State Street Floating Rate Fund

STATE STREET GLOBAL ADVISORS

Q3 2019 – a tale of two halves for credit and FRN's

- The senior unsecured credit spread rally continued into Q3.
- Bank spreads then gave up some of these gains from early September until the end of the quarter.
- Over the quarter the fund has outperformed the benchmark, RBA Cash Rate, by 0.22% net of fees[1].

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The September quarter of 2019 was a tale of two halves for credit, bond and indeed floating rate note markets.

The quarter started with a continued search for yield in senior unsecured bank names as both the bond and swap curves rallied on back of easier RBA monetary policy. Governor Stevens made it very clear in both June and July that if the time proven target of Consumer Price Index (CPI) annually being in the 2-3% band was not achieved, and if unemployment were not hovering around 4.5% (sooner rather than later to in itself spur wage inflation which will hopefully and subsequently add to a benign CPI profile of late), then additional easing of the official cash rate is "inevitable".

Knowing it wasn't just the RBA aggressively on the front foot, and that other central banks were aggressively trying to calm markets globally as US/China trade tensions both escalated and seemed some way off a resolution, there was a rally in most interest rate products which was soon coming undone and selling off as we approached both the mid and later parts of the quarter. There was a growing belief that money markets should not underestimate the resolve of central banks focus on creating inflation. Yields in Australia have broken many records during the quarter with the Australian Commonwealth Government Bond (ACGB) / Government curve out to 10yrs trading sub 1% at times. This again paved the way for funds and balance sheets that focus on additional yield through bank exposures adding a bid tone to FRN' s, until early August where market globally became rather pessimistic in outlook and decided to sell bonds, sell equity and with this tone of risk off sell FRN's too. The selloff in spreads was not due to a reprice, such that we have seen many times over the last 18 months, as

[1] Past performance is not a reliable indicator of future performance. Performance returns for periods of less than one year are not annualized. 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.

domestic banks swapped offshore issuance back to AUD and repriced the secondary market bank curve, nor was it a sell-off sparked by specific bad bank or country specific news. It was a gradual sell-off that extended to 30 September as banks and funds reached quarter end, and indeed year end for three of the domestic major four banks.

The portfolio as at the end of September 2019 was still well diversified with both Australian and International senior unsecured AUD bank issuance. It still had an average S&P long term credit quality of A and was still delivering an average coupon of 1.93%, well above RBA. The spread duration of the fund had shortened to ~2.5yrs which seemed the appropriate conservative position to take as markets became more volatile heading into quarter end.

Figure 1. **5 Year iTraxx Spreads, 9-Oct-15 to 30-Sep-19**

Source: Bloomberg Finance L.P., as at 30 September 2019**.** Past performance is not a reliable indicator of future results.

Important Disclosures

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