Insights
Institutional Client Group

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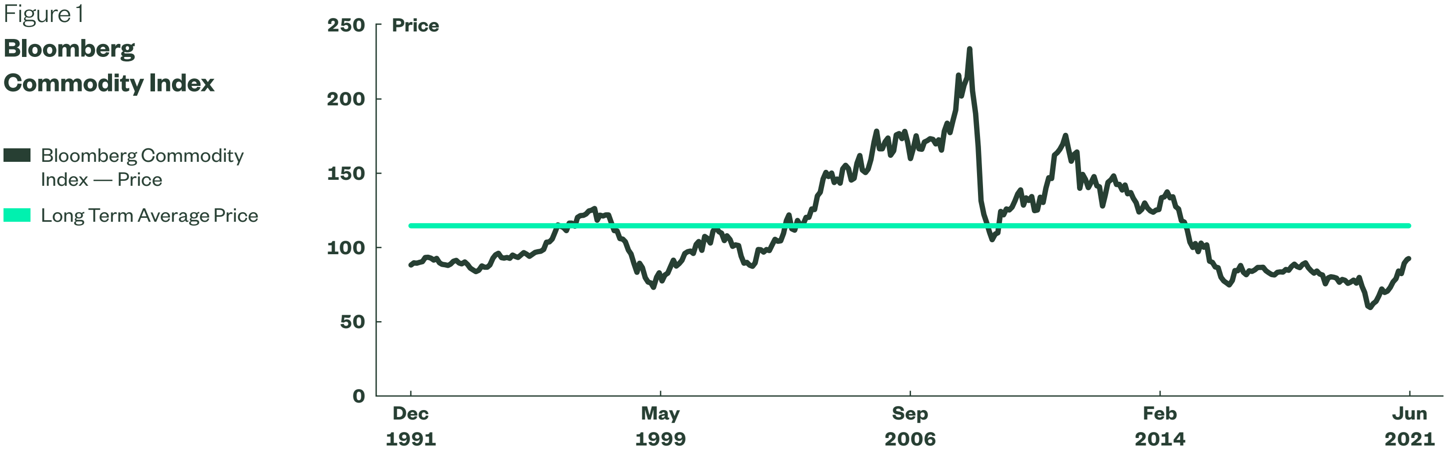
The post-pandemic recovery is not complete, but economies appear much improved and signs continue to point to accelerated growth over the second half of 2021. Inflation remains a concern as COVID-19 related headwinds, logistical bottlenecks and increased demand continue to pressure prices higher. However, healthy consumer balance sheets and fading mobility restrictions should help soften the impact.

In this quarter's newsletter, we explore the role commodities can serve as an inflation hedge. Next, we discuss fee compression in asset management and share five key questions that endowments and foundations should ask outsourced investment providers. Finally, we review State Street Global Advisors' current tactical asset allocation positioning as a source for potential alpha.

Are Commodities Expensive?

Consumer price inflation (CPI) has accelerated sharply and broadly in recent months. There are multiple drivers of these inflation readings, including year-over-year base effects, supply chain challenges, and elevated money supply from monetary and fiscal policy support. When inflation becomes a concern, commodities are known to be a very good way to hedge.

Figure 1
Bloomberg Commodity Index



Source: State Street Global Advisors, Bloomberg Barclays L.P., FactSet. Series based on monthly index level from 12/31/1991 to 06/17/2021.

True to expectations, there has recently been a significant rise in commodity prices with the recent uptick in inflation, causing investors to question if there is further upside. Despite the recent rise, Bloomberg Commodity Index prices are still at historically low levels. Inflation has been latent over the last decade, and commodities have been mostly out of favor, resulting in some underexposure to the asset class.

We believe inflation will remain elevated over the short to intermediate term. Over time, base effects will roll off and supply chains will eventually heal. The infusion of money supply from monetary and fiscal policy will be longer lasting and encourage higher inflation until the Federal Reserve starts raising rates, which most likely won't happen before 2023.

Click *here* for more insights about how commodities, as a part of the broader real assets universe, can serve as an inflation hedge.

Source: State Street Global Advisors, Bloomberg Barclays L.P., FactSet. Past performance is not a guarantee of future results.

Five Questions to Ask an Outsourced Investment Provider

Over the past decade, fee compression has been a steady trend in the asset management industry, as competing firms seek to win market share and increase scale.[1] Outsourced CIO services are no exception. When evaluating a potential OCIO provider, fees are important. At the same time, it's crucial to consider fees within a broader context when engaging an outsourced provider. An OCIO relationship is not a commodity. While some providers may offer only strategic advice for a base-level fee, OCIO relationships can deliver a significant premium through a wider and deeper range of services with varying levels of discretion. Here are five questions to ask your outsourced investment provider to help ensure that you get the outcomes you need and expect for the fees you pay.

1.

What level of fiduciary responsibility is being offloaded and what is being retained?

Many providers can take on as much — or as little — discretion as a client wishes to delegate. The level of discretion that the OCIO assumes and the range of services provided are reflected in the advisory fee. When determining the decision-making authority that will be assumed by the OCIO, it is also important to consider the scope of services the client is able to offload in addition to delegated decision making. Advisory fees are an explicit contractual arrangement and often increase for greater level of delegated services.

When comparing similar delegated models, it is also important to consider potential opportunity cost factors caused by inefficient trading and rebalancing services that can erode portfolio values. These include transactional drag, being out of the market, and ineffective rebalancing processes. Each of these factors could supersede a 10 basis point advisory fee, for example, in any one week, let alone for a year.

2.

What trading infrastructure and risk systems are used to manage and monitor client portfolios?

OCIO providers often use sophisticated tools to handle portfolio management (including trading and rebalancing) and to effectively analyze, manage and report on risk. The most effective trading infrastructure and risk systems are very expensive platforms on a standalone, per client basis. Providers that offer these tools tend to fall in the higher range for advisory fees. Clients can access the benefits of these platforms far more cheaply than building or buying them directly.

An OCIO with a centralized trading and implementation function that is responsible for managing cash flows, portfolio rebalancing and tactical positioning, executing hedges and overlays, and ensuring timely movements of capital using a consistent approach not only reduces potential transaction cost, but also improves governance related to portfolio actions for approved investment decisions. Providers that offer these enhanced service levels are likely to be on the higher end of the fee range, and rightfully so. It's critical to keep in mind that adverse trading costs or operational errors can more than offset fee differentials among providers.

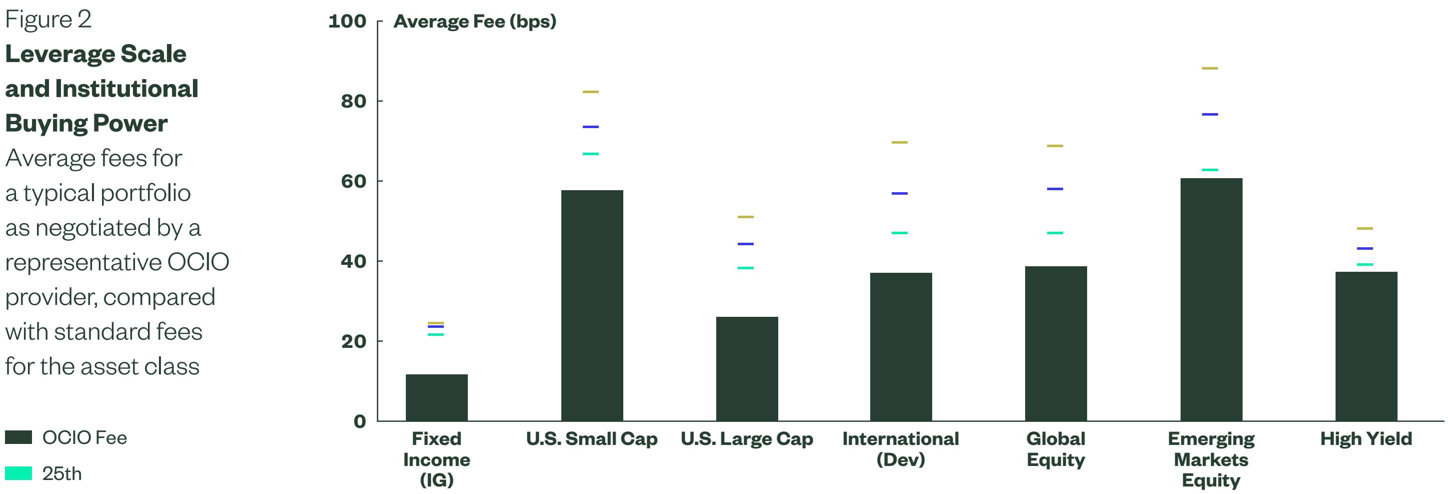
3.

Does the OCIO have access to appropriate private market vehicles and the negotiating power to lower overall portfolio fees?

One of the key benefits of working with an outsourced investment provider is the ability to access the return advantages of illiquid assets in a fee-efficient structure. Clients should ensure that their alternative investment allocations are customized to their specific investment horizon and objectives. Some OCIOs utilize proprietary private market fund-of-funds for all clients, regardless of size. These proprietary vehicles are neither custom nor portable and typically incur higher costs than direct investments. Clients with sizeable private market allocations and a longer investment horizon should have access to more customized portfolio construction with deep alternative investment expertise and relationships.

Another benefit of partnering with an OCIO — especially an OCIO with exceptional scale — is the potential to gain cost savings by leveraging the buying power of the provider and the know-how of its manager research function to negotiate reduced management fees for best-in-class investment strategies. The cost savings passed along to endowments, foundations, operating funds, defined contribution and defined benefit plans can be significant and should be considered when comparing outsourced providers (see Figure 2).

Figure 2
Leverage Scale and Institutional Buying Power
Average fees for a typical portfolio as negotiated by a representative OCIO provider, compared with standard fees for the asset class



Source: State Street Global Advisors and eVestment. For illustrative purposes only.
Fees shown are averages using December 31, 2020 AUM and existing fee schedules. Percentiles from eVestment universes based on average mandate size and using December 31, 2020 fee schedules published by the investment managers.
eVestment universes: Long Duration Fixed Income, US Small Cap Equity, US Large Cap Equity, All EAFE Equity, All Global Equity, Global Emerging Markets Equity, US High Yield Fixed Income.

4.

What type of reporting can I expect?

Standard reports providing baseline information from the custodian, such as portfolio values, performance, and attribution, are sufficient for some OCIO clients. Custom reporting typically involves additional costs for OCIO mandates. Quality custom reporting should not be mistaken for overcomplicated risk reports with a range of outcomes, simulations and back tests. These can ultimately overwhelm and distract clients from what matters most. Custom reporting worth paying for yields insight, allowing you to quickly and easily understand the possible outcomes and what may require some adjustment. Risk assessments should summarize this range of outcomes, highlight where the most significant risks are coming from, and make clear whether any segment of the portfolio may not perform in line with expectations in an abnormal market event. Providing the right amount of data to a client and reducing the risk of surprising the investment committee and senior management is key to a successful OCIO relationship.

5.

Am I overpaying for OCIO services?

For institutional investors already engaged in an OCIO relationship, regular review and consideration of fee arrangements can be helpful. Some client segments haven't benefited from the fee compression trends that have prevailed among OCIO providers in recent years. Institutions such as endowments and foundations are more asset focused, total-return oriented, and have less complex requirements than, for example, a corporate pension plan, which needs liability valuations, glide path development, and funded status monitoring. Institutions with more straightforward needs may find they are paying higher fees versus the value they're receiving when compared to corporate pension plan sponsors. These client types should carefully review the outsourced investment fees they are charged against the services required for their specific mandate.

The fees associated with retaining an OCIO to oversee your total investment management program are just one consideration when searching for a new provider or conducting a due diligence assessment of your current one. An OCIO relationship can offer governance and investment expertise, operational efficiency, and improved risk management. These benefits can lead to fortified standards for not-for-profit boards and retirement plan fiduciaries, and ultimately benefit your organization's mission. To unlock these benefits, it's important to place fees in context with the quality services that will contribute to your desired outcomes.

Tactical Asset Allocation

At State Street Global Advisors, our quantitative models still favor equities and other growth assets such as commodities, but our forecast for core bonds continues to improve. While the expanding economic growth backdrop supports equities broadly, we have become slightly less optimistic on emerging markets.

Within fixed income, we reduced credit exposure to both high yield and intermediate investment grade in favor of core bonds. Our forecast for core bonds continues to improve and it now ranks near the top of our fixed income quantitative framework. Our expectation for core bonds is a meaningful decrease in the level of rates with a sizable flattening of the yield curve.

From a sector perspective, we maintained allocations to technology, energy and industrials while removing the split allocation with our rotation out of materials.

State Street Global Advisors' tactical asset allocation views are based upon a 1–3 month forward-looking horizon. If you are interested in reading more about our current tactical positioning, please follow the hyperlink *here*.

Endnote

1 Source: Casey Quirk, a business of Deloitte Consulting LLP.

About State Street Global Advisors

Our clients are the world's governments, institutions and financial advisors. To help them achieve their financial goals we live our guiding principles each and every day:

- Start with rigor
- Build from breadth
- Invest as stewards
- Invent the future

For four decades, these principles have helped us be the quiet power in a tumultuous investing world. Helping millions of people secure their financial futures. This takes each of our employees in 30 offices around the world, and a firm-wide conviction that we can always do it better. As a result, we are the world's fourth-largest asset manager* with US $3.90 trillion† under our care.

* Pensions & Investments Research Center, as of December 31, 2020.
† This figure is presented as of June 30, 2021 and includes approximately $63.59 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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Equity securities may fluctuate in value in response to the activities of individual companies and general market and economic conditions.

Currency risk is a form of risk that arises from the change in price of one currency against another. Whenever investors or companies have assets or business operations across national borders, they face currency risk if their positions are not hedged.

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.

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