State Street Floating Rate Fund

STATE STREET GLOBAL ADVISORS

What a Change a Quarter Made!

- Over the quarter, senior unsecured bank debt spreads clawed back all of the COVID-19 induced March widening.
- Australian money market flooded with cash – RBA implemented successful yield curve control which other central banks are now analysing for their financial systems.
- The fund outperformed the benchmark, RBA Cash Rate, by 1.43% for the quarter (net of fees).[1]

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In the face of a global pandemic that has the potential to drag on for many years, three months is a very brief period. During the last three months however, senior unsecured bank debt spreads have clawed back all of the COVID-19 induced March widening, and if you compare January 2020 to June 2020 AUD senior unsecured bank levels, spreads have indeed rallied!

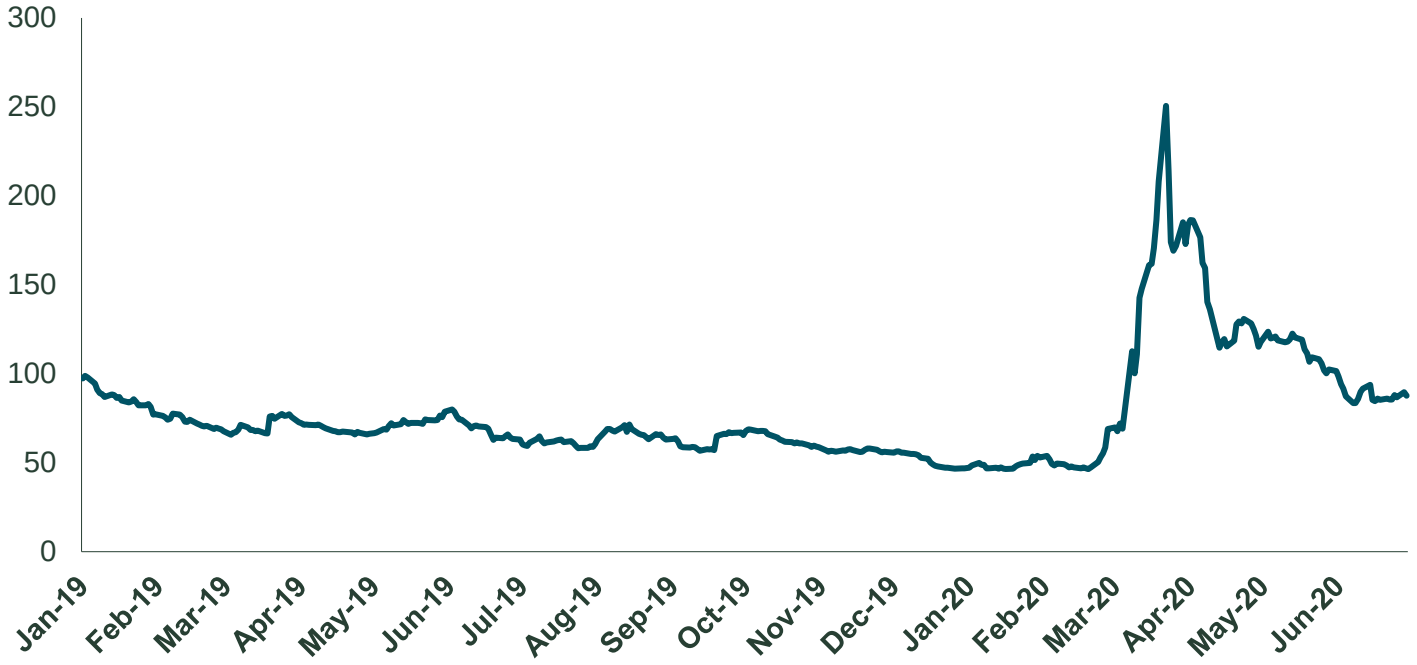
As mentioned in last quarter's State Street Floating Rate Fund market commentary, the risk off trade that affected so many asset classes in March was driven by a fear of the unknown. Many of us had experienced the volatility and difficult market conditions driven by defaults and sparse liquidity during the GFC but few had experienced a global pandemic and what effect that would have on markets. The difference this time was that the realisation hit the market very quickly that this was not a financial crisis but a biological crisis. It was also crystal clear that the central banks globally were on the front foot with monetary stimulus and the governments globally were splurging on fiscal measures that would also calm worried markets down. The ferocity with which the market sold off in March was rivalled by the snap-back in market sentiment once it was acknowledged that the banks were strong, their balance sheets were sturdy and the regulatory oversight that had been implemented post 2009 was, and had worked. There were many investors that implemented a GFC style playbook and that trade was quickly on the wrong side of a fast paced rally in many asset classes over the quarter.

The Australian money market over the quarter was, and still is flooded with cash. The RBA has successfully implemented yield curve control that many other central banks the Federal Reserve included, are analysing and discussing if the same trade of targeting a specific yield on a precise section of the curve could also work for their financial systems. To this end there is now so much liquidity in the Australian money market that banks are running substantial exchange settlement account positions with the RBA, due to the lack of availability of regulatory approved assets that banks can buy and hold on their balance sheets. This search for yield and good quality assets played out very well for senior unsecured bank debt and their secondary market spreads during the quarter.

[1] Past performance is not a reliable indicator of future performance. Performance returns for periods of less than one year are not annualized. The performance figures contained herein reflect Total Returns and are provided on a net of fees basis. Net performance figures are calculated using end-of-month exit prices, assume the reinvestment of distributions, are post management and transaction costs, and make no allowance for tax.

The portfolio maintained spread duration over the period of around 3 years, the credit quality did not change from an average S&P credit rating of A/A+ and the fund outperformed the benchmark, RBA Cash Rate by 1.43% for the quarter (net of fees)[2] .

Figure 1. **5 Year iTraxx Spreads, 2 January 2019 to 30 June 2020**



Source: Bloomberg Finance L.P., as at 30 June 2020**.** Past performance is not a reliable indicator of future results.

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Important Disclosures

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