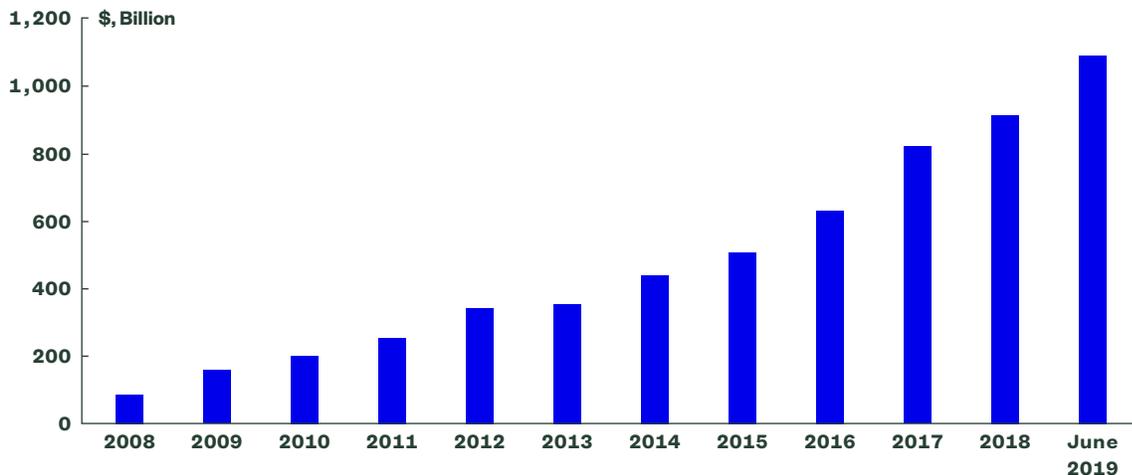


Why Invest in Fixed Income ETFs

Global fixed income exchange traded fund (ETF) assets have increased to more than \$1 trillion.¹ And Cerulli² and Greenwich Associates³ have reported that both wealth management and institutional investors expect to increase their use of fixed income ETFs over the next few years. This steady growth has created a more centralized and transparent fixed income marketplace.

More Than a Decade of Fixed Income ETF Growth



Source: Bloomberg Finance, L.P., Morningstar, June 30, 2019.

Benefits of Fixed Income ETFs

ETFs' unique characteristics enable investors to:

Lower Costs US-listed fixed income ETFs have a median expense ratio of 0.25%, versus mutual funds' 0.66%. While many ETFs are index based, this lower-cost profile carries over to actively managed ETFs that have a median expense ratio of 0.41%, versus 0.68% for actively managed bond mutual fund strategies.⁴

Improve Liquidity ETFs' robust secondary market allows investors to tap into market liquidity more easily than they can with single-CUSIP bond holdings. This enables them to reallocate portfolios quickly across asset classes or meet investor redemptions by selling an ETF position into the market without having to sell single-CUSIP bonds.

Increase Transparency Both index-based and actively managed ETFs report holdings daily, increasing transparency for investors performing daily portfolio due diligence and attribution for risk management.

Target Duration ETFs precisely cover the entire term structure along the yield curve, so investors can fine tune a portfolio's interest rate risk (duration) to match market views or client liabilities.

Modulate Credit Risk Ranging from investment-grade credit to crossover debt to senior loans to high yield, ETFs allow investors to control the amount of credit risk in a portfolio with ease and transparency.

Strategic and Tactical Uses

Launched in 2002, fixed income ETFs gained traction after the financial crisis. Price and holdings transparency and ease of trading drove that growth as many dealers reduced their balance sheets and transitioned from principal- to agency-based trading models in cash bonds.

Fixed Income ETFs allow you to:

Be Active with an Index Using the vast array of ETFs to optimize portfolios for precise yield, duration, spread, and sector, or even to naively reweight sectors of the Bloomberg Barclays U.S. Aggregate Index, investors can create custom portfolios across a wide array of bond subsectors.

Seek Active Management More than 110 actively managed bond ETFs have launched in the US over the past 10 years and now have more than \$61 billion of AUM. Some of these ETFs have 3-, 5- or 10-year track records.⁵

Replicate Beta The expansion of liquid ETF products supports more adaptable beta solutions to equitize cash or provide easy reinvestment of accumulated coupon payments.

Target Trends Investors can seek alpha by rotating efficiently in and out of asset classes based on macro, technical or fundamental trends. For example, investors can rotate into emerging market local debt in a declining rate and softer dollar environment. Or they can short ETFs to make relative value trades, such as loans over high yield, by executing on just two CUSIPs.

Additional Portfolio Uses

ETFs' in-kind creation/redemption process also supports their use in a variety of other portfolio roles:

Transfer of Assets The breadth of securities owned by ETFs allow large investors holding single bonds to leverage the in-kind creation/redemption process to efficiently transfer select underlying bonds on their books into an ETF.

Transition Management If an asset manager receives an influx of cash, index-based fixed income ETFs can be used as temporary placeholders to obtain exposure while searching for a new manager. When a new strategy is decided on, investors working through an AP can redeem out of the ETF and take delivery of the individual bonds through the redemption process.

Inventory Consolidation Sell-side brokerage firms can use fixed income ETFs to manage the inventory held by their trading desks, consolidating positions across traders, and move bonds off their books by creating ETF shares that they can then sell in the market.

Derivative Alternatives

Fixed income ETFs provide alternatives to total return swaps and credit default swaps indices.

Also, investors can tap into the nearly \$70 billion of ETF option notional value open interest on fixed income products for risk mitigation, income generation or more advanced strategies.⁶

Endnotes

- 1 Source: Morningstar, as of 06/30/2019.
- 2 “Bond ETFs: Financial Advisors Drive Use With Specialized Applications,” Cerulli 2017.
- 3 “ETFs: Valuable Versatility in a Newly Volatile Market,” Greenwich Associates 2018.
- 4 Morningstar as of 06/30/2019. Oldest share class of mutual funds used in calculation.
- 5 Morningstar as of 06/30/2019.
- 6 Morningstar as of 06/30/2019.

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Important Risk Discussion

The information provided does not constitute investment advice and it should not be relied on as such. It should not be considered a solicitation to buy or an offer to sell a security.

It does not take into account any investor's particular investment objectives, strategies, tax status or investment horizon. You should consult your tax and financial advisor.

ETFs trade like stocks, are subject to investment risk, fluctuate in market value and may trade at prices above or below the ETFs' net asset value. Brokerage commissions and **ETF** expenses will reduce returns.

Frequent trading of ETFs could significantly increase commissions and other costs such that they may offset any savings from low fees or costs. In general, ETFs can be expected to move up or down in value with the value of the applicable index. Although ETF shares may be bought and sold on the exchange through any brokerage account, ETF shares are not individually redeemable from the Fund.

Bonds generally present less short-term risk and volatility than stocks, but contain interest rate risk (as interest rates rise, bond prices usually fall); issuer default risk; issuer credit risk; liquidity risk; and inflation risk. These effects are usually pronounced for longer-term securities. Any **fixed income** security sold or redeemed prior to maturity may be subject to a substantial gain or loss.

Derivatives are based on one or more underlying securities, financial benchmarks, indices, or other obligations or measures of value; additional risks with derivatives trading (e.g., market, credit, counterparty and illiquidity) are possibly greater than the risks associated with investing directly in the underlying instruments. Derivatives can have a leveraging effect and increase fund volatility that can have

a large impact on Fund performance. **Actively managed funds** may underperform its benchmarks. An investment in the fund is not appropriate for all investors and is not intended to be a complete investment program. Investing in the fund involves risks, including the risk that investors may receive little or no return on the investment or that investors may lose part or even all of the investment.

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