State Street Floating Rate Fund

STATE STREET GLOBAL ADVISORS

Tapering Likely to Come in 2021

- Senior unsecured credit performed admirably in the last three months of 2020.
- Floating rate securities have the potential to gather impressive returns again in 2021.
- The fund outperformed the benchmark, RBA Cash Rate, by 0.83% for the quarter (net of fees).[1]

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The final three months of 2020 in the Australian money market were characterised by the Reserve Bank of Australia (RBA) taking monetary policy into unchartered waters. As we have discussed in previous insights, central banks globally were adamant that this COVID-19 induced market volatility was not going to become another financial crisis of sorts, and at a minimum, liquidity in financial markets would be buoyed to ensure secondary markets functioned properly and yields would be kept low for borrowers of all calibers.

To that end, the RBA in Q4 2020 reduced the official cash rate target to 0.10% and continued the yield curve control measures whereby Governor Lowe has targeted the 3yr Government Bond Yield, and pegged it to the cash rate target, thereby signaling to the market that monetary policy will be maintained at this stimulatory setting for the next three years. Add to this the announcement by the RBA in November that a Quantitative Easing (QE) program via secondary market purchases was to be added to the already bond friendly yield curve control measures and it was broadly acknowledged that the Australian money market was, if not already, very soon to be awash with cash. The RBA had also extended its Term Funding Facility (TFF) to authorised deposit-taking institutions (ADI's) into 2021 which meant that banks did not have to issue notes via the primary market but could instead procure up to three years of funding from the RBA at 0.10%. This combination of multiple RBA monetary policy and liquidity measures, coupled with a TFF ensuring limited primary market senior unsecured issuance in the second half of 2020, compressed credit spreads for the last 6 months of 2020 as market participants sought to invest in existing credit issuance in the secondary market.

The market dynamic outlined above for 2020 has the potential to change in 2021. Central banks will taper their additional liquidity measures as both the COVID-19 vaccine(s) are distributed and economies get back to the new normal. As global markets, and in particular rates and credit markets, have seen in previous periods where central banks reduce stimulatory measures, there is the likelihood of 'taper tantrums' where markets object, albeit briefly, about the reduced access to cheap money. If there is a tapering of stimulatory measures, this will be a confirmation of the fact that both employment, growth and potentially inflation are back on track and Governor Lowe deems such extraordinary additional market liquidity measures are no longer warranted.

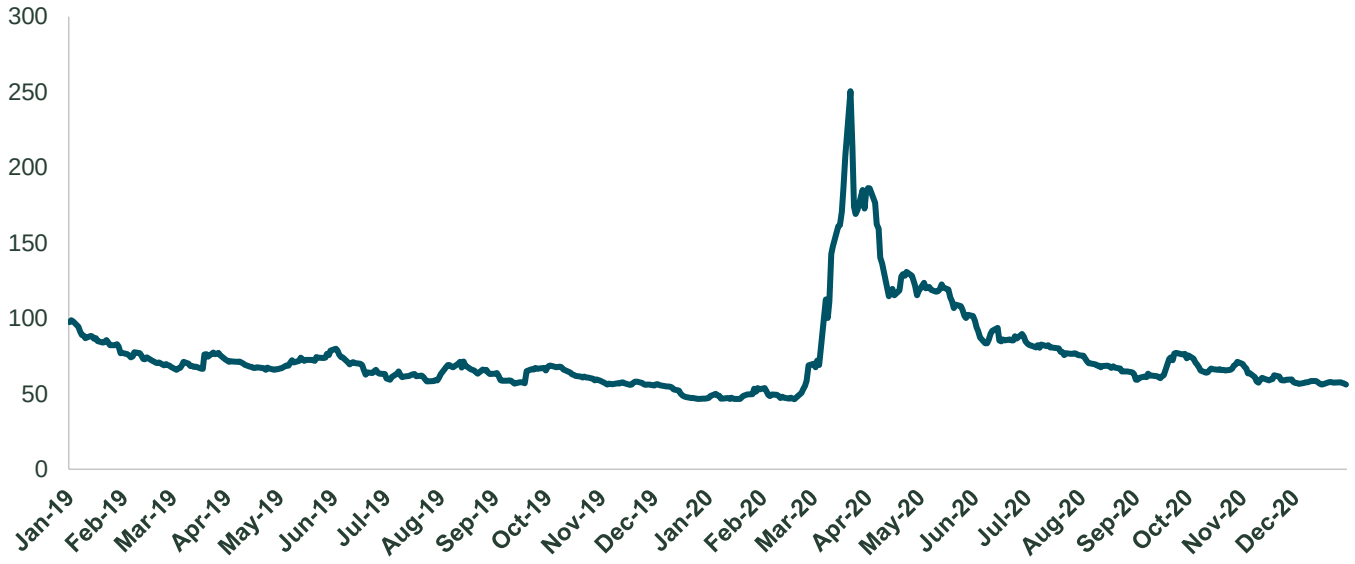
If this scenario were to play out and tapering were to begin at some point in 2021, bonds would lose their

[1] Source: SSGA as of 31 December 2020. 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.

secondary market QE driven bid from the RBA, inflation would again start to hit economists radars, the TFF would be retired and banks would start issuing senior unsecured debt again into a market that isn't awash with surplus funds, and investors will be able to buy in the primary space higher yielding, highly liquid senior unsecured bank names. Acknowledging that is a lot of 'ifs', even if only a portion of this scenario plays out this year, it still bodes well for floating rate senior unsecured bank debt in 2021.

The State Street Floating Rate Fund outperformed the RBA Cash Rate again in Q4. The portfolio as at 31 December was running a spread duration of 2.84 years, had an average credit quality of A+/A and had an average coupon of 0.93%.

Figure 1. **5 Year iTraxx Spreads, 2 January 2019 to 31 December 2020**



Source: Bloomberg Finance L.P., as at 31 December 2020**.** Past performance is not a reliable indicator of future results.

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