

State Street Active Asset Allocation ETF Portfolios

The global growth recovery broadened in the second quarter, aided by accelerated COVID-19 vaccine rollouts in the United States and Europe. Incoming data in the second half of the quarter points to a robust global recovery cycle despite persistent headwinds, including supply chain disruptions, new variants of the Coronavirus and the potential for central bank tightening on inflationary concerns.

The Market in Review

Risk assets continued to rally in the second quarter, aided by the strong economic recovery across key developed markets (DM). Commodities registered solid gains on the back of strong growth in energy prices. The US dollar remained flat for the quarter. Its decline in the first half of the quarter was offset by strong monthly performance in June. For the quarter, the yield on the US 10-year Treasury note fell to 1.47% from 1.74%, giving up some of the large gains made during the first quarter.

On the fiscal front, US President Biden secured a deal on an infrastructure package worth US\$1 trillion, which fell short of the US\$2.3 trillion plan proposed in March. The deal authorizes additional spending for roads, bridges, highway safety and electronic vehicle charging stations over the next eight years. In Europe, the European Commission started to publish its assessment of recovery plans for member states. Many countries, including Portugal, Spain and Greece, received the green light for European Union (EU) recovery funding.

On the monetary policy front, although the US Federal Reserve reiterated that the rise in inflation is transitory, its tone was more hawkish. The Fed acknowledged discussions around tapering and indicated the possibility of at least two rate hikes by the end of 2023 through its “dot plot” projections. In Europe, the European Central Bank (ECB) chose not to discuss tapering. It expected inflation to remain below target for the foreseeable future and committed to purchase €1.85 trillion worth of bonds until March 2022 as part of its pandemic emergency purchase program. In Japan, the Bank of Japan kept monetary policy steady and reiterated its view on subdued inflationary pressures. It also unveiled a plan to boost funding for climate change to be rolled out by the end of 2021.

On the COVID-19 front, over a fifth of the world’s population received at least one vaccine dose, up from 3.0% in mid-March, with DM leading emerging market (EM) economies. The EU closed the gap on the vaccinations in the second quarter with infection rates falling and social and economic activities being eased in many countries.

On the economic front, incoming US data points to strong recovery momentum. US Q1 GDP registered solid 6.4% QoQ annualized growth though it was lower than consensus estimates of 6.7%. Leading indicators for both services and manufacturing registered record highs during the quarter with the IHS Markit US Composite Purchasing Managers' Index (PMI) moving to 63.9 in June from 59.7 in March. Though Eurozone GDP contracted in the first quarter, business activity picked up in the second quarter and expanded at its fastest rate in 15 years in June. Business activity in the United Kingdom (UK) also expanded in the second quarter with the IHS Markit Composite PMI interim number at 61.7 for June, the highest since the series began in 1998. Inflation continued to trend higher across regions as a result of supply-side constraints (in both manufacturing and services), resurgent demand and base effect. Inflation had already topped the targets of central banks across the US and Europe, but monetary policymakers expect price pressures to be transitory.

Market Performance and Commentary

Global Equities Equity markets had a strong quarter on quarter performance registering positive growth, and the MSCI All Country World Index rose by 7.53%. The performance was dominated by DM equities as measured by the MSCI World Index, which returned 7.89% during the quarter as the vaccination pace accelerated in developed economies. The MSCI Emerging Markets Index posted modest positive returns of 5.05% but lagged behind DM equities as some countries within the region still struggled with increasing COVID-19 cases.

In the US, the S&P 500 Index gained 8.55% during the quarter as the pandemic was reined in, consumer spending increased, growth stocks rebounded, first-quarter earnings grew strongly and the prospects of fiscal stimulus improved in the context of President Biden concluding a bipartisan deal to boost infrastructure spending by US\$600 billion. The US president also outlined two more spending packages — a US\$2.3 trillion American Jobs Plan and a US\$1.8 trillion American Families Plan, with many key tax credits from the rescue bill being extended or made permanent. The plans are designed to bolster the country's infrastructure and ensure a more equitable recovery. The Chicago Board Options Exchange's CBOE Volatility Index (VIX) posted negative returns of -18.40% over the quarter, indicating reduced market volatility. Real Estate (13.09%) and Information Technology (11.56%) were the best performing sectors while Utilities (-0.41%) was the only sector posting negative returns on the broader index. Mid- and small-cap companies, which tend to be more domestically focused, lagged behind their larger counterparts during the quarter with the S&P Midcap 400 Index rising by 3.64% and the Russell 2000 Index gaining 4.29%.

In Europe, the equity markets were supported by the reopening of regional economies and strong global goods demand. Increasing vaccination rates bolstered prospects for a strong economic rebound. Despite a 0.6% contraction in the first quarter, Eurozone PMIs reached multi-year highs in many regions as vaccination rates boosted confidence in the service sector, anticipating that resilient spending would boost retail sales. The ECB kept its monetary policy unchanged during the quarter but emphasized a faster paced liquidity injection going forward. MSCI Europe returned 7.74% in the quarter in US dollar terms. Health Care (12.66%) and Real Estate (10.94%) were the best performing sectors. Although Financials (3.95%) and Utilities (0.13%) posted positive performance, they were ranked at the bottom compared to other sectors. In terms of region, MSCI Denmark and MSCI Switzerland were the top performers during the quarter, returning 13.11% and 12.02%, respectively, in US dollar terms.

MSCI Pacific lagged other DM during the quarter and rose by only 1.36% in US dollar terms. With gains of 6.91% and 2.53%, respectively, MSCI Australia and MSCI Hong Kong were the top performers. MSCI Singapore had moderate gains of 0.49%. MSCI Japan and MSCI New Zealand were the laggards with negative returns of -0.25% and -5.07%, respectively. Japanese equity markets, in particular, experienced a sell-off as tensions between Japan and China, the emergence of new forms of the Coronavirus, reports of a fourth wave of the pandemic and the slow vaccination campaign all weighed on performance.

EM equities lagged behind their DM counterparts as many countries faced a spike in COVID-19 cases, the reimposition of lockdowns and a slowdown in vaccinations. Although the Chinese economy was less buffeted by the pandemic, it was weighed down by concerns over monetary policy normalization and tougher regulations on the Technology sector. China renewed its pledge to make its economy carbon neutral by 2060, which helped to boost investor sentiment. Most EM countries also faced logistical challenges in terms of vaccine supply. The MSCI Emerging Markets Index, the broad measure of the performance of EM, was up by 5.12% for the quarter in USD terms. At the country level, the top-performing markets included MSCI Brazil (22.93%) and MSCI Poland (18.72%). The markets that were ranked at the bottom were MSCI Egypt (-9.21%) and MSCI Chile (-13.72%).

Global Fixed Income Global bonds (Bloomberg Barclays Global Aggregate Bond Index — USD Hedged) saw modest positive returns (+0.98%) in Q2. Spreads were flat overall, and bond yields were relatively range-bound over the quarter as markets saw a balance between improving global growth and the major central banks signaling potential tapering plans. Despite a more hawkish than expected outcome in the Federal Open Market Committee's June meeting, risk assets recovered after an initial slide and long-end Treasury yields fell to a low not seen since February.

Investment grade (IG) spreads (Bloomberg Barclays U.S. Aggregate Corporate Index) tightened by 11 basis points (bps) to end Q2 at 80 bps over Treasuries. Spreads over the quarter were the tightest they've been since the global financial crisis, driven by positive earnings outlook and business sentiment. Upcoming IG bond supply is expected to be modest as heavy issuance in the first half of the year (IG net supply of US\$345.2 billion) suggested significant frontloading. Also, companies still carry sizable cash and the M&A pipeline with issuance implications is relatively low. Demand has been solid as well given higher inflation uncertainty, but low rates volume supported flows into short-term IG funds.

High yield (HY) spreads (Bloomberg Barclays U.S. HY 2% Issuer Cap Index) tightened by 42 bps to end Q2 at 269 bps based on increased confidence in the global economic recovery and expectations that the recent inflation spike will prove to be transitory. US\$140.5 billion worth of new HY issuance was priced in Q2, the third highest quarterly volume on record, and HY funds saw US\$3.2 billion of outflows in Q2 compared with US\$10.6 billion in Q1. Defaults have been coming down, with 2021 witnessing the mildest start to a calendar year for defaults/distressed transactions since 2011. US HY 12-month default rate ended Q2 at 1.87%, as large defaults from June 2020 exited the 12-month rolling window.

Market-based inflation expectations for the US, as measured by five-year break-evens, slightly declined over Q2, ending at 2.50%. The modest drop in inflation expectations contrasted the latest actual data, which saw the US Consumer Price Index rising 5.0% in the 12 months ended May 2021, the strongest level since August 2008. Both Treasury inflation-protected securities (TIPS) and nominal Treasury bonds saw positive returns over the quarter, with TIPS significantly outperforming Treasuries.

Real Estate Real estate investment trusts (REITs), as indicated by the FTSE EPRA Nareit Global Real Estate Index, gained 7.9% in Q2, while the Dow Jones U.S. Select REIT Index returned 11.8% for the quarter. By the end of the second quarter, REITs total returns fully recovered from the initial losses recorded in early 2020. Nearly all property sectors registered positive returns during the quarter. Self-storage, residential and industrial REITs registered double digit gains, while lodging/resorts languished.

Commodities Commodities (as measured by the Bloomberg Commodities Total Return Index) posted robust gains for the second quarter as accelerated vaccine rollout and strong global economic recovery brightened the demand outlook for many commodities. Despite a weak June, the index returned 13.3% for the quarter, the highest in almost a decade. With this, the index has jumped more than 50% from the lows touched in March 2020. Energy was the best performing index component as oil and gas prices continued to pick up. Agricultural commodities also registered strong gains as poor weather conditions and transportation bottlenecks pushed prices higher. The Bloomberg Precious Metals Subindex posted modest gains with silver increasing 6.5% during the quarter. Despite registering a strong monthly gain in May, gold posted a mere 3.2% for the quarter as gold prices struggled in June, falling more than 7%. The Fed's hawkish tilt, along with a rebound in the US dollar, weighted on the yellow metal.

Source for index returns: FactSet, as of June 30, 2021.

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Glossary

PMI, or Purchasing Managers Index

An indicator of the economic health of the manufacturing sector. The PMI is based on five major indicators: new orders, inventory levels, production, supplier deliveries and the employment environment.

MSCI ACWI Index, or MSCI All Country World Index

A free-float weighted global equity index that includes companies in 23 emerging market countries and 23 developed market countries and is designed to be a proxy for most of the investable equities universe around the world.

High Yield A company or bond that is rated 'BB' or lower is known as junk grade or high yield, in which case the probability that the company will repay its issued debt is deemed to be speculative.

TIPS, or Treasury Inflation Protected Securities

Treasury inflation protected securities (TIPS) refer to Treasury securities that are indexed to inflation in order to protect investors from the negative effects of inflation. TIPS are backed by the US government and are thus considered an extremely low-risk investment. The par value of TIPS rises with inflation, as measured by the Consumer Price Index, while the interest rate remains fixed.

MSCI World Index The MSCI World Index is a free-float weighted equity index. It includes about 1,600 stocks from developed world markets, and does not include emerging markets.

S&P Midcap 400 Index A benchmark that seeks to target the mid-cap portion of the US equities market. The index covers more than 7 percent of the U.S. equities market. Included in the index are companies with market cap in

the range of \$1 billion to \$4.5 billion. This range is reviewed from time to time to ensure consistency with market conditions.

Russell 2000® Index A benchmark that measures the performance of the small-capitalization segment of the U.S. equity universe. The Russell 2000® is a subset of the Russell 3000® Index representing approximately 10% of the total market capitalization of that index. It includes about 2,000 of the smallest securities based on a combination of their market cap and current index membership. The Russell 2000® Index is completely reconstituted annually to ensure larger stocks do not distort the performance and characteristics of the true small-cap opportunity set.

MSCI Emerging Markets Index The MSCI Emerging Markets Index captures large and mid-cap representation across 23 emerging markets countries. With 834 constituents, the index covers approximately 85% of the free float-adjusted market capitalization in each country.

Large Cap A stock with a high level of capitalization, usually with a market value of more than \$10 billion.

Bloomberg Barclays Global Aggregate Bond Index A benchmark that provides a broad-based measure of the global investment-grade fixed income markets. The three major components of this index are the U.S. Aggregate, the Pan-European Aggregate, and the Asian-Pacific Aggregate Indices. The index also includes Eurodollar and Euro-Yen corporate bonds, Canadian government, agency and corporate securities, and USD investment-grade 144A securities.

Bloomberg Barclays Global Aggregate Corporate Bond Index A benchmark of global investment-grade, fixed-rate corporate

debt. This multi-currency benchmark includes bonds from developed and emerging markets issuers within the industrial, utility and financial sectors.

Bloomberg Barclays Global Corporate High Yield Bond Index

A multi-currency fixed-income benchmark of the global high yield debt market. The index represents the union of the US High Yield, the Pan-European High Yield, and Emerging Markets (EM) Hard Currency High Yield Indices. The high yield and emerging markets sub-components are mutually exclusive.

Bloomberg Barclays US Corporate High Yield 2% Issuer Cap Index

The index measures the performance of high yield corporate bonds, with a maximum allocation of 2% to any one issuer.

VIX Index Often referred to as the equity market's "fear gauge," the VIX Index is a measure of market risk based on expectations of 30-day volatility. It is constructed using the implied volatilities of a wide range of S&P 500 index options – both calls and puts. The VIX volatility measure is meant to be forward looking.

S&P 500 Index A benchmark for U.S. large-cap equities that includes 500 companies from leading industries and captures approximately 80% coverage of available market capitalization.

MSCI Europe Index A benchmark capturing large- and mid-cap representation across 15 developed market countries in Europe.

MSCI Pacific Index An index that captures large and mid cap representation across 5 Developed Markets countries in the Pacific region. The index covers approximately 85% of the free float-adjusted market capitalization in each country.

Dow Jones U.S. Select REIT Index

The index tracks the performance of publicly traded REITs and REIT-like securities and is designed to serve as a proxy for direct real estate investment, in part by excluding companies whose performance may be driven by factors other than the value of real estate.

FTSE EPRA Nareit Global Real Estate Index

A free-float adjusted, market capitalization-weighted index designed to track the performance of listed real estate companies in both developed and emerging countries worldwide. Constituents of the index are screened on liquidity, size and revenue.

Bloomberg Commodity Total Return Index

The index is composed of futures contracts and reflects the returns on a fully collateralized investment in the BCOM. This combines the returns of the BCOM with the returns on cash collateral invested in 13 week (3 Month) U.S. Treasury Bills.

Bloomberg Industrial Metals Subindex

The index is composed of futures contracts on aluminum, copper, nickel and zinc. It reflects the return of underlying commodity futures price movements only. It is quoted in USD.

Developed Markets Refers to countries or market areas with relatively high levels of economic growth, market liquidity and transparency as well as political stability, rule of law and safety.

Emerging Markets Developing countries where the characteristics of mature economies, such as political stability, market liquidity and accounting transparency, are beginning to manifest. Emerging market investments are generally expected to achieve higher returns than developed markets but are also accompanied by greater risk, decreasing their correlation to investments in developed markets.

REITs or Real Estate Investment Trusts

Companies that own and operate commercial properties, such as office buildings and apartment complexes.

Important Risk Information

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Risk associated with **equity investing** include stock values which may fluctuate in response to the activities of individual companies and general market and economic conditions. Investing in **REITs** involves certain distinct risks in addition to those risks associated with investing in the real estate industry in general. Equity REITs may be affected by changes in the value of the underlying property owned by the REITs, while mortgage REITs may be affected by the quality of credit extended. REITs are subject to heavy cash flow dependency, default by borrowers and self-liquidation. REITs, especially mortgage REITs, are also subject to interest rate risk (i.e., as interest rates rise, the value of the REIT may decline).

The **index returns** are unmanaged and do not reflect the deduction of any fees or expenses. Investing involves risk including the risk of loss of principal.

Investing in **foreign domiciled securities** may involve risk of capital loss from unfavorable fluctuation in currency values, withholding taxes, from differences in generally accepted accounting principles or from economic or

political instability in other nations. Investments in emerging or developing markets may be more volatile and less liquid than investing in developed markets and may involve exposure to economic structures that are generally less diverse and mature and to political systems which have less stability than those of more developed countries.

Asset allocation is a method of diversification which positions assets among major investment categories. Asset allocation may be used in an effort to manage risk and enhance returns. It does not, however, guarantee a profit or protect against loss. Investing in commodities entail significant risk and is not appropriate for all investors.

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