

December 2022



Olivia Engel, CFA
Global Chief Investment Officer
Active Quantitative Equity

The Sustainability Signal in AQE

- AQE creates sustainability scores for the companies we are evaluating and uses those scores to complement our other Quality metrics.
- When tracked as a standalone signal, sustainability delivers strong results when compared with Value, Sentiment, and Quality.

With the COP27 conference occurring in November 2022, it is an opportune time to highlight some of our thinking on “sustainability” and how it is used in the Active Quantitative Equity (AQE) team’s investment process, as well as to share some current observations about the signals and themes that markets are rewarding in the current environment.

Part of the Process

When AQE evaluates companies on one of the core themes¹ that we deem most important — **Quality** — environmental, social, and governance (ESG) characteristics form a part of our evaluation. This is because we believe that select ESG characteristics can be considered a proxy for long-term forward planning and thinking in companies, and can signal a different kind of resilience from that which is found on financial statements.

The kinds of ESG characteristics that we take into account are generally those that would be considered material for the future financial performance of a company. Examples would include: green buildings for real estate; animal treatment policies for consumer apparel, cosmetics, or food; and bribery and corruption policies for financials.

Using these characteristics, we create **sustainability** scores for the companies we are evaluating and use those scores to complement our other Quality metrics, which in many (but not all) cases are gleaned from financial data. We began using sustainability in our investment process in 2013 (focusing on governance, to start with) and broadened our approach to create our current sustainability signal in 2018.

Performance and Sustainability

When tracked as a standalone signal, sustainability has delivered strong results, over the last three years. In fact, when compared with our core themes (Value, Sentiment, and Quality), sustainability delivered returns almost as high as sentiment and value, but with lower volatility, and delivered a higher return than quality. See Figure 1.

Figure 1
Three-Year Returns and Volatility, by Signal
 As at 31 October 2022



Source: State Street Global Advisors AQE. Measured using the spread in return between best and worst equal weighted quintile of stocks in each theme within the MSCI World universe. For illustrative purposes only. Past performance is not a reliable indicator of future performance. 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 as applicable.

Are Sustainable Companies Expensive?

We don't think so. In fact, our sustainability signal is positively correlated with our Value theme, which means that sustainable companies are more likely to be cheaper on our measures. Within the developed market universe, companies in the top quintile of our sustainability scoring are, on average, within the cheapest 40% of our Value scoring. Companies in the worst quintile of our sustainability scoring are, on average, in the most expensive 40% of our Value scoring.

Sector Preferences

While many of AQE's preferred segments (i.e., those with the highest expected returns) also have good sustainability scores, there are market segments with great sustainability scores that we don't currently find attractive, for example, European telecoms, utilities, and real estate companies. Also, within our preferred segments there are pockets where sustainability is only average, for example, North America and APAC energy and tech stocks. See Figure 2.

Figure 2
Sustainability Scores of Equity Market Segments as of 31 October 2022

	Good Sustainability	Average Sustainability	Bad Sustainability
AQE High Alpha	EU Energy NA Energy NA Staples NA Utilities	NA Health Care AP Energy	—
AQE Average Alpha	EU Materials EU Staples	—	NA Industrials NA Telecoms
AQE Low Alpha	EU Utilities EU Real Estate	EU Industrials EU Technology	NA Real Estate AP Industrials

Source: State Street Global Advisors AQE. For illustrative purposes only. Past performance is not a reliable indicator of future performance.

The Bottom Line

The sustainability signal clearly captures something different from the measures of Quality that we derive from financial data. Over the last three years, the correlation of the monthly returns of our sustainability signal² with those of our broader Quality theme has been relatively low, measuring 0.3. Sustainability is a valuable characteristic to track, along with many other others. It doesn't dominate, but it has performed solidly and with lower variability than other signals in recent years.

About State Street Global Advisors

For four decades, State Street Global Advisors has served the world's governments, institutions and financial advisors. With a rigorous, risk-aware approach built on research, analysis and market-tested experience, we build from a breadth of index and active strategies to create cost-effective solutions. And, as pioneers in index, ETF, and ESG investing, we are always inventing new ways to invest. As a result, we have become the world's fourth-largest asset manager* with US \$3.26 trillion[†] under our care.

* Pensions & Investments Research Center, as of December 31, 2021.

[†] This figure is presented as of September 30, 2022 and includes approximately \$55.12 billion USD of assets with respect to SPDR products for which State Street Global Advisors Funds Distributors, LLC (SSGA FD) acts solely as the marketing agent. SSGA FD and State Street Global Advisors are affiliated. Please note all AUM is unaudited.

Endnotes

- 1 Value, Quality, and Sentiment are the core themes we deem most important.
- 2 Measured as quintile spread returns within the developed market universe.

ssga.com

Marketing communication

State Street Global Advisors Worldwide Entities

APAC

Australia: State Street Global Advisors, Australia, Limited (ABN 42 003 914 225) is the holder of an Australian Financial Services License (AFSL Number 238276). Registered office: Level 14, 420 George Street, Sydney, NSW 2000, Australia. T: +612 9240-7600. F: +612 9240-7611.

Hong Kong: State Street Global Advisors Asia Limited, 68/F, Two International Finance Centre, 8 Finance Street, Central, Hong Kong. T: +852 2103-0288. F: +852 2103-0200.

Japan: State Street Global Advisors (Japan) Co., Ltd., Toranomon Hills Mori Tower 25F 1-23-1 Toranomon, Minato-ku, Tokyo 105-6325 Japan. T: +81-3-4530-7380. Financial Instruments Business Operator, Kanto Local Financial Bureau (Kinsho #345), Membership: Japan Investment Advisers Association, The Investment Trust Association, Japan, Japan Securities Dealers' Association. **Singapore:** State Street Global Advisors Singapore Limited, 168, Robinson Road, #33-01 Capital Tower, Singapore 068912 (Company Reg. No: 200002719D, regulated by the Monetary Authority of Singapore). T: +65 6826-7555. F: +65 6826-7501.

EMEA

Abu Dhabi: State Street Global Advisors Limited, ADGM Branch, Al Khatem Tower, Suite 42801, Level 28, ADGM Square, Al Maryah Island, P.O. Box 76404, Abu Dhabi, United Arab Emirates. Regulated by the ADGM Financial Services Regulatory Authority. T: +971 2 245 9000. **Belgium:** State Street Global Advisors Belgium,

Chaussée de La Hulpe 185, 1170 Brussels, Belgium. T: +32 2 663 2036. State Street Global Advisors Belgium is a branch office of State Street Global Advisors Europe Limited, registered in Ireland with company number 49934, authorised and regulated by the Central Bank of Ireland, and whose registered office is at 78 Sir John Rogerson's Quay, Dublin 2. **France:** State Street Global Advisors Europe Limited, France Branch ("State Street Global Advisors France") is a branch of State Street Global Advisors Europe Limited, registered in Ireland with company number 49934, authorised and regulated by the Central Bank of Ireland, and whose registered office is at 78 Sir John Rogerson's Quay, Dublin 2. **Germany:** State Street Global Advisors Europe Limited, Branch in Germany, Brienner Strasse 59, D-80333 Munich, Germany ("State Street Global Advisors Germany"). T: +49 (0)89 55878 400. State Street Global Advisors Germany is a branch of State Street Global Advisors Europe Limited, registered in Ireland with company number 49934, authorised and regulated by the Central Bank of Ireland, and whose registered office is at 78 Sir John Rogerson's Quay, Dublin 2. **Ireland:** State Street Global Advisors Europe Limited is regulated by the Central Bank of Ireland. Registered office address 78 Sir John Rogerson's Quay, Dublin 2. Registered Number: 49934. T: +353 (0)1 776 3000. F: +353 (0)1 776 3300. **Italy:** State Street Global Advisors Europe Limited, Italy Branch ("State Street Global Advisors Italy") is a branch of State Street Global Advisors Europe Limited, registered in Ireland with company number 49934, authorised and

regulated by the Central Bank of Ireland, and whose registered office is at 78 Sir John Rogerson's Quay, Dublin 2. State Street Global Advisors Italy is registered in Italy with company number 11871450968 – REA: 2628603 and VAT number 11871450968, and its office is located at Via Ferrante Aporti, 10 - 20125 Milan, Italy. T: +39 02 32066 100. F: +39 02 32066 155.

Netherlands: State Street Global Advisors Netherlands, Apollo Building 7th floor, Herikerbergweg 29, 1101 CN Amsterdam, Netherlands. T: +31 20 7181 000. State Street Global Advisors Netherlands is a branch office of State Street Global Advisors Europe Limited, registered in Ireland with company number 49934, authorised and regulated by the Central Bank of Ireland, and whose registered office is at 78 Sir John Rogerson's Quay, Dublin 2.

Switzerland: State Street Global Advisors AG, Beethovenstr. 19, CH-8027 Zurich. Registered with the Register of Commerce Zurich CHE-105.078.458. T: +41 (0)44 245 70 00. F: +41 (0)44 245 70 16. **United Kingdom:** State Street Global Advisors Limited. Authorised and regulated by the Financial Conduct Authority. Registered in England. Registered No. 2509928. VAT No. 5776591 81. Registered office: 20 Churchill Place, Canary Wharf, London, E14 5HJ. T: 020 3395 6000. F: 020 3395 6350.

North America

Canada: State Street Global Advisors, Ltd., 1981 McGill College Avenue, Suite 500, Montreal, Qc, H3A 3A8, T: +514 282 2400 and 30 Adelaide Street East Suite 800, Toronto, Ontario M5C 3G6. T: +647 775 5900. **United States:** State Street Global Advisors, 1 Iron Street, Boston, MA 02210-1641. T: +1 617 786 3000.

The information contained in this communication is not a research recommendation or 'investment research'

and is classified as a 'Marketing Communication' in accordance with the Markets in Financial Instruments Directive (2014/65/EU) or applicable Swiss regulation. This means that this marketing communication (a) has not been prepared in accordance with legal requirements designed to promote the independence of investment research (b) is not subject to any prohibition on dealing ahead of the dissemination of investment research.

This communication is directed at professional clients (this includes eligible counterparties as defined by the appropriate EU regulator) who are deemed both knowledgeable and experienced in matters relating to investments. The products and services to which this communication relates are only available to such persons and persons of any other description (including retail clients) should not rely on this communication.

Important Risk Information

The information provided does not constitute investment advice and it should not be relied on as such. It should not be considered 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 is from SSGA unless otherwise noted and 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 and it should not be relied on as such.

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's express written consent.

A "quality" style of investing emphasizes companies with high returns, stable earnings, and low financial leverage. This style of investing is subject to the risk that the past performance of these companies does not continue or that the returns on "quality" equity securities are less than returns on other styles of investing or the overall stock market.

The value style of investing that emphasizes undervalued companies with characteristics for improved valuations, which may never improve and may actually have lower returns than other styles of investing or the overall stock market.

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

The views expressed are the views of Active Quantitative Equity through December 1, 2022, 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.

SSGA uses quantitative models in an effort to enhance returns and manage risk. While SSGA expects these models to perform as expected, deviation between the forecasts and the actual events can result in either no advantage or in results opposite to those desired by SSGA. In particular, these models may draw from unique historical data that may not predict future trades or market performance adequately. There can be no assurance that the models will behave as expected in all market conditions. In addition,

computer programming used to create quantitative models, or the data on which such models operate, might contain one or more errors. Such errors might never be detected, or might be detected only after the Portfolio has sustained a loss (or reduced performance) related to such errors. Availability of third-party models could be reduced or eliminated in the future.

The returns on a portfolio of securities which exclude companies that do not meet the portfolio's specified ESG criteria may trail the returns on a portfolio of securities which include such companies. A portfolio's ESG criteria may result in the portfolio investing in industry sectors or securities which underperform the market as a whole.

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.

© 2022 State Street Corporation.
All Rights Reserved.
ID1317236-390724.2.1.GBL.RTL 1222
Exp. Date: 12/31/2023