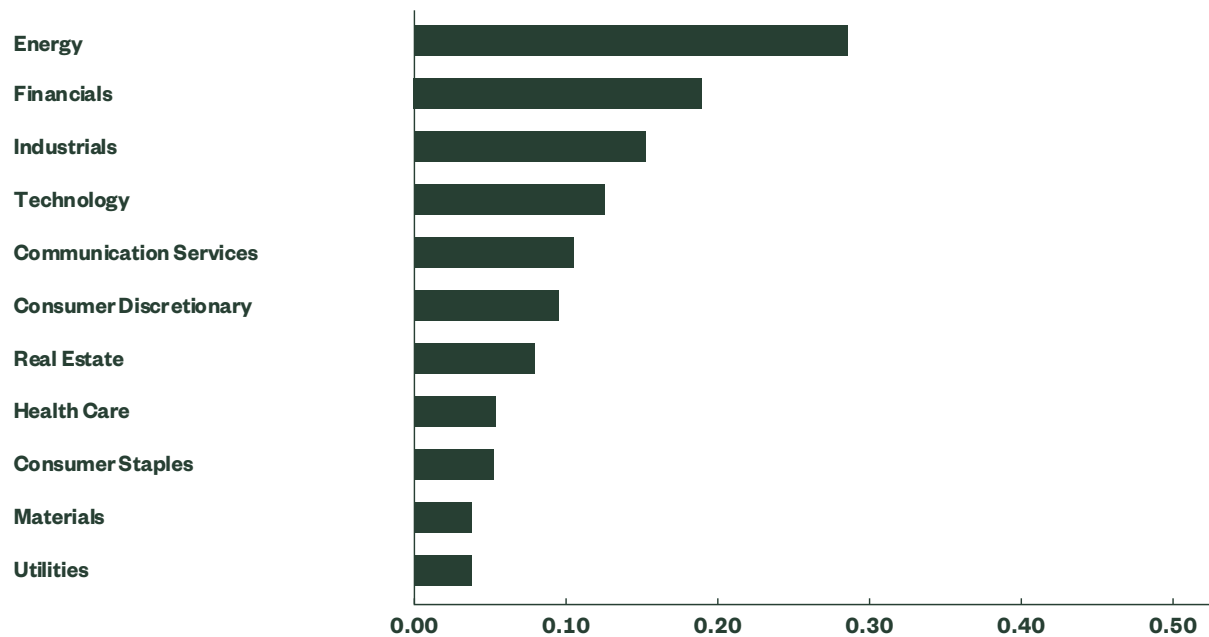
**Banks** (39% of US sector market cap). The impact of short versus long-term interest rates varies across the diversified and regional banks in the sector, depending on the shape of their balance sheet structures, loan mixes and funding profiles. Having fallen sharply last year, net interest income margins are expected to have stabilised in Q1 from the benefit of curve steepening, although low short-term interest rates are unhelpful.

Banks will be among the first US corporates to publish Q1 earnings results and comments on margins are key. Loan loss provisions will also be a focus and hopefully they come in much lower than at the depths of the COVID crisis, which may allow reserve releases and loan growth.

**Insurance** (17%). Higher rates are easing the drag on life insurers' portfolio returns. Again the sensitivity to rate changes depends on company-specific factors such as duration and account composition. Property and casualty insurance earnings are less levered to interest rates and demand tends to be less elastic. The good news for P&C is that premiums are expected to rise at a higher than average rate in 2021.

**Diversified Financials** (44%). This is a more amorphous industry group and higher bond yields may have more of an impact on earnings for investment banking and consumer finance operations compared with asset managers and financial exchanges.

### Sensitivity of US Sectors to US Bond Yields (over last 3 years)



Source: Bloomberg Finance L.P., as of 31 March 2021. The chart uses S&P Select sector Indices. Bond yield sensitivity measure is taken from US Government 10-Year Yield. Past performance is not a reliable indicator of future performance.

### Relatively Attractive Fundamentals

Rising yields tend to augur greater economic growth, into which banks are geared via expanding loan books and which helps across financial markets. Earnings sentiment for Financials was second only to Energy in Q1, having received upgrades after positive surprises from Q4 earnings announcements as well as the improving US GDP growth outlook since then. We expect to see continued good news and upgrades in coming months.

The other helpful factor in the quarter ahead will be higher distributions allowed by the banks' stronger capital bases. The sector has been a significant source for share buybacks historically.

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

# Materials

## Favoured Sector Play for Commodity Supercycle

World	US	Europe
✓	✓	✓

### Inflation and Commodities

While Energy is often seen as the obvious choice for investors wanting to access commodity inflation, we believe the supply situation for crude oil is at a precarious position versus the much tighter supply situation for most industrial metals. Prices of these metals (including zinc, iron ore, aluminium, lead and copper) have risen sharply since the second half of 2020 on the back of demand prospects and restrained supply. Over the longer term, the intensifying environmental issues could continue to haunt Energy, making it less attractive than Materials as an overall investment choice.

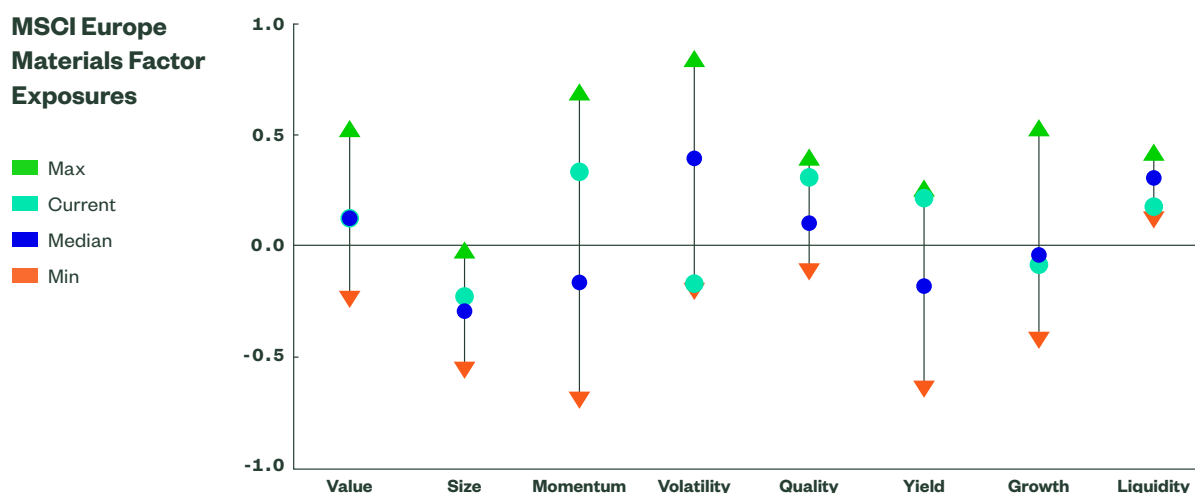
### Metals for Reopening

Industrial metals, supplied by the sector's mining operations, have a stronger relationship with GDP growth (as measured by PMIs) than most other commodities, including crude oil, gas, gold and agricultural commodities. We have seen a metals-heavy economic recovery thus far, both in China and elsewhere, spanning consumer goods, construction, machinery, autos and electronics activity.

There is particularly strong demand for copper, which feeds many of these processes as well as the use of copper electrical wire during transition to renewable sources. Combined with low stockpiles caused by interruption to mining activities last year, copper's spot price is trading at the highest level for nearly 10 years, according to Bloomberg Finance L.P. Greenfield projects are not expected to correct the demand-supply imbalance for several years.

As with Industrials, many of the Materials sector outputs would be used during proposed infrastructure programs, including building materials, iron and steel.

### MSCI Europe Materials Factor Exposures



Source: MSCI Indices, 10 years to 31 December 2020.



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## Chemicals for Reopening

Chemical manufacturers saw disruption during the COVID crisis and related shutdowns, but are well-placed to prosper in recovery. There are four main chemical sub-industries:

**Speciality Chemicals** is the largest, with products used in solvents, dispersants and catalysts by manufacturers. Growth products include electronic chemicals used in semiconductors and industrial coatings employed for functional or environmental use, and could be boosted by autos this year.

**Industrial Gas** applications for the production and refining of oil and gas should benefit from better outlooks for their customers.

**Basic Chemicals** face a mixed outlook. Non-durables use (e.g. in household cleaning products and toiletries) was steady through lockdowns, with recovery hoped for in consumer durables such as autos and domestic appliances.

**Agricultural Chemicals** include fertilisers and pesticides. The outlook is helped by positive crop pricing.

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## Preference for Europe Versus the US

The macro-level drivers are compelling across regions, but so far in 2021 we have favoured Europe and World Materials over the US for their higher weighting to mining and speciality chemicals. International aspects are important: Europe Materials has the second-highest international revenues of any European sector, with over one third of sales in emerging markets, mainly China. In addition to European and US constituents, World Materials contains leading companies based in Australia, Canada and Japan.

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## Delivering Climate Change Solutions

The sector touches the green revolution in several ways. Most obvious is the production of copper, which is used in electronics and automobiles. The typical electric vehicle (EV) contains 83 kilos of copper (e.g. for high voltage wiring, rotors), which is four times a typical internal combustion car. Among speciality chemicals involved in EV and battery production is lithium. China has a significant lead in battery technology but there are major efforts in Europe to introduce domestic production. Within chemicals, the US and French gas companies Linde and Air Liquide are considered environmental leaders.\* These companies produce hydrogen, which is being lauded as a renewable energy source for power plants and industrial applications.

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

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## Industrials

### Building Back

World	US	Europe
✓	✓	✓

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### Reopening Boost

Our belief in Industrials for Q1 was driven by expectation of recovery in capital expenditure by corporates, infrastructure projects and Chinese demand. There has been progress in most of these areas. At an industry level, we believed the outlook for machinery orders (particularly driven by residential construction and mining) and electrical equipment (important to power generation and industrial automation) would thrive alongside transportation and logistics recovery, but that other parts of the sector may not recover in such a straightforward manner.

In Q2, we expect recovery to be more widespread. Among the factors to watch at a sector level are a boost from reopening, inflation beneficiaries and infrastructure bills.

The latest data releases confirm that the recovery is on track. UK and eurozone preliminary PMIs surprised to the upside, and together with China, the US and Japan, all Manufacturing PMIs are running over 50. In this scenario we can expect continued growth among machinery, electrical equipment and transportation, but may also see it from the industries that were harder hit, such as those supplying oil and gas operations and aerospace picking up.

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### Inflation Beneficiary

Given the sector's diverse grouping of manufacturers, engineers and consultancies, it is not easy to generalise, but it is fair to say that most benefit from cyclical trends at this stage of economic recovery. Industrials tends to show a high inflation beta but without experiencing the high volatility of some other sectors, such as Energy.

The price components of the latest US PMI figures signal intensifying inflationary pressures, with manufacturers suffering from input price increases (close to four-year highs) as well as benefiting from the output price measure at its highest level since January 2017. Again, it is important to watch the ability of different industries in passing on cost increases.

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### Infrastructure Bills

Excitement over Biden's proposals for a possible \$2 billion+ infrastructure and clean energy plan is important for the sector. The most likely projects that we would see first are those that are shovel-ready and local and often carried out by Industrials companies.

A large amount of proposals fit in the sustainable transport infrastructure space, which would undoubtedly need engineering capacity and know-how as well as construction capability to realise ambitions. Key among US proposals is the transformation of energy sources that power transportation, involving commuter trains, school and transit buses, and passenger vehicles. The huge sums of investment into roads, bridges, ports, etc. will need machinery, consultancy and transportation expertise, all offered by this sector.

While the current headlines are focused on US infrastructure plans, there is also the four-year €750 million COVID recovery fund pledged by the European Council, which intends to help develop green options, such as building renovation, across the European Union.

## Selection of proposals from Biden that could be included in an American Jobs Plan and Industrial sub-industries

Policy	Potential Proposals	Industries involved
Transport/ Sustainable Infrastructure	<ul style="list-style-type: none"> <li>• Modernisation of highways, roads and bridges</li> <li>• Expansion of the passenger rail network and rapid bus transit</li> <li>• Support of EV supply chain</li> <li>• Electrify public transportation sector</li> <li>• Dredging of harbors and inland waterways</li> </ul>	Transportation Infrastructure Construction & Engineering Road & Rail Commercial Services Machinery Electrical equipment
Commercial Building & Home Upgrades	<ul style="list-style-type: none"> <li>• Retrofit 2 million homes and commercial buildings</li> <li>• Build 1.5 million new sustainable homes</li> <li>• Modernise schools &amp; hospitals</li> </ul>	Building Products Construction & Engineering Electrical equipment
Protect environment & communities from climate change	<ul style="list-style-type: none"> <li>• Protect against flooding</li> <li>• Invest in water efficiency and recycling program</li> </ul>	Building Products Environmental & Facilities Services
Power infrastructure	<ul style="list-style-type: none"> <li>• Build more resilient electric transmission system</li> <li>• Cap orphan oil &amp; gas wells</li> <li>• Retrofits and installations to decarbonise industry</li> </ul>	Construction Machinery Commercial machinery

Source: State Street Global Advisors, White House statement, as of 31 March 2021. The above list is not exhaustive.

## Delivering Climate Change Solutions

Adapting to tougher legislation and standards will be disruptive across Industrials companies. However, the sector does contain some promising technologies and processes to help tackle climate change. The heavyweights in this area include GE, Honeywell and Siemens, which are all involved in energy efficiency, along with ABB, WEG and Schneider in smart grid and clean energy storage solutions.\* On the retrofitting of buildings, Kingspan, Saint-Gobain and Owens Corning all offer products for building efficiency.\*

European companies have an advantage when it comes to climate change solutions and thus makes a case for European Industrials for the long term. In terms of shorter-term macroeconomic drivers, the US looks better placed.

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

# Consumer Discretionary

## The Luxury of Reopening

World	US	Europe
		✓

### Reopening Means a Lot to this Sector

The four industry groups in the Consumer Discretionary sector have all struggled during the COVID pandemic. These groupings can now look forward to better times as mobility returns and visibility improves for employment and wages. Below we assess the landscape and key drivers in each industry grouping.

**Consumer Durables and Apparel.** This industry grouping has produced significant outperformance over the past two decades, with investors attracted to strong sales growth and pricing power of global luxury brands. The luxury goods manufacturers are largely French and Swiss listings, but trade internationally and are often considered as exposure to Chinese consumers.

While the international nature of the brands has been helpful, shutdowns hit traffic to most stores and outlets at airports worldwide. Recent company statements have indicated recovering momentum, helped by Chinese and Asian markets in particular.

**Automobiles.** This grouping is one of the most cyclical across equity markets. Auto and component manufacturers suffered a significant fall in sales during lockdowns, with share prices reacting quickly. On the initial bounce-back in demand, auto manufacturers have been caught in the COVID-disrupted supply chain for electronics manufacture because of their lean manufacturing process, resulting in a struggle for supply of microprocessors against phone, game and computer suppliers.

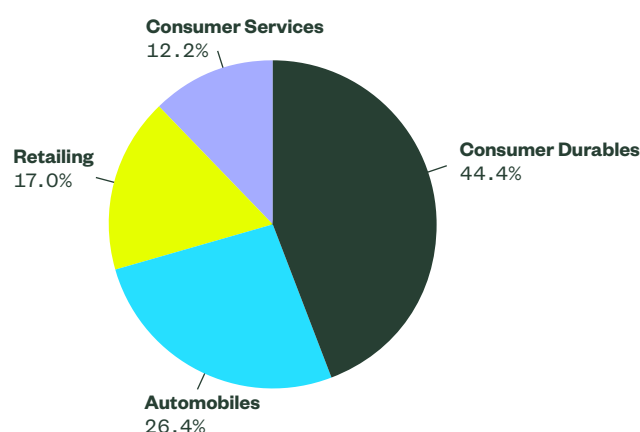
Auto orders in March 2021 showed recovery from depressed sales a year before; comparisons remain soft for some months. Going forward, of particular interest is the split between electric and diesel vehicles. The recent rerating of European autos suggests they are attracting a green premium.

**Retailing.** The grouping contains a mix of digital and high street retailers as well as newer food delivery companies. Most of the quoted retailers have an online presence, but stores reopening would likely still drive a significant boost to sales. Retail sales in Europe could benefit from a high level of pent-up demand. Nevertheless, as a discretionary category with rising staff and input costs, there could be margin pressure, along with the necessity to permanently close some stores.

Retail sales in Europe could benefit from a high level of pent-up demand. Nevertheless, as a discretionary category with rising staff and input costs, there could be margin pressure, along with the necessity to permanently close some stores.

**Consumer Services.** This grouping of contract caterers, hotels, restaurants and casinos has faced acute headwinds from the COVID crisis in terms of physical mobility and low consumer confidence. A recovery in travel and tourism would directly benefit hotel operators in particular. A return of business spending would also help travel businesses and contract catering operations. This is one of the few parts of the equity market still trading at lower levels than the start of 2021.

### MSCI Europe Consumer Discretionary by Industry



Source: Bloomberg Finance L.P., as of 31 March 2021. Sector breakdown is as of the date indicated and should not be relied upon as current thereafter.

## Varied Opportunity in Europe Versus US

Consumer Discretionary is a great example of how different stock composition by region changes the prospects for the sector. In the US (and World), the sector is dominated by Amazon, which accounts for 32% of US sector market cap and significantly more of index performance over recent years.\* Tesla, at 12% of the US sector, entered the S&P 500 index in December 2020 and is another outsized contributor to performance, volatility and valuation.\*

By contrast, the European sector is more diversified by stock, with LVMH the largest stock (15% of market cap) and luxury goods stocks account for a much larger proportion of the sector.\*

Another strength for Europe Consumer Discretionary is the lower reliance on domestic economies than most European sectors. As mentioned earlier, it is particularly relevant for Chinese exposure given Chinese consumers represent approximately one third of global luxury sales, most of which is earned offshore, for example in Hong Kong, Japan and South Korea, hence the importance of travel and tourism.

## Delivering Climate Change Solutions

European automakers' technological credentials had been largely ignored until last year, with Tesla capturing the most news flow and sales. The electric vehicle roll-out planned by VW, Renault and Porsche was delayed by COVID disruptions and slashed cap ex, but there is undoubtedly more focus now.\* Recent statements by VW and Mercedes on reaching carbon-neutrality represent a huge task given their substantial Scope 1 and 2 emissions today. While not at the scale of Tesla, there should be a premium rating courtesy of their growing EV platforms along with European government incentives and infrastructure plans.

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

# Implementing Sector Investing

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**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 (%)***
<b>MSCI World Sector Indices</b>									
<b>MSCI World Index</b>	<b>19.5</b>	<b>16.1</b>	<b>–</b>	<b>18.6</b>	<b>–</b>	<b>–</b>	<b>13.7</b>	<b>141</b>	<b>1.91</b>
Comm. Services	13.1	12.0	1.14	19.7	1.54	1.43	10.6	105	1.28
Consumer Disc.	42.9	39.0	1.49	22.6	1.29	1.16	11.0	128	1.03
Consumer Staples	6.6	4.5	1.43	19.0	0.92	1.13	21.7	102	2.73
Energy	291.7	222.2	0.50	13.4	0.37	0.54	8.5	77	4.60
Financials	19.8	20.5	0.42	12.4	0.59	0.60	6.4	229	2.93
Health Care	9.2	7.4	1.39	16.4	1.16	1.13	26.3	84	1.80
Industrials	33.9	17.6	1.25	20.9	1.05	1.09	10.5	106	1.65
Materials	23.6	29.4	0.79	15.7	0.89	0.93	16.8	57	3.07
Real Estate	8.2	0.5	0.54	26.7	1.02	1.23	5.1	86	3.09
Technology	11.4	9.0	2.74	25.9	1.65	1.31	66.1	69	0.89
Utilities	4.1	1.8	0.64	17.1	0.84	0.93	11.4	144	3.64
<b>US S&amp;P Select Sector Indices</b>									
<b>S&amp;P 500 Index</b>	<b>19.7</b>	<b>14.7</b>	<b>–</b>	<b>19.9</b>	<b>–</b>	<b>–</b>	<b>33.3</b>	<b>120</b>	<b>1.50</b>
Comm. Services	18.5	13.8	0.93	19.8	1.35	1.50	16.0	97	0.86
Consumer Disc.	37.1	18.9	2.39	26.0	1.54	1.20	19.8	248	0.80
Consumer Staples	5.7	3.4	1.39	19.6	0.74	0.92	31.9	124	2.68
Energy	n.a.	n.a.	0.43	16.3	0.33	0.60	8.0	71	4.41
Financials	23.0	23.3	0.37	13.8	0.66	0.57	14.9	140	1.85
Health Care	9.4	8.8	1.04	15.5	0.93	1.02	29.3	93	1.68
Industrials	50.9	32.0	1.40	20.6	0.90	0.97	12.6	159	1.49
Materials	24.5	25.8	0.75	19.0	0.91	1.00	14.2	71	1.88
Real Estate	6.8	-2.9	0.43	47.2	1.45	1.74	5.9	124	2.83
Technology	10.8	9.6	2.25	24.4	1.18	1.03	71.8	79	0.95
Utilities	5.1	2.4	0.50	18.2	1.45	1.74	11.0	145	3.25
<b>MSCI Europe Sector Indices</b>									
<b>MSCI Europe Index</b>	<b>26.6</b>	<b>21.4</b>	<b>–</b>	<b>15.3</b>	<b>–</b>	<b>–</b>	<b>7.6</b>	<b>176</b>	<b>3.01</b>
Comm. Services	11.6	6.9	0.76	14.8	0.73	0.85	4.8	144	3.82
Consumer Disc.	87.9	86.5	1.22	16.9	1.24	1.48	12.6	111	1.79
Consumer Staples	8.0	3.7	1.68	17.8	1.07	1.38	17.6	91	2.99
Energy	172.5	173.6	0.58	9.7	0.48	0.62	8.8	77	4.61
Financials	24.0	23.1	0.44	10.4	0.69	0.63	5.8	304	4.44
Health Care	8.2	1.1	1.87	15.9	1.15	1.24	25.1	72	2.73
Industrials	43.6	26.9	1.96	20.5	1.56	1.46	17.7	114	2.07
Materials	26.4	35.0	1.12	14.8	1.15	1.12	17.1	55	3.98
Real Estate	3.8	-2.6	0.47	17.4	0.91	1.12	3.0	87	3.47
Technology	16.1	9.4	2.78	27.6	3.99	3.35	13.4	62	0.91
Utilities	9.1	5.6	0.98	16.0	0.96	0.73	12.4	138	4.45

Source: State Street Global Advisors, FactSet, Bloomberg Finance L.P., Morningstar, as of 31 March 2021. 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)
<b>MSCI World Sector Indices</b>						
<b>MSCI World Index</b>	<b>0.10</b>	<b>0.26</b>	<b>0.63</b>	<b>1.00</b>	<b>18.12</b>	<b>–</b>
Comm. Services	0.11	0.23	0.63	0.86	17.37	0.92
Consumer Disc.	0.11	0.29	0.82	1.13	21.70	0.97
Consumer Staples	0.04	0.11	0.38	0.57	12.84	0.83
Energy	0.24	0.51	0.93	1.59	34.34	0.86
Financials	0.19	0.35	0.77	1.20	24.13	0.92
Health Care	0.04	0.12	0.39	0.67	15.02	0.83
Industrials	0.14	0.30	0.71	1.13	21.71	0.97
Materials	0.12	0.29	0.64	1.05	20.70	0.95
Real Estate	0.06	0.21	0.47	0.77	16.88	0.85
Technology	0.08	0.28	0.64	1.04	20.95	0.92
Utilities	0.04	0.11	0.35	0.46	13.63	0.64
<b>US S&amp;P Select Sector Indices</b>						
<b>S&amp;P 500 Index</b>	<b>0.10</b>	<b>0.24</b>	<b>0.65</b>	<b>1.00</b>	<b>18.40</b>	<b>–</b>
Commun. Services	0.11	0.28	0.64	0.96	19.96	0.91
Consumer Disc.	0.10	0.28	0.77	1.10	21.68	0.96
Consumer Staples	0.05	0.11	0.43	0.61	14.46	0.80
Energy	0.29	0.59	1.07	1.81	41.38	0.83
Financials	0.19	0.33	0.75	1.17	24.43	0.90
Health Care	0.05	0.12	0.45	0.69	15.82	0.83
Industrials	0.15	0.31	0.77	1.18	24.07	0.93
Materials	0.13	0.27	0.64	1.04	21.21	0.93
Real Estate	0.04	0.18	0.39	0.67	16.16	0.78
Technology	0.08	0.26	0.66	1.02	20.93	0.93
Utilities	0.04	0.07	0.31	0.37	15.08	0.46
<b>MSCI Europe Sector Indices</b>						
<b>MSCI Europe Index</b>	<b>0.11</b>	<b>0.28</b>	<b>0.59</b>	<b>1.00</b>	<b>19.11</b>	<b>–</b>
Comm. Services	0.12	0.21	0.59	0.83	19.70	0.83
Consumer Disc.	0.17	0.36	0.79	1.18	24.23	0.96
Consumer Staples	0.03	0.12	0.38	0.56	13.86	0.80
Energy	0.18	0.39	0.64	1.30	31.30	0.82
Financials	0.21	0.41	0.83	1.41	29.49	0.94
Health Care	0.01	0.10	0.25	0.52	13.63	0.75
Industrials	0.14	0.35	0.76	1.15	23.35	0.97
Materials	0.14	0.33	0.61	1.05	22.07	0.94
Real Estate	0.09	0.31	0.71	1.00	22.77	0.86
Technology	0.10	0.32	0.58	1.04	22.24	0.92
Utilities	0.03	0.21	0.42	0.75	18.78	0.79

Source: State Street Global Advisors, FactSet, Bloomberg Finance L.P., Morningstar, as of 31 March 2021. 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.



# Performance and ETF Flows — Equities

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**Analysis of recent equity performance across regions and flows into regional ETF exposures split between US and European domicile.**

## Performance

Over the last six months, since the announcements of vaccines that came late in 2020, we have seen a significant shift in performance across regions.

Last year, emerging markets, driven largely by China, saw strong performance due to the overweight to Technology-focused sectors that did very well in the immediate aftermath of the pandemic, which also largely benefitted US markets.

More recently we have seen regions with more cyclically focused markets, such as the UK and Europe that have large overweight exposure to Financials and Energy sectors, benefit massively from the reflation and value rotation that has gripped markets.

Particularly over the last month, as the USD began to strengthen again on higher US Treasury yields, we have seen this largely hurt performance for emerging markets, which tend to be more growth-focused, and continue to benefit the performance of more value-oriented regions.

	Performance			
	1M (%)	YTD (%)	6M (%)	1Y (%)
Asia Emerging Markets	-3.0	2.2	21.4	60.1
Global Emerging Markets	-1.5	2.3	22.4	58.4
US Equities	4.3	6.1	18.8	55.6
Global Equities	2.7	4.6	19.9	54.6
Eurozone Developed	6.6	9.0	22.8	44.0
Japan Equities	4.8	8.7	22.6	43.0
Europe Equities	6.5	8.4	20.1	35.3
UK Equities	4.0	5.2	18.5	26.7

Source: Bloomberg Finance L.P., as of 31 March 2021. Past performance is not a guarantee of future returns. Returns are net total returns. Reference indices are: UK Equities — S&P 500 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.

## Equity ETF Flows

ETF investors have continued to be strong buyers of equity exposures this year, with European investors adding \$52 billion in the first three months of 2021, while US investors committed a massive \$208 billion over the same period.

In both regions, there has been strong buying of US and global exposures, while other regions have seen more lagged flows. European countries and the UK in particular have been serious laggards for European investors.

Emerging markets have also seen strong flows from both European and global investors, despite having seen much weaker flows than other regions during the past year.

	European-Domiciled (\$mn)				US-Domiciled (\$mn)		
	Prior Month	Year to Date	Trailing 12 Months		Prior Month	Year to Date	Trailing 12 Months
Global	8,928	25,051	57,393	US	68,338	127,701	262,082
US	6,829	11,707	28,251	Global	3,325	32,653	72,003
Europe	1,712	1,397	8,412	International — Developed	7,736	21,603	40,141
UK	1,209	3,231	5,943	International — Emerging Markets	8,070	17,976	22,199
Other Region	-87	394	412	International — Region	797	5,252	7,445
Single Country	1,820	2,461	6,855	International — Single Country	693	3,921	11,382
EM	2,087	7,820	19,750	Currency Hedged	44	-428	-3,892
Total	22,498	52,060	127,015	Total	89,003	208,678	411,360

Source: Bloomberg Finance L.P., as of 31 March 2021. Flows shown above are as of the date indicated, are subject to change, and should not be relied upon as current thereafter.

# Institutional Flows and Positioning — Equities

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**The direction of flows and relative positioning of institutional sector flows, referencing \$39 trillion of equity assets under custody.\***

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\* Source: State Street, as of 31 December 2020.

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## Flows Overview

Institutional investors remain heavily overweight to US equities, while maintaining significant underweights to most other regions, particularly Japan, emerging markets, Pacific ex Japan and UK.

However, we are beginning to see a turn in flows, with US flows over the past month starting to show some negative movement, while we see strong buying in UK equities over both one-month and three-month periods.

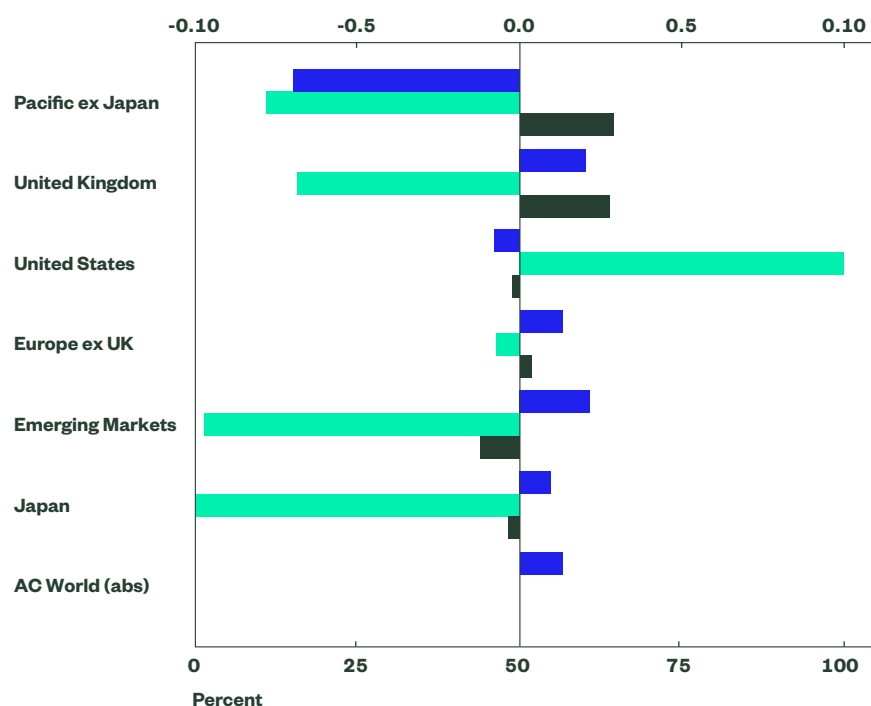
While Pacific ex Japan had been seeing very strong inflows at the start of this year, we have seen this drop off in the most recent month and move back to outflows. However, this has not impacted Chinese equity flows, and instead is largely driven by Taiwan and the Philippines, as well as some outflows from Australia.

Broader emerging market exposures, on the other hand, have begun to see some buying over the last month, largely driven by strong flows toward Mexico, South Africa and certain emerging European countries, although Turkey has offset this slightly with strong selling.

### Flows and Holdings

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

■ 3-month flow (Upper Axis)  
■ 1-month flow (Upper Axis)  
■ Holdings (Lower Axis)



Source: State Street Global Markets, Thomson Datastream, as of 31 March 2021. 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.

# Equity Valuations

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**An analysis of long-term forward valuations for global equities, short-term valuation changes and long-term absolute valuation comparisons.**

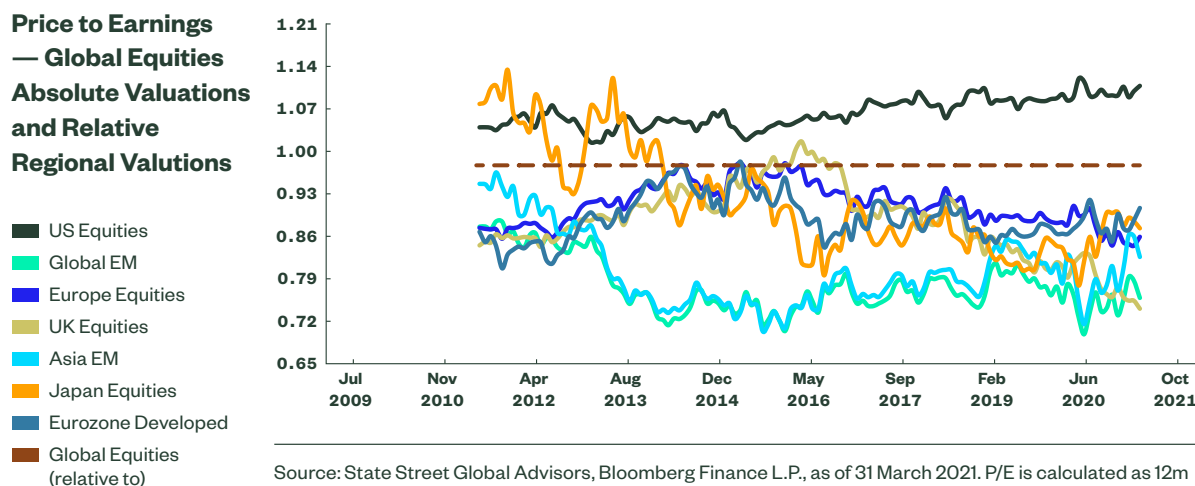
# Long-Term Forward Valuations Relative to Global Equities

Following the initial surge in global equity forward valuations after the pandemic crisis, as surging technology asset prices drove price to earnings ever higher, valuations have remained relatively elevated in the proceeding months, as cyclical valuations also caught up.

Over this time we have seen US equities trading more expensive on a relative basis to the rest of the world, as well as EM Asia, although these have come down more in recent months.

The two markets that currently look most attractively priced relative to the rest of the world are the UK and Japan. Despite the more positive performance more recently for both regions, they still look undervalued on a relative basis compared to historically.

The UK in particular has seen valuations fall fairly consistently for several years, with a pronounced drop during the last few months as Financial and Energy companies have seen their analyst-predicted earnings climb faster than other regions more recently.



Source: State Street Global Advisors, Bloomberg Finance L.P., as of 31 March 2021. P/E is calculated as 12m fwd BEST\_PE\_RATIO. The above estimates based on certain assumptions and analysis made by Bloomberg Finance L.P. There is no guarantee that the estimates will be achieved.

## Short-Term Valuation Changes

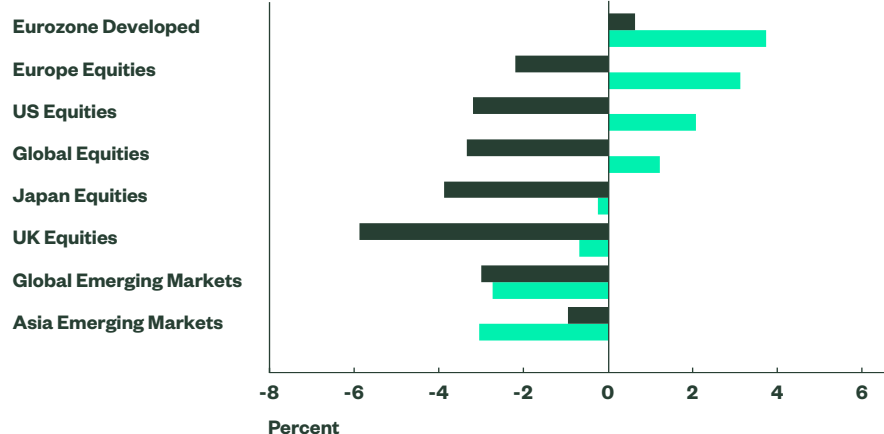
The last three months have seen a significant shift in valuations across regions, both on an absolute basis and relative to global equities.

Perhaps most stark is the change in UK equities, which have seen a significant uptick in analyst expectations for earnings but have not seen an equivalent increase in prices, largely due to investor concerns over the impact of Brexit and fears around stalls in re-opening the economy.

Emerging markets have also seen an interesting shift more recently. While at the start of the year valuations began getting more expensive during the reflation risk-on trade, over the last month valuations have fallen dramatically as investors became nervous over risks of rising inflation and higher Treasury yields causing the USD to spike.

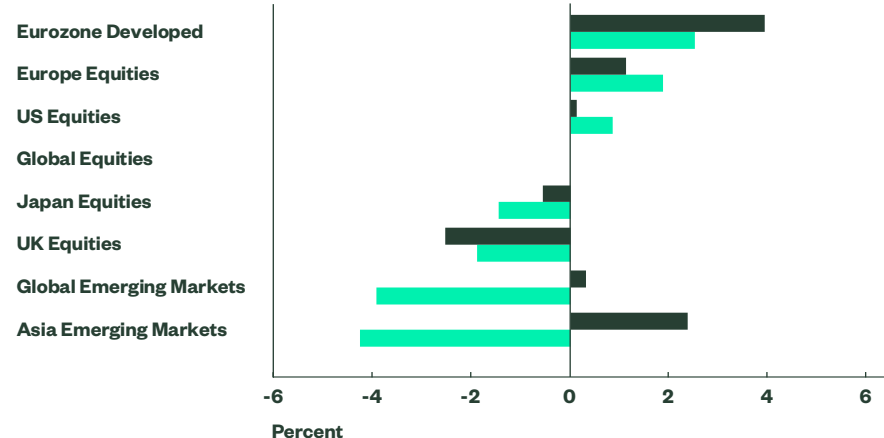
### Price to Earnings Rerating (absolute)

■ 3M Rerating  
■ 1M Rerating



### Price to Earnings Rerating (relative)

■ 3M Relative Rerating  
■ 1M Relative Rerating



Source: State Street Global Advisors, Bloomberg Finance L.P., as of 31 March 2021. P/E is 12m fwd BEST\_PE\_RATIO, Dividend yield is 12m fwd BEST\_DIV\_YLD, EV/EBITDA is 12m fwd BEST\_CUR\_EV\_TO\_EBITDA, P/B is 12m fwd BEST\_PX\_BPS\_RATIO. The above estimates based on certain assumptions and analysis made by Bloomberg Finance L.P. There is no guarantee that the estimates will be achieved.



# Long-Term Absolute Valuation Comparisons

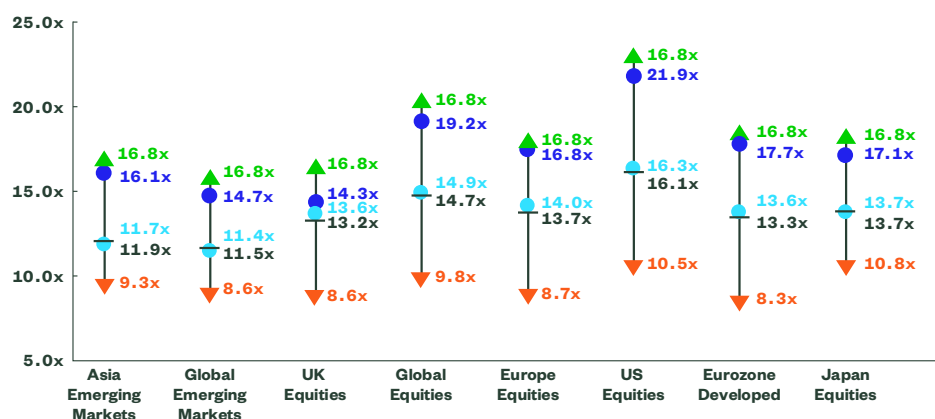
Looking back over 10 years of history, we can see the majority of regions are currently sitting at historical highs in terms of absolute valuations, across numerous different measures.

The only exception is UK equities, which are actually close to historical averages both in terms of earnings valuations and dividend yield.

US equities have a particularly high absolute valuation currently, largely due to the weight of more growth-focused sectors within the exposure. However, it is worth noting that these valuations have slightly come off the highs that we saw earlier in the year, partly due to the recent sell-offs that we have seen in the Technology and Consumer Discretionary sectors following the retail-fueled trading frenzy in February.

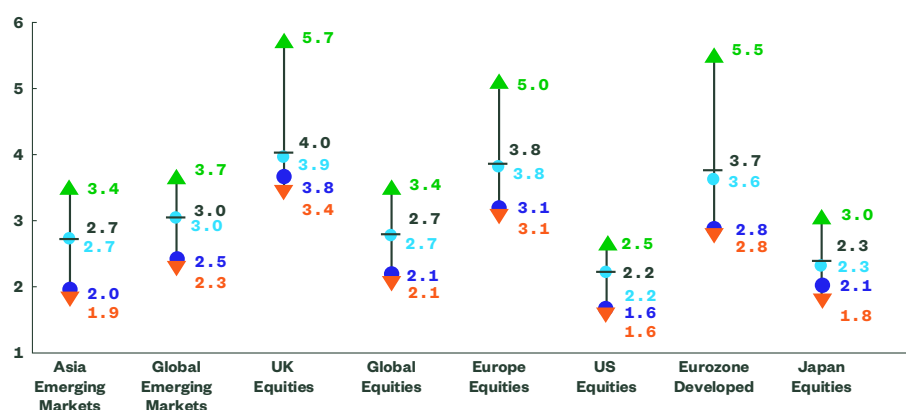
## 10Y Peak to Trough — P/E

- Max
- Current
- Median
- Average
- Min



## 10Y Peak to Trough — Dividend Yield

- Max
- Current
- Median
- Average
- Min



Source: State Street Global Advisors, Bloomberg Finance L.P., as of 31 March 2021. P/E is 12m fwd BEST\_PE\_RATIO, Dividend yield is 12m fwd BEST\_DIV\_YLD, EV/EBITDA is 12m fwd BEST\_CUR\_EV\_TO\_EBITDA, P/B is 12m fwd BEST\_PX\_BPS\_RATIO. The above estimates based on certain assumptions and analysis made by Bloomberg Finance L.P. There is no guarantee that the estimates will be achieved.

# Equity Regions in Focus

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**Ideas for the quarter ahead based on current market themes, valuation metrics, flows and potential drivers for each region.**

## Capture the Value Rotation with the FTSE All Share Index

Institutional investors have largely shunned UK equities for some time now, but as flows start to return to this exposure, and with valuations looking attractive both on an absolute and relative basis, this could be an interesting entry point.

The FTSE All Share index is a great way to access the UK market, made up of the FTSE 100, FTSE 250 and FTSE Small indices, as it captures the total market cap of UK-listed stocks in a single trade.

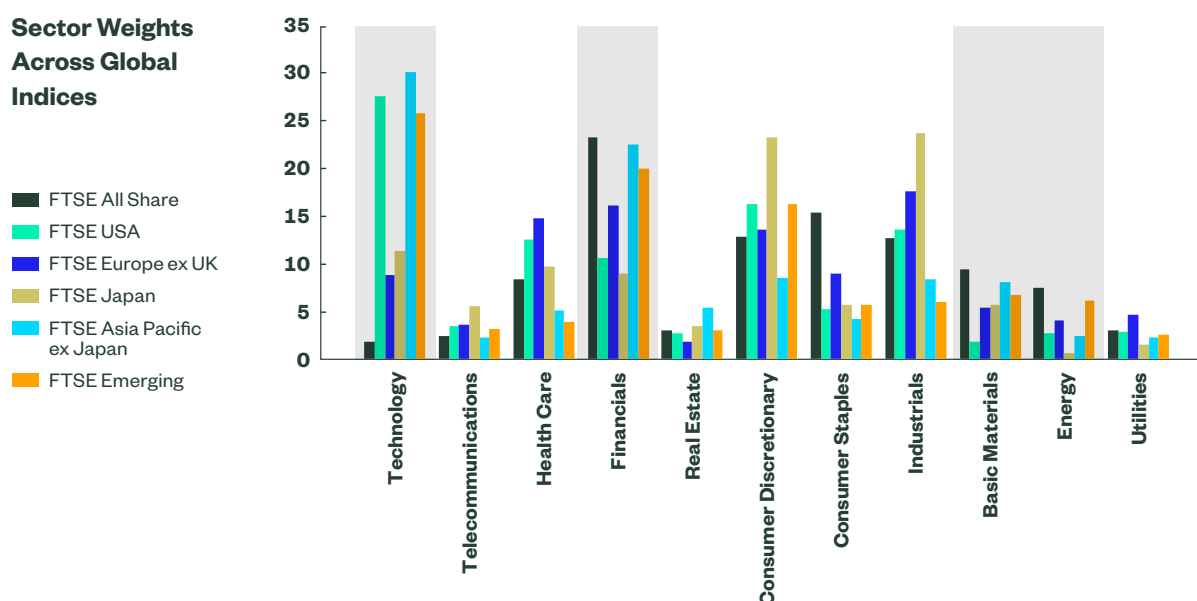
In addition to being well placed to capture the value rotation and being heavily weighted to cyclical sectors such as Financials and Energy, the UK has also seen a surprise success in its vaccine program, outpacing the majority of regions globally, and particularly the rest of Europe.

Given the UK appears to be meeting targets set by the government for re-opening the economy, many are now optimistic that the economy should be able to re-open on schedule, giving a much-needed boost to the services sectors that make up a large part of GDP.

Another factor that has thus far helped the UK perform well this year has been strength in the oil price, which may continue to climb as other economies begin to re-open and demand for oil increases. This should help support the large oil producers that make up a large chunk of the FTSE All Share index.

Overall, the UK is positioned to continue to perform well if the value rotation continues to gather pace, and institutional investors returning to this space should continue to support asset prices going forward.

### Sector Weights Across Global Indices



Source: FactSet, as of 31 March 2021. Weights are as of the date indicated and should not be relied upon as current thereafter.

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## Diversifying US Equity Exposure Using the S&P 400 MidCap Index

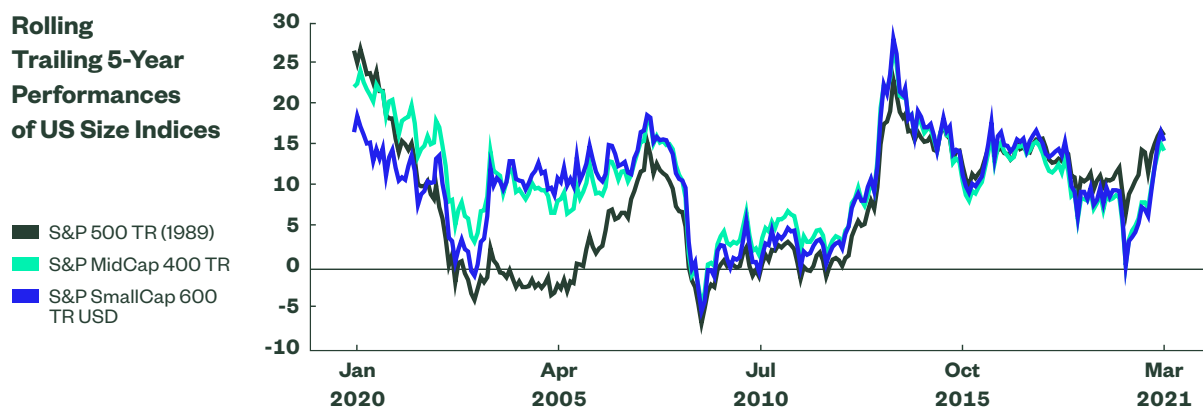
Many investors are keen to stay invested in US equities due to the strong growth anticipated to come from the region, as well as the recently announced \$2.5 trillion fiscal stimulus plan that should continue to boost the productivity of US companies.

However, some investors are also nervous by how concentrated the US large cap stock market has now become, with the dominance of FAANG stocks and the Technology sector alone making up more than a quarter of the index.

One way investors can seek to address this issue by allocating some of their US equity allocation to mid caps through the S&P 400 MidCap Index.

This index is far more diversified than the S&P 500, with the largest sector, Industrials, making up just 18.3% of the index, while the weight to the Technology sector is massively reduced, making up just 14.3% of the total index. The index is also far more exposed to other cyclical sectors, with Financials the second largest sector at 15.8% and Consumer Discretionary taking 14.6%.

Over the longer term, mid caps also tend to outperform their larger cap peers, due to the greater potential for earnings growth in the smaller cap space, while tending to have a lower level of volatility than pure small cap stocks. When we take five-year rolling returns going back to the index start date of 1995, the S&P 400 outperformed the S&P 500 in 73% of periods.<sup>1</sup> We can see this borne out in the chart below.



Source Morningstar Direct as of 31 March 2021. Inception dates for the reference indices are: 30 August 1991 for S&P MidCap 400 TR, 31 January 1995 for S&P SmallCap 600 TR. Past performance is not a guarantee of future returns. Index returns reflect all items of income, gain and loss and the reinvestment of dividends and other income as applicable.

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<sup>1</sup>Source State Street Global Advisors, Morningstar Direct as of 31 March 2021.

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## Look for a Restart to Growth with Emerging Markets

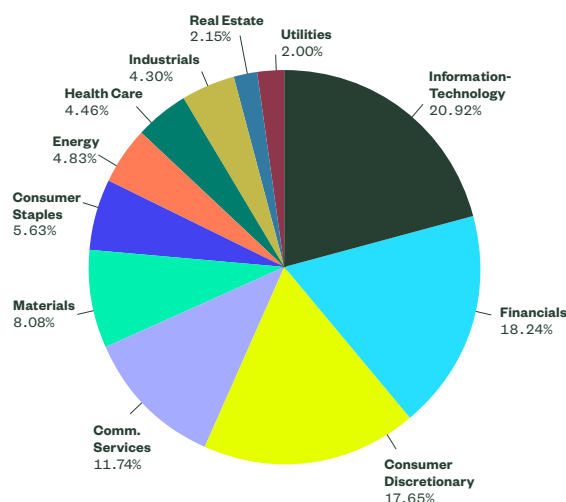
Although emerging markets have been hit by a particularly weak start to the year due to the USD strengthening and a slower rate of vaccination than in developed markets, and may continue to face headwinds if the USD strengthens further, there are reasons to continue considering allocating to these exposures.

Investors who believe the value rotation may have been overdone, and believe that growth exposures may be due a comeback, can access this theme using emerging markets, where there are large overweights to more growth-focused sectors such as Technology, Consumer Discretionary and Communication Services.

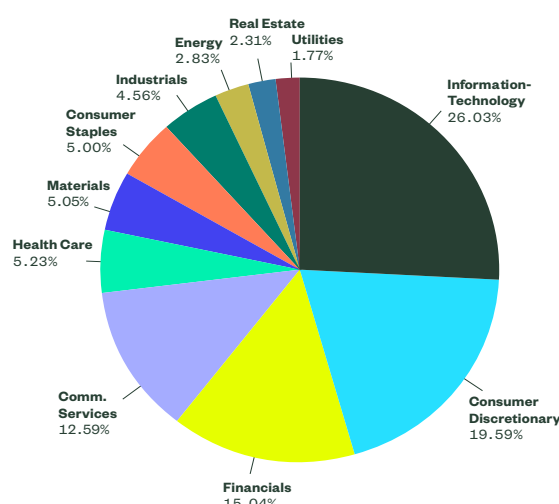
While there have been concerns more recently as China began to crack down on their Technology giants, some of these issues have now been resolved after the companies were fined and no further action was taken. These companies have seen their prices recover since then.

Finally, institutional flows appear to support the broader emerging market complex, with strong flows coming into this exposure in the last month. Although more recently flows into Pacific ex Japan have been more challenged, with institutional investors being heavy sellers of this region, it is worth noting that this has not been driven by China (the largest weight in the exposure) and has instead been driven largely by outflows from Taiwan and the Philippines.

### MSCI Emerging Market Sector Weights



### MSCI EM Asia Sector Weights



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Source: FactSet as of 31 March 2021. Weights are as of the date indicated and should not be relied upon as current thereafter.

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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.<sup>1</sup>

**Access to 15% of World's Tradeable Securities<sup>2</sup>** As part of State Street, we have access to information gleaned from our large global custody business. By aggregating \$39 trillion of financial 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).

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## Endnotes

- <sup>1</sup> 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.
- <sup>2</sup> Source: State Street, as of 31 December 2020.

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\* This figure is presented as of December 31, 2020 and includes approximately \$75.17 billion of assets with respect to SPDR products for which State Street Global Advisors Funds Distributors, LLC (SSGA FD) acts solely as the marketing agent. SSGA FD and State Street Global Advisors are affiliated.

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