State Street Global Equity Fund

STATE STREET GLOBAL ADVISORS

Looking Beyond Mega-Cap Stocks to Find Opportunities in Equities

- In September, investor sentiment shifted away from expensive mega-caps toward pockets of the market that have long been out of favor.
- This shift has expanded the potential opportunity set for equity investors seeking reasonably priced, good quality stocks with positive sentiment.

Olivia Engel, CFA
Chief Investment Officer
Active Quantitative Equity (AQE)

Over the past quarter, we've remarked on the extent to which expensive and high-sentiment stocks were becoming more and more concentrated in the listed equity market, driving a larger and larger share of the index returns. Stocks with reasonable valuations languished, while those benefiting from positive sentiment hurtled upward. This gap accelerated over the second and third quarters of this year, increasingly narrowing our options in our search for companies that "tick all the boxes"[1] — and we cautioned that investors **should be wary of these market extremes**.

During September, we saw a decided departure from this trend, as mega-caps' share prices moved away from their highs and dropped meaningfully compared with the index.[2] While this cohort of companies remains expensive and market sentiment associated with them is still high, the recent price retracement has created some new opportunities.

We're currently seeing sentiment pick up in some pockets of the market that have long been out of favour. Investors are starting to look beyond current trends to find attractive investment opportunities. This matters, because it means that we can now find more companies that tick all of our boxes.

A Sector View

Improving investor sentiment[3] is leading to renewed opportunities in some industrials, materials, and consumer discretionary stocks. Figure 1 shows the proportion of stocks in each industry group that have experienced a meaningful improvement in sentiment during September, along with the proportion of stocks within the industry

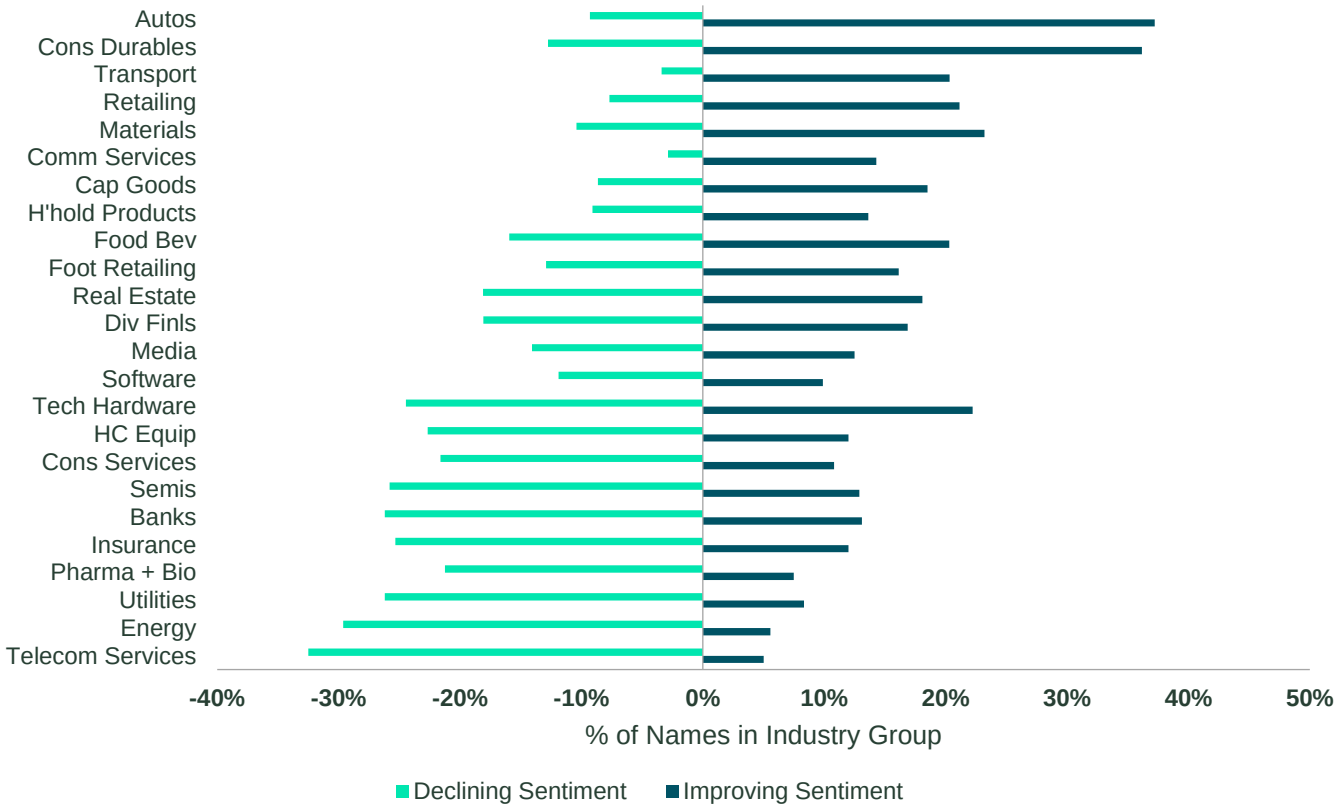
[1] In Active Quantitative equity, we look for high-quality, sustainable companies that are reasonably priced with respect to relevant fundamentals, with improving earnings outlooks and positive investor sentiment.

[2] The ten largest companies in the high-sentiment quintile that are also in the two most expensive value quintiles experienced an average return of -6.2% during September. This group includes Apple, Microsoft, Amazon, Facebook, Nvidia, Adobe, Netflix, Salesforce.com, Paypal, and SAP. Source: Refinitiv, as of 30 September 2020.

[3] In Active Quantitative Equity, we measure market sentiment by looking at price changes in stocks, changes to earnings estimates, hedge fund positioning, movements in sentiment linked through the supply chain, and analysis of language used in conference call transcripts.

group that have had a meaningful decline in sentiment. This reveals improving sentiment in a large part of the universe in Autos, Consumer Durables, Transportation, Retailing, Materials, Commercial Services, and Capital Goods.

Figure 1: Stocks with Meaningful Improvement in Investor Sentiment in the MSCI World Universe (September 1 through to September 30, 2020)



Source: State Street Global Advisors as of 30 September 2020.

The Bottom Line

Investors are starting to divert their attention away from the expensive, mega-cap technology and consumer stocks that have dominated the market in recent months. This, in turn, has expanded the universe of potentially attractive stocks, as more reasonably-priced names are now starting to benefit from improved investor sentiment. As we've noted in recent commentaries, extreme market conditions warrant caution. This month, we observe that a shift away from those extremes can offer affirmative opportunity for equity investors.

Portfolio Attribution and Performance[4]

Global markets retreated through September, led by cyclical sectors. Cyclicals underperformed on lower growth expectations and a retracement in large cap US tech names. A higher USD and the less optimistic growth outlook saw oil prices fall modestly, causing a severe retracement in Energy. Elsewhere, Communication Services,

[4] Source: Factset, SSGA as at 30 September 2020. Past performance is not a reliable indicator of future performance. This information should not be considered a recommendation to buy or sell any security or sector shown. It is not known whether the securities or sectors shown will be profitable in the future. Characteristics are as of the date indicated, subject to change, and should not be relied upon as current thereafter. 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.

Financials and IT also fell. The AUD fell 2.3c to US$0.72[5], partly due to a fall in iron ore prices and general risk-off sentiment in markets.

While stock selection added value during the month, the State Street Global Equity Fund underperformed after impacts of currency hedging. From a sector perspective, good stock picking within Communication Services and Consumer Discretionary were the key contributors towards relative performance. This was partially offset by negative stock selection within Materials and our lower than benchmark weight in Industrials. Currency hedging lost -1.6% and was the single biggest detractor from relative performance.

Year to date, underperformance has been concentrated in two cohorts – the very expensive (where we are underweight) and the very cheap (where we are overweight). The strategy aims to minimise total portfolio volatility and as part of achieving that objective, we have avoided the most expensive, high sentiment segments of the market that harbor higher valuation risks. While COVID-19 and central bank interventions have exacerbated certain trends that favoured the most expensive, high sentiment (stay-at-home) stocks, our current positioning (in reasonably valued, higher quality stocks with positive sentiment) reflects our strong conviction that these market imbalances will inevitably revert. As such, we stand by our belief that a risk-aware strategy requires a balanced view of return drivers.

[5] Source: Factset, SSGA as at 30 September 2020.

Important Disclosures

ssga.com

Issued by State Street Global Advisors, Australia Services Limited (AFSL Number 274900, ABN 16 108 671 441) (“SSGA, ASL”). Registered office: Level 14, 420 George Street, Sydney, NSW 2000, Australia · Telephone: +612 9240-7600 · Web: www.ssga.com. State Street Global Advisors, Australia, Limited (AFSL Number 238276, ABN 42 003 914 225) (“SSGA Australia”) is the Investment Manager.

References to the State Street Global Equity Fund ("the Fund") in this communication are references to the managed investment schemes domiciled in Australia, promoted by SSGA Australia, in respect of which SSGA, ASL is the Responsible Entity. This general information has been prepared without taking into account your individual objectives, financial situation or needs and you should consider whether it is appropriate for you. You should seek professional advice and consider the product disclosure document and target market determination, available at www.ssga.com, before deciding whether to acquire or continue to hold units in the Funds.

This material should not be considered a solicitation to apply for interests in the Funds and investors should obtain independent financial and other professional advice before making investment decisions. There is no representation or warranty as to the current or accuracy of, nor liability for, decisions based on such information.

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.

All information has been obtained from sources believed to be reliable, but its accuracy is not guaranteed.

The views expressed in this material are the views of the Active Quantitative Equity team through the period ended 30 September 2020 and are subject to change based on market and other conditions. This document contains certain statements that may be deemed forward-looking statements. Please note that any such statements are not guarantees of any future performance and actual results or developments may differ materially from those projected.

Investing involves risk including the risk of loss of principal.

Equity securities may fluctuate in value and can decline significantly in response to the activities of individual companies and general market and economic conditions.

Quantitative investing assumes that future performance of a security relative to other securities may be predicted based on historical economic and financial factors, however, any errors in a model used might not be detected until the fund has sustained a loss or reduced performance related to such errors.

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.

Actively managed funds do not seek to replicate the performance of a specified index.

The Fund is actively managed and 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.

The trademarks and service marks referenced herein are the property of their respective owners. Third party data providers make no warranties or representations of any kind relating to the accuracy, completeness or timeliness of the data and have no liability for damages of any kind relating to the use of such data.

www.ssga.com

Tracking: 2912960.1.9.ANZ.RTL

Exp. Date: 31/10/2021