Market Commentary | March 2020

State Street Global Equity Fund
How we’re forming our investment response to coronavirus

- The first order effects of the coronavirus shock have been acute, but the longer term will bring more widespread economic impact — likely an economic downturn and subsequent recovery, each of unknown timing, magnitude and duration.

- Our approach first focused on assessing our portfolios’ exposure to the direct impact of the outbreak; as its economic consequences unfold, we will rely on our investment process, which has been designed to respond to changing economic conditions and refined through many years of research over many market cycles.

The extreme market environment connected to the coronavirus outbreak raises two key questions for investors: “How are we positioned?” and “What should we do about it?” As the impact of the coronavirus spread beyond the segments most directly affected to engulf the global economy, our first step in Active Quantitative Equity was to gauge our portfolio exposure to vulnerable companies. To decide what to do about those exposures, we continue to rely on our investment process. In this commentary, we’ll outline our approach for gauging our positioning, and explain how we apply our investment process, in light of the coronavirus and its emerging consequences.

Assessing our portfolio exposure as the coronavirus impact unfolds

Over the past weeks, coronavirus has impacted markets with changing sentiment:

<table>
<thead>
<tr>
<th>Date Range</th>
<th>Event Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>17 January 2020 – 19 February 2020</td>
<td>Curtailment of travel and shutdown of factories in China; hit to tourism stocks and companies linked to China’s manufacturing supply chain.</td>
</tr>
<tr>
<td>19 February 2020 onward</td>
<td>Market sentiment flipping among concern over wider spread of virus beyond China; concern over impact on global economy; and extreme market volatility.</td>
</tr>
</tbody>
</table>

During the first phase of sentiment (between January 17 and February 19), the AQE team moved quickly to establish a metric to measure our exposure to companies impacted most directly by the virus, using unique data sets to map the supply chain and analyse text statements by company management. Unsurprisingly, the most vulnerable developed-market segments were Automobiles, Household & Personal Products, Consumer Durables

---

1 CFA® is a trademark of the CFA Institute
Market Commentary | March 2020

& Apparel, Tech Hardware and Semi-conductors. Using that metric, we evaluated our portfolios for concentrated or outsized exposures to those segments and determined they did not have outsized risk.

We also used the metric to calculate the performance of the companies most exposed to the direct impact of the coronavirus versus those least exposed, for developed and emerging markets (see Figure 1).

Figure 1: Our proprietary measures suggest that EM companies that are especially vulnerable to the direct impact of the Virus are rebounding more quickly than their DM counterparts

Active Quantitative Equity’s Proprietary Metric\(^2\) Measuring Coronavirus-related Portfolio Risk Exposure

Cumulative Spread, Most Exposed vs. Least Exposed — Developed Markets


Cumulative Spread, Most Exposed vs. Least Exposed — Emerging Markets


---

\(^2\) Formed by aggregating scores on a) revenue exposure to China, b) supply chain input exposure to China-based suppliers, for disruption from factory closures in China, c) the initial week’s news of the outbreak’s impact on returns across the equity market, and d) how often the virus was mentioned in company conference calls.
Interestingly, emerging markets quickly rebounded as new cases of the virus in China seemingly came under greater control, as evidenced by a slowdown in daily new cases. China had the strongest equity market in the world in February (up 3%).

**Applying our investment process**

As more cases of the virus appeared outside of China, the exogenous shock swiftly moved from its initial stage — impacting equity markets on a first order, direct basis — to broader concern about the virus’s impact on the economic cycle.

Our investment process is based on the knowledge that economies go through different cycles, and different company characteristics are rewarded at different times in the cycle. While the first order effects of the coronavirus shock have been acute, the longer term will bring more widespread economic impact. This will likely take the form of an economic downturn and subsequent recovery, each of unknown magnitude and duration. In the face of that threat, we expect the core themes that form the foundation of our investment process will be impacted as follows:

**Value:** Given that the cheapest parts of the market right now are cyclicals and financials, we don't expect that cheap stocks will be rewarded at the start of an economic downturn.

**Quality:** This will likely be the most resilient pocket of the market. Strong companies do best in a market downturn and defensive characteristics are generally rewarded.

**Sentiment:** Right now, companies with the strongest sentiment are technology and other secular growth segments as well as traditionally defensive companies. These should do well through a downturn, and we've also observed this as markets moved beyond the initial stages of the outbreak’s impact. As sentiment shifts, our process will also adjust depending on changes in earnings forecasts for 2020, hedge fund positioning, how much company management are talking about the outbreak during earnings season, and other measures of investor sentiment.

With that backdrop in mind, our most preferred equity sectors — which in our view are generally relatively cheap, exhibiting good quality and improving sentiment — are US Food & Staples Retailing, and Japanese Telecom Services and Tech Hardware. Our least favored sectors are Japanese Household and Personal Products and Retailing, and European Retailing and Consumer Services (see Figure 2). Of course, the degree to which a given sector exhibits these traits influences its desirability — so we do not favor Japanese Consumer Services on the grounds that they are extremely expensive, but we do favor Japanese Semi-conductors, as their valuation does not dominate other positive quality and sentiment characteristics.
### Figure 2: Current preferences of the Active Quantitative Equity Team’s stock selection model

<table>
<thead>
<tr>
<th>Good quality &amp; improving sentiment</th>
<th>Neutral</th>
<th>Poor quality &amp; falling sentiment</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Cheap</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>US Food &amp; Staples Retailing</td>
<td>European Insurance</td>
<td>US Energy</td>
</tr>
<tr>
<td>Japan Telecom Services</td>
<td>Asia Pacific ex-Japan Consumer Durables</td>
<td>US Autos</td>
</tr>
<tr>
<td>Japan Tech Hardware</td>
<td>Asia Pacific ex-Japan Retailing</td>
<td>European Food &amp; Staples Retailing</td>
</tr>
<tr>
<td><strong>Neutral</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>US Health Care Equipment</td>
<td></td>
<td></td>
</tr>
<tr>
<td>US Diversified Financials</td>
<td></td>
<td></td>
</tr>
<tr>
<td>European Pharmaceuticals</td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Expensive</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Japan Consumer Services</td>
<td>Asia Pacific ex-Japan Semi-Conductors</td>
<td>Japan Household &amp; Personal Product</td>
</tr>
<tr>
<td>Japan Semi-Conductors</td>
<td>Asia Pacific ex-Japan Pharmaceuticals</td>
<td>Japan Retailing</td>
</tr>
<tr>
<td>European Semi-Conductors</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Asia Pacific ex-Japan Health Care Equipment</td>
<td></td>
<td>European Consumer Services</td>
</tr>
</tbody>
</table>

[Most Preferred] [Least Preferred]

Source: State Street Global Advisors as of 3 March 2020.

This information should not be considered a recommendation to buy or sell any sector shown. It is not known whether the securities or sectors shown will be profitable in the future.

### The bottom line

We’re investors, not epidemiologists. Our forecasts of the actual spread of the virus would not likely be as accurate as official reports issued by the WHO or the CDC. Even those organisations are less focused on forecasting the spread of the virus and more focused on what to do to contain and treat the illness. So, rather than speculating about the trajectory of the coronavirus pandemic, we believe we’re better off relying on our investment process to respond as it was designed to, through many years of research over many different market and economic cycles.

### Portfolio positioning and performance

In February, COVID-19 fears saw global equity markets sell off sharply and bond yields collapse. The first 20 days of the month were similar to the first two weeks of January 2020 with the MSCI World ex AU index generating +4.5% gain as developed markets largely shrugged off what they considered a China-only coronavirus issue. However, things quickly started to unravel as coronavirus cases in Italy increased from 3 on 20th February to 152 on 23rd February, an astronomical increase of 5000%. Shortly after numerous countries in Europe started recording initial cases, sparking fears of a widespread pandemic that could potentially become unstoppable. This fear resulted in the developed markets (MSCI World index) registering its 3rd worst weekly performance since January 2000 – falling just short of the weekly declines observed during the depths of the Global Financial Crisis and the Tech Bubble. But in contrast to the other two weekly occurrences, the market reaction was markedly different as investors shunned all investments. Stocks operating in Corona-sensitive or China-sensitive industries suffered the worst de-ratings – these included miners, airlines, cruise liners and retailers. Outside of that, even the traditionally Defensive sectors – typically viewed as safe havens – were cast aside as the exogenous effects of the virus became increasingly difficult to ascertain.

---

3Bloomberg Finance, L.P. SSGA as at 28 February 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.
The State Street Global Equity Fund underperformed its benchmark during the month. While overall stock selection was marginally negative, the single biggest cause of our underperformance was the effect of currency hedging. With the AUD falling further into undervalued territory since the beginning of the year, our currency hedge detracted 1.6% from performance in February (following a -2.1% detraction in January). The AUD is now trading at ~0.66USD and significantly below our fair value estimate. With that in mind, we expect future mean reversions towards fair value will be beneficial from returns perspective. From a sector perspective, having a lower exposure to Energy and Industrials added value during February, but was offset by our lower than benchmark weight in IT (not holding Microsoft and overweight Western Union) and negative stock selection within Financials.

Year to date, the fund generated a downside capture of ~70% on days the market delivered negative returns – this remains broadly within expectations given the short-term nature of the measurement period. Relative performance was disappointing in terms of upside capture, however, primarily due to the Value theme underperforming. The spread between expensive and cheap names have once again been stretched to extreme levels last seen during the dot-com bubble.
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 17, 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, available at www.ssga.com, before deciding whether to acquire or continue to hold units in the Funds.

Investors should read and consider the relevant Product Disclosure Statement (PDS) for a Fund carefully before making an investment decision. A copy of SSGA’s Managed Fund PDS’s are available at www.ssga.com.au

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 currency 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. There is no representation or warranty as to the current accuracy, reliability or completeness of, nor liability for, decisions based on such information.

The views expressed are the views of the Active Quantitative Equity team only through March 10, 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. Actively managed funds do not seek to replicate the performance of a specified index. Equity securities may fluctuate in value in response to the activities of individual companies and general market and economic conditions.

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.

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.

Currency Hedging involves taking offsetting positions intended to substantially offset currency losses on the hedged instrument. If the hedging position behaves differently than expected, the volatility of the strategy as a whole may increase and even exceed the volatility of the asset being hedged. There can be no assurance that the Fund's hedging strategies will be effective.

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 MSCI World Index is a trademark of MSCI Inc.

MSCI indices are the exclusive property of MSCI Inc. ("MSCI"). MSCI and the MSCI index names are service mark(s) of MSCI or its affiliates and have been licensed for use for certain purposes by State Street Global Advisors ("SSGA"). The financial securities referred to herein are not sponsored, endorsed, or promoted by MSCI, and MSCI bears no liability with respect to any such financial securities. No purchaser, seller or holder of this product, or any other person or entity, should use or refer to any MSCI trade name, trademark or service mark to sponsor, endorse, market or promote this product without first contacting MSCI to determine whether MSCI's permission is required. Under no circumstances may any person or entity claim any affiliation with MSCI without the prior written permission of MSCI.

All the index performance results referred to are provided exclusively for comparison purposes only. It should not be assumed that they represent the performance of any particular 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.

The whole or any part of this work may not be reproduced, copied or transmitted or any of its contents disclosed to third parties without SSGA Australia's express written consent.

www.ssga.com

©2020 State Street Corporation. All Rights Reserved.

Tracking: 2912960.1.2.ANZRTL

Exp. Date: 31/03/2021