Insights
Low-Cost Core

December 2019

Build Your Core with SPDR® Portfolio ETFs™

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A strong, flexible portfolio depends on how you allocate assets in the core. That's because the core is the largest part of a portfolio and research has long shown that asset allocation decisions explain over 90% of the variance in portfolio returns.[1] Simply put, it all starts with asset allocation. And today's low return expectations make building a low-cost, diversified core more important than ever, as costs accumulate over time, eroding a portfolio's total return.

While an effective core may look different for each investor, we believe that there are four principles to core construction:

1 Broaden Your Reach
2 Customize to Your Client's Needs
3 Control Costs
4 Impose Discipline

1

Broaden Your Reach

We believe today's core should reflect an expansive investment universe, including US equities, international equities and fixed income. Investors have a well-documented tendency to exhibit a home bias (a heavier allocation to domestic stocks).[2] Given how globalized the economy has become, where countries outside the US represent 77% of nominal global GDP,[3] international equities are essential to broaden reach, mitigating any home bias tendency.

Yet, while a portfolio concentrated in equities has historically generated strong returns over the long term, these returns merely compensate for the higher risks assumed. And not all investors can tolerate the significant drawdown risk inherent within equities. Diversifying your core by allocating to bonds may help mitigate portfolio drawdowns and improve returns per unit of risk.[4] As shown in Figures 1 and 2, relative to a pure equity portfolio, a hypothetical portfolio comprised of 60% equity and 40% fixed income reduced drawdowns and more quickly recovered its maximum losses after stock market crashes.

Figure 1

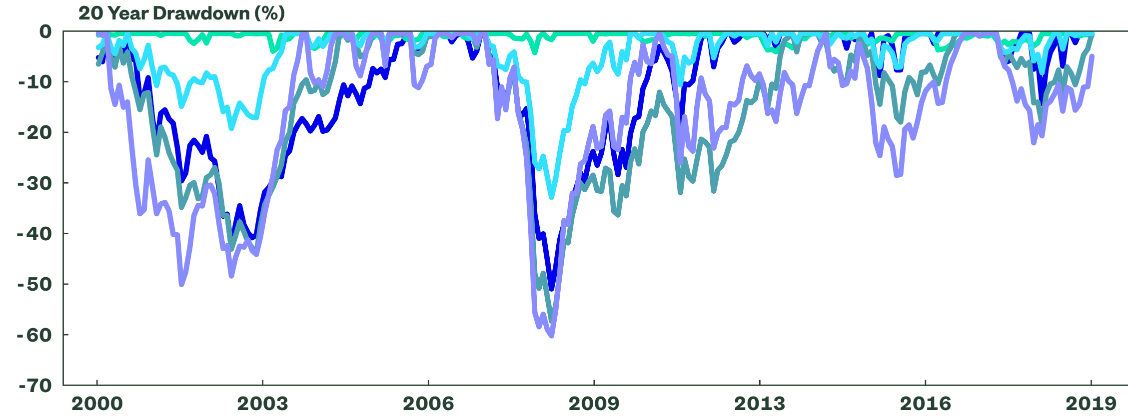
Broaden Reach for Potential Diversification Benefits

Description	20 Year					1-Year Return	
	Annualized Return (%)	Annualized Standard Deviation (%)	Return Per Unit of Risk	Max Draw Recovery Period (Months)	Max Drawdown (%)	Worst	Best
S&P Composite 1500 Index	6.44	14.60	—	37.00	-50.84	-43.18	55.02
60% Equity + 40% Bond Portfolio	6.33	8.84	—	20.00	-32.61	-27.82	38.94

Source: FactSet, for the period from 01/01/2000 to 12/31/2019. The 60% Equity + 40% Bond Portfolio consists of 36% of the S&P Composite 1500 Index, 17% of the S&P Developed ex-U.S. BMI Index, 7% of the S&P Emerging BMI Index, and 40% of the Bloomberg Barclays U.S. Aggregate Bond Index, rebalanced annually, without taking into account transaction costs. The returns were achieved by mathematically combining the actual performance of the indexes listed above. Past performance is not a guarantee of future results. Index returns are unmanaged and do not reflect the deduction of any fees or expenses. Index returns reflect all items of income, gain and loss and the reinvestment of dividends and other income.

Figure 2

Broaden Reach for Potential Drawdown Mitigation

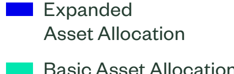


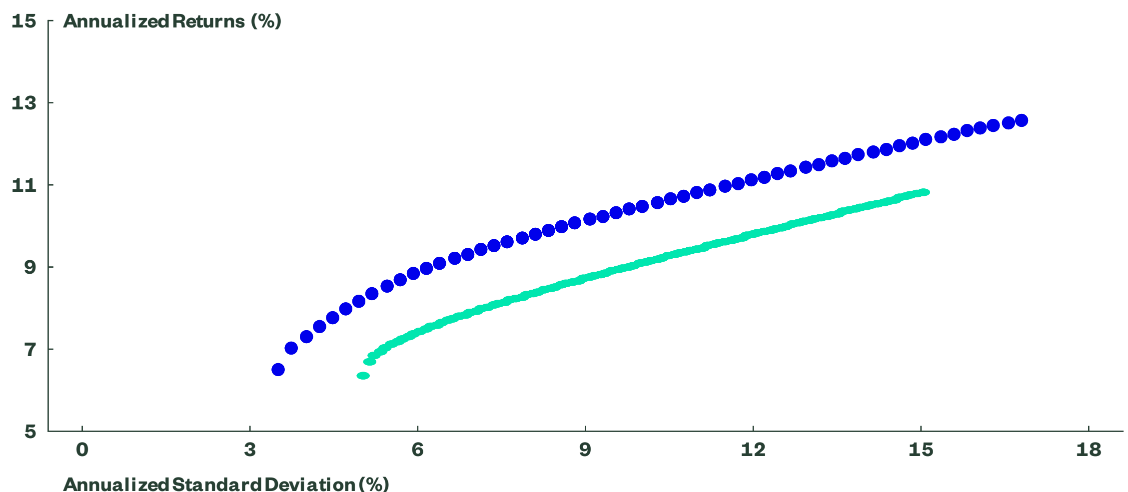
- S&P Composite 1500 Index
- Bloomberg Barclays U.S. Aggregate Bond Index
- S&P Developed Ex-U.S. BMI Index
- 60% Equity + 40% Bond Portfolio
- S&P Emerging BMI Index

Source: FactSet, for the period from 01/01/2000 to 12/31/2019. The 60% Equity + 40% Bond Portfolio consists of 31% of the S&P Composite 1500 Index, 29% of the S&P Developed ex-U.S. BMI Index, 7% of the S&P Emerging BMI Index, and 40% of the Bloomberg Barclays U.S. Aggregate Bond Index, rebalanced annually, without taking into account transaction costs. The returns were achieved by mathematically combining the actual performance of the indexes listed above. Past performance is not a guarantee of future results. Index returns are unmanaged and do not reflect the deduction of any fees or expenses. Index returns reflect all items of income, gain and loss and the reinvestment of dividends and other income. Performance returns for periods of less than one year are not annualized.

The sample 60% global equity and 40% US bond portfolio is only a starting point for diversification. The diversification benefits could be enhanced if investors include more asset categories that are less or negatively correlated to each other. As shown in Figure 3, by including more granular asset classes, such as small and mid caps, dividend stocks, high yield and investment grade bonds of different duration, inflation-protected securities, etc., the portfolio has the potential to improve returns across all risk spectrum without taking additional risks.

Figure 3
Efficient Frontiers





Source: Morningstar, State Street Global Advisors. The Expanded Asset Allocation portfolio consists of S&P 500, S&P MidCap 400, S&P Small Cap 600, Dow Jones US Dividend 100, S&P Developed ex US BMI, S&P Emerging BMI, Bloomberg Barclays US Corporate, ICE BofA US High Yield, Bloomberg Barclays US Treasury, Bloomberg Barclays US MBS, Bloomberg Barclays US TIPS Indices. The Basic Asset Allocation Portfolio consists of Russell 3000, S&P Developed ex US BMI, S&P Emerging BMI and Bloomberg Barclays US Aggregate Bond Indices. Historical standard deviation, returns and correlations of indexes over the past 20 years through 12/31/2019 are used to generate efficient frontiers.

2

Customize to Your Client's Needs

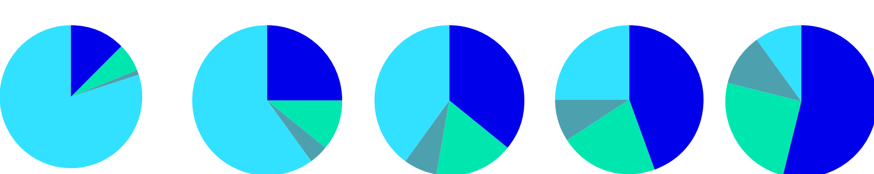
Your client's risk tolerance, return expectations and time horizon inform a blueprint for constructing a core with the necessary foundational support. And, obviously, a core that's appropriate for one client may not be appropriate for another.

In general, longer investment horizons tend to result in greater risk tolerance and higher return expectations. For example, young investors just starting their careers likely have longer investment horizons and greater risk tolerance than retirees who rely on the income from their portfolio to fund their retirement. A young couple preparing to buy their first home may have different risk and return expectations than a middle-age couple saving for their kids' college.

Again, the combination of core asset classes can create a portfolio core tailored to clients' risk and return requirements. As shown below, five hypothetical core examples calibrate the risk level by adjusting the broad allocations to US equities, international equities and fixed income. A more conservative investor should have a higher allocation to bonds. If your client needs to access principal relatively soon, making withdrawals during one of those equity drawdowns shown in Figure 2 simply won't work. On the contrary, a more risk-seeking investor might be more willing to ride out those drawdowns to seek higher total returns over the long term.

Thus, as shown in Figure 4, as you move up the risk tolerance scale, you take on exposure to equities, both domestic and international.

Figure 4
Match Core Allocations to Client Risk Profiles



Allocations		Conservative (%)	Moderate-Conservative (%)	Moderate (%)	Moderate-Aggressive (%)	Aggressive (%)
S&P Composite 1500 Index	US Equity	12.5	25.0	36.0	44.5	54.0
S&P Developed ex-U.S. BMI Index	Developed ex-US	6.5	11.0	17.0	21.5	25.0
S&P Emerging BMI Index	Emerging Markets	1.0	4.0	7.0	9.0	11.0
Bloomberg Barclays U.S. Aggregate Bond Index	Fixed Income	80.0	60.0	40.0	25.0	10.0
Risk Tolerance		Less ⟵				⟶ More
		Shorter Investment Horizon Current Income Capital Preservation				Longer Investment Horizon Capital Growth Target Return Opportunity

Source: State Street Global Advisors, as of 12/31/2019. All asset allocation scenarios are for hypothetical purposes only and are not intended to represent a specific asset allocation strategy or recommend a particular allocation. Each investor's situation is unique and asset allocation decisions should be based on an investor's risk tolerance, time horizon and financial situation.

It's all about underlying exposures. If a client is more focused on capital growth over the longer term, a portfolio can be tailored to move up the risk spectrum and allocate more to equities, becoming more equity-like, as measured by the beta to the S&P 500® Index, and less bond-like, as measured by the beta to the Bloomberg Barclays U.S. Aggregate Bond Index.

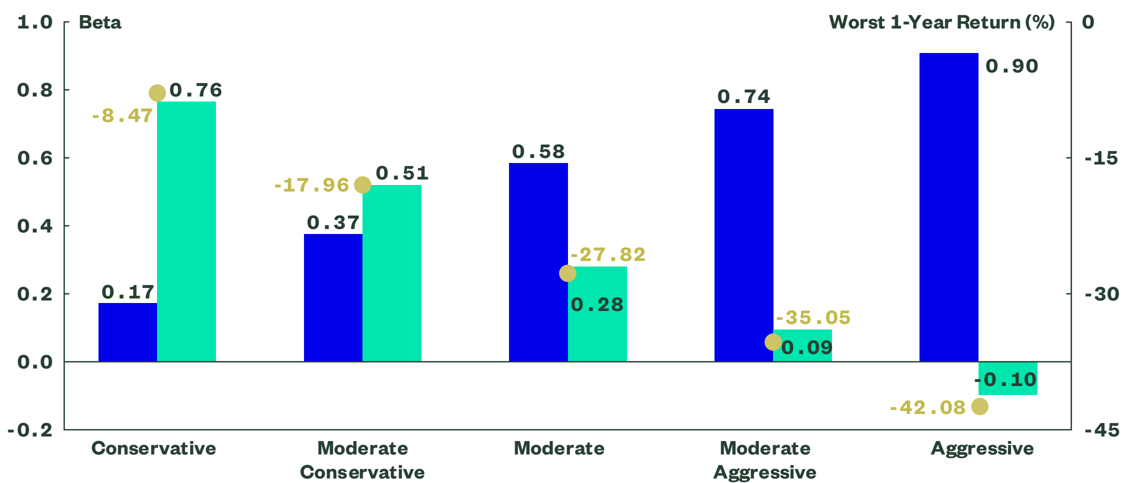
Equity market fluctuations typically have a larger impact on more risk-seeking portfolios, while shifts in the bond market typically impact more risk-averse allocations. The difference is most stark when examining the worst 1-year return periods, as more bond-sensitive portfolios experienced less significant drawdowns.

However, the risk and return relationship is generally asymmetrical. The Conservative allocation with 20% equities does have some sensitivity to the stock market, while the Aggressive allocation with only 10% bonds has nearly no sensitivity to the bond market. This underscores how even slight asset allocation differences can impact risk and return, as shown in Figure 5.

Figure 5

Portfolio Sensitivities to Stocks and Bonds

Last 20 Years

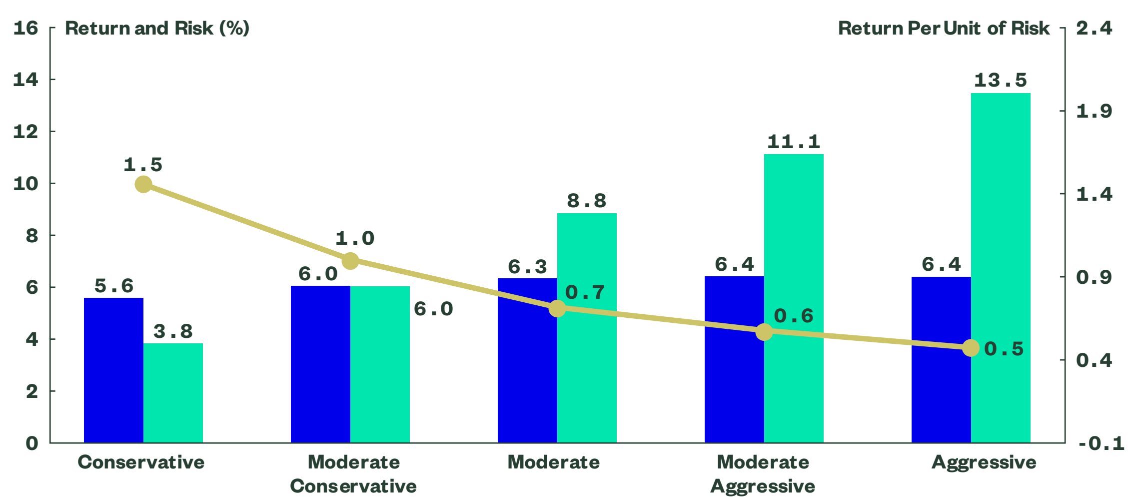


Source: FactSet, for the period from 01/01/2000 to 12/31/2019. Each portfolio is rebalanced annually, without taking into account transaction costs. The returns were achieved by mathematically combining the actual performance of the indexes listed above. Past performance is not a guarantee of future results. Index returns are unmanaged and do not reflect the deduction of any fees or expenses. Index returns reflect all items of income, gain and loss and the reinvestment of dividends and other income.

Figure 6 also illustrates the impact of moving up and down the risk spectrum and how modest adjustments to an allocation can dictate risk sensitivities.

Figure 6

20-Year Risk and Return Profile



Source: FactSet, for the period from 01/01/2000 to 12/31/2019. Each portfolio is rebalanced annually, without taking into account transaction costs. The returns were achieved by mathematically combining the actual performance of the indexes listed above. Past performance is not a guarantee of future results. Index returns are unmanaged and do not reflect the deduction of any fees or expenses. Index returns reflect all items of income, gain and loss and the reinvestment of dividends and other income.

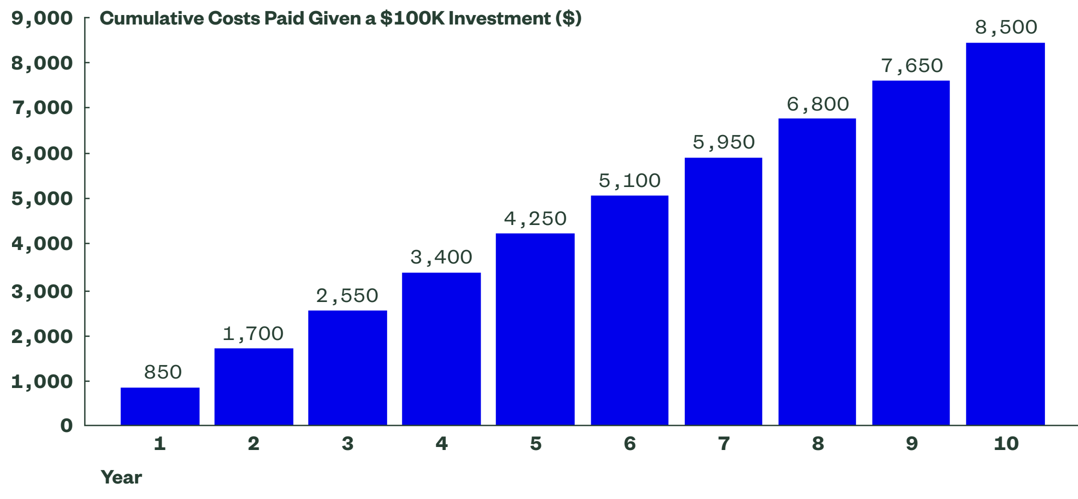
3

Control Costs

It's this simple: high costs erode portfolio returns. And, as the largest part of your portfolio, the core should never be the most expensive component. So, as you add asset classes to the core to help improve stability, generate income or pursue performance, it's important to ensure your portfolio's cost profile remains under control.

How can high costs impact portfolio returns over the long term? Consider that the expense ratio of the median US-listed mutual fund is 0.85% a year.[5] While that doesn't seem like much, assuming an industry standard return target of 7.6%[6] was met each year over a decade, investors consistently using mutual funds to gain core exposures would end up paying cumulative fees of 8.50% of starting principal. That's nearly 1% higher than one year of portfolio returns.

Figure 7
The Impact of Fees
Over a decade, a portfolio invested at the median US-listed mutual fund costs would have forfeited 8.5% of starting principal to fees



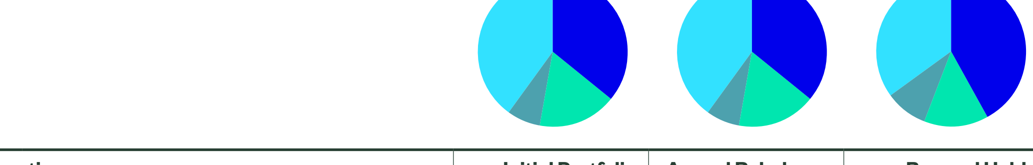
Median US-Listed Mutual Fund TER = 0.85%
Source: Morningstar, State Street Global Advisors, as of 12/31/2019. Actual fees paid by an investor will differ.

4

Impose Discipline

Once a strategic allocation is set, we believe investors should continue to manage it through systematic and disciplined portfolio rebalancing. Keep in mind that performance of different asset classes may shift the portfolio allocation over time. As shown in Figure 8, after two decades a buy-and-hold portfolio had a greater allocation to equities, exhibiting lower return per unit of risk. Therefore, it's important to have a disciplined rebalancing program in place to ensure your portfolio doesn't deviate significantly from your initial allocation and expose you to additional risk.

Figure 8
Rebalancing Can Impact Returns and Risks
Asset allocation of a 60/40 portfolio after 20 years



Allocation	Initial Portfolio as of 12/31/1999	Annual Rebalance as of 12/31/2019	Buy and Hold as of 12/31/2019
S&P Composite 1500 Index	36%	36%	42%
S&P Developed Ex U.S. BMI Index	17%	17%	14%
S&P Emerging BMI Index	7%	7%	9%
Bloomberg Barclays U.S. Aggregate Bond Index	40%	40%	35%

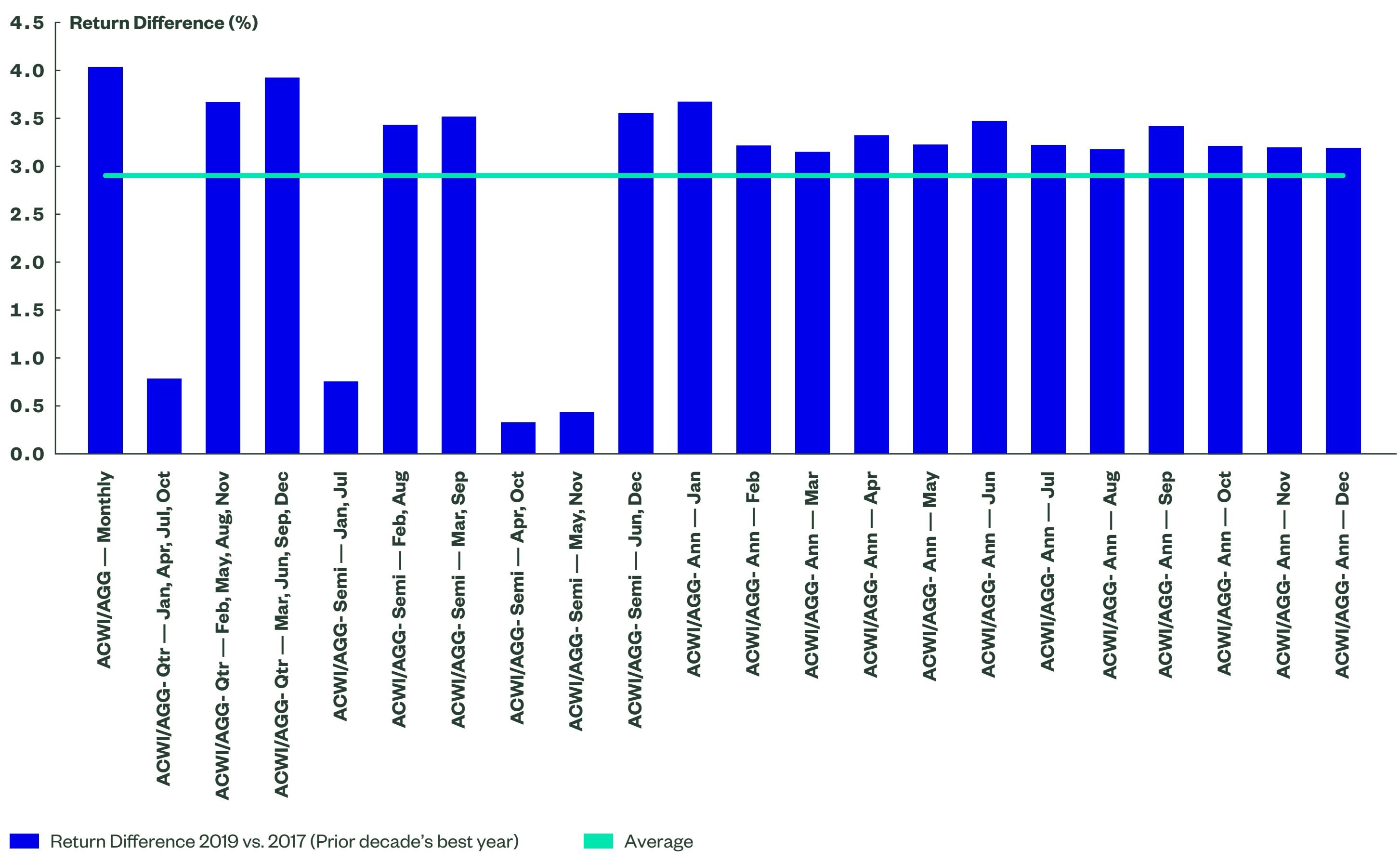
	Annual Rebalance	Buy and Hold
20-Year Annualized Return	6.33	5.68
20-Year Annualized Standard Deviation	8.84	8.11
Return Per Unit of Risk	0.72	0.70

Source: FactSet as of 12/31/2019. The performance does not reflect any transaction costs. Past performance is not a guarantee of future results. The returns were achieved by mathematically combining the actual performance of the indexes listed above. Index returns are unmanaged and do not reflect the deduction of any fees or expenses. Index returns reflect all items of income, gain and loss and the reinvestment of dividends and other income.

In addition, our research has found that the timing and frequency of portfolio rebalancing can have a big impact on cumulative returns and the return paths of a naïve 60/40 ACWI/Agg blend portfolio. As shown in Figure 9, the difference between the 2019 return and the prior decades' record high ranged from a mere 40 basis points (or 0.40%) to upward of 4%, depending on when and how frequently they were rebalanced.

Figure 9

Return Differences Between 2019 Return and the Record High of Prior Decade



Source: FactSet, as of 12/31/2019. Calculation by SPDR Americas Research. Stock exposures as represented by the MSCI ACWI Index, and bonds by Bloomberg Barclays US Aggregate Bond Index. All index returns used are total returns. **Past performance is no guarantee of future results.** Index returns are unmanaged and do not reflect the deduction of any fees or expenses. Index returns reflect all items of income, gain and loss and the reinvestment of dividends and other income.

When extending the asset allocation mix by including more granular exposures, such as developed ex-US, Emerging markets for equities, high yield bonds, the impact of rebalancing timing and frequency intensifies.[7] Therefore, investors should understand the impact of a rebalancing strategy can have on their portfolios and be aware of the rationale as to why the defined course of rebalancing action was taken.

Invest with SPDR Portfolio ETFs: Low-Cost Building Blocks

For investors seeking to expand their toolbox for diversification, we provide a comprehensive suite of low-cost ETFs covering detailed segments of the broad equity and fixed income exposures. Our family of 22 SPDR Portfolio ETFs covers domestic and international equity and fixed income categories, making it easy to construct cost-efficient customized cores. Whether you seek to generate income, manage risk or grow capital, you can build a core with funds that have a median expense ratio of just 6 basis points.[8]

Figure 10
SPDR Portfolio ETFs

Exposure	Fund Name	Ticker	Net Expense Ratio (%)
US Equity			
Broad Market	SPDR Portfolio S&P 1500 Composite Stock Markets ETF	**SPTM**	0.03
Large Cap	SPDR Portfolio S&P 500 ETF	**SPLG**	0.03
Mid Cap	SPDR Portfolio S&P 400 Mid Cap ETF	**SPMD**	0.05
Small Cap	SPDR Portfolio S&P 600 Small Cap ETF	**SPSM**	0.05
Growth	SPDR Portfolio S&P 500® Growth ETF	**SPYG**	0.04
Value	SPDR Portfolio S&P 500 Value ETF	**SPYV**	0.04
Dividend Income	SPDR Portfolio S&P 500 High Dividend ETF	**SPYD**	0.07
International Equity			
Global Stock	SPDR Portfolio MSCI Global Stock Market ETF	**SPGM**	0.09
Developed ex-US	SPDR Portfolio Developed World ex-US ETF	**SPDW**	0.04
Europe	SPDR Portfolio Europe ETF	**SPEU**	0.09
Emerging Markets	SPDR Portfolio Emerging Markets ETF	**SPEM**	0.11
Fixed Income			
US Aggregate	SPDR Portfolio Aggregate Bond ETF	**SPAB**	0.04
Short Corporate	SPDR Portfolio Short Term Corporate Bond ETF	**SPSB**	0.07
Intermediate Corporate	SPDR Portfolio Intermediate Term Corporate Bond ETF	**SPIB**	0.07
Long Corporate	SPDR Portfolio Long Term Corporate Bond ETF	**SPLB**	0.07
Broad Corporate	SPDR Portfolio Corporate Bond ETF	**SPBO**	0.06
Short Government	SPDR Portfolio Short Term Treasury ETF	**SPTS**	0.06
Intermediate Government	SPDR Portfolio Intermediate Term Treasury ETF	**SPTI**	0.06
Long Government	SPDR Portfolio Long Term Treasury ETF	**SPTL**	0.06
Mortgages	SPDR Portfolio Mortgage Backed Bond ETF	**SPMB**	0.06
High Yield	SPDR Portfolio High Yield Bond ETF	**SPHY**	0.15
TIPS	SPDR Portfolio TIPS ETF	**SPIP**	0.12

Source: State Street Global Advisors, as of 01/24/2020.

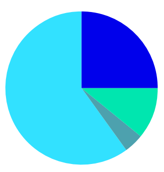
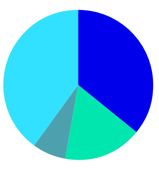
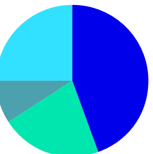
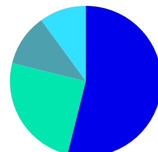
Prior to 01/24/2020, the SPDR Portfolio S&P 1500 Composite Stock Market ETF (SPTM) was known as the SPDR Portfolio Total Stock Market ETF (SPTM), the SPDR Portfolio S&P 500 ETF (SPLG) was known as the SPDR Portfolio Large Cap ETF (SPLG), the SPDR Portfolio S&P 400 Mid Cap ETF (SPMD) was known as the SPDR Portfolio Mid Cap ETF (SPMD), and the SPDR Portfolio S&P 600 Small Cap ETF (SPSM) was known as the SPDR Portfolio Small Cap ETF (SPSM).
A fund's net expense ratio includes waivers and reimbursements. It is the actual expense ratio that investors paid during the fund's most recent fiscal year. Some of the funds listed may have current fee agreements in place that reduces fund expenses and if removed or modified will result in higher expense ratios and reduce fund performance. Complete details can be found in each fund's prospectus on our website spdrs.com.

For thoughts on how you can build portfolios that match your clients' risk/return objectives, check out five illustrative allocation examples. From conservative to aggressive allocations, each of these portfolios seeks to enhance diversification by offering exposure to thousands of securities across 94 countries.[9] And all have a weighted average expense ratio around 4 basis points.

Figure 11

5 Hypothetical Risk-based Core Portfolio Examples for Less than 4 Basis Points

Hypothetical Portfolio Allocations

Ticker	Exposure	Conservative	Moderate-Conservative	Moderate	Moderate-Aggressive	Aggressive
SPTM	US Equities	12.5%	25.0%	36.0%	44.5%	54.0%
SPDW	Developed ex-U.S. Equities	6.5%	11.0%	17.0%	21.5%	25.0%
SPEM	Emerging Market Equities	1.0%	4.0%	7.0%	9.0%	11.0%
SPAB	Bonds	80.0%	60.0%	40.0%	25.0%	10.0%
Weighted Average Expense Ratio (bps)		**3.9**	**4.0**	**4.1**	**4.2**	**4.2**

Source: State Street Global Advisors, 12/31/2019. Characteristics are as of the date given and should not relied upon as current thereafter.
All asset allocation scenarios are for hypothetical purposes only and are not intended to represent a specific asset allocation strategy or recommend a particular allocation. Each investor's situation is unique and asset allocation decisions should be based on an investor's risk tolerance, time horizon and financial situation.
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Do More with Your Core — for Less

While constructing a core with a long-term strategic view, you also want to be able to adjust your allocations with more targeted allocations to address client-specific needs and respond to shifts in market regimes.

A core built with SPDR Portfolio ETFs provides the support you need to pivot confidently in any direction. Our lineup of 22 funds can help you expand your toolkit to pursue outcome-oriented objectives, such as:

Seek Growth and Income

Consider allocating a portion of your core equity exposure to segments focused on stocks with higher than average earnings growth and higher than average dividend yields.

SPYG SPDR Portfolio S&P 500 Growth ETF
SPYD SPDR Portfolio S&P 500 High Dividend ETF

Seek Capital Appreciation

Consider allocating a portion of your core equity exposure to segments that represent long-term opportunities due to expanding growth rates, improving valuations and demographic shifts.

SPYV SPDR Portfolio S&P 500 Value ETF
SPSM SPDR Portfolio Small Cap ETF
SPMD SPDR Portfolio Mid Cap ETF
SPEM SPDR Portfolio Emerging Markets ETF

Manage the Impact of Fluctuating Interest Rates

Consider tailoring your core fixed income exposure to either shorten or lengthen duration depending on your view of rate movements, without taking on additional credit risk.

SPTS SPDR Portfolio Short Term Treasury ETF
SPTI SPDR Portfolio Intermediate Treasury ETF
SPTL SPDR Portfolio Long Term Treasury ETF
SPIP SPDR Portfolio TIPS ETF

Balance Income and Risk within Bonds

Consider augmenting core aggregate bond allocations with precise credit exposures across different maturity ranges and credit quality brackets that represent a potential source of income.

SPMB SPDRD Portfolio Mortgage Backed Bond ETF
SPSB SPDR Portfolio Short Term Corporate Bond ETF
SPIB SPDR Portfolio Intermediate Term Corporate Bond ETF
SPLB SPDR Portfolio Long Term Corporate Bond ETF
SPHY SPDR Portfolio High Yield Bond ETF

Choosing low-cost SPDR Portfolio ETFs can help you keep more of your return.
Because when building your clients' portfolios, every little bip counts. Visit spdrs.com/lowcost or call 866-787-2257 for more information.

Endnotes

1 Gary P. Brinson, L. Randolph Hood, Gilbert L. Beebower, "Determinants of Portfolio Performance", Financial Analyst Journal Vol.42 Issue 4 1986.

2 Coval and Moskowitz, "Home Bias at Home: Local Equity Preference in Domestic Portfolios." Journal of Finance, December 1999.

3 World Bank, as of 12/31/2018.

4 Return Per Unit of Risk is calculated by dividing returns by the standard deviation for the same time period.

5 Morningstar, as of 08/31/2019.

6 Saret, Jeffrey N., Zhan, Barbara and Mitra, Subhadeep. "Investment return assumptions of public pension funds." pionline.com, March 23, 2017.

7 Rebalancing, Returns, and Luck in the Last Decade, Matthew Bartolini, January 2020.

8 State Street Global Advisors, Morningstar, as of 08/31/2019.

9 State Street Global Advisors, FactSet, Bloomberg Finance L.P., as of 12/31/2019.

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Non-diversified funds that focus on a relatively small number of securities tend to be more volatile than diversified funds and the market as a whole.

Equity securities may fluctuate in value in response to the activities of individual companies and general market and economic conditions.
Investments in **small-sized companies** may involve greater risks than in those of larger, better known companies. Returns on investments in stocks of small companies could trail the returns on investments in stocks of larger companies.
Value stocks can perform differently from the market as a whole. They can remain undervalued by the market for long periods of time.
Dividend paying securities can fall out of favor causing securities to underperform companies that do not pay dividends. Changes in dividend policies of companies may adversely affect fund performance.
Foreign investments involve greater risks than US investments, including political and economic risks and the risk of currency fluctuations, all of which may be magnified in emerging markets.
Bond funds contain interest rate risk (as interest rates rise bond prices usually fall); the risk of issuer default; issuer credit risk; liquidity risk; and inflation risk.
Increase in real interest rates can cause the price of inflation-protected debt securities to decrease. Interest payments on inflation-protected debt securities can be unpredictable.
Returns on investments in stocks of large US companies could trail the returns on investments in stocks of smaller and mid-sized companies.
Passively managed funds invest by sampling the index, holding a range of securities that, in the aggregate, approximates the full Index in terms of key risk factors and other characteristics. This may cause the fund to experience tracking errors relative to performance of the index.
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Exp. Date: 03/31/2021

Not FDIC Insured
No Bank Guarantee
May Lose Value