Our longer-term forecasts are forward-looking estimates of total return generated through a combined assessment of current valuation measures, income payouts, economic growth, and inflation prospects, as well as historical risk premia. We also include shorter-term return forecasts that incorporate output from our tactical asset allocation models. Outlined below is the process we use to arrive at our return forecasts for the major asset classes, including recent modifications to our process for forecasting equity returns. Over the course of the past year we have enhanced our global developed ex US and emerging markets forecasts to incorporate country-specific information. Our annualised return forecasts are calculated for three horizons: short (1 year), intermediate (3–5 years), and long-term (10+ years).

### Inflation

The starting point for our nominal asset class return projections is an inflation forecast. We incorporate both consensus estimates of long-term inflation and the inflation expectations implied in current bond yields. Treasury inflation-protected securities (TIPS) provide a marketplace observation of the real yields that are available to investors. The difference between the nominal bond yield and the real bond yield at longer maturities furnishes a marketplace assessment of long-term inflation expectations.

Our inflation outlook for Canada remains unchanged while Canadian 30-year breakevens held relatively steady throughout the second quarter, ending June at 1.56%, down slightly from the end of the first quarter as the 30-year Canadian nominal yield closed the quarter 18 basis points (bps) lower while real yields at similar maturities decreased by 10 bps. As central bank policy continues to shift from a recent highly accommodative stance, a recent run of positive data prints coupled with a hawkish tone from the Bank of Canada suggests that a tightening cycle may have begun.

### Summary

**Fixed Income**

The Canadian curve has flattened slightly and Canadian provincial and corporate credit spreads have come down across maturities. In Canada, 10-year government bond yields ended the second quarter slightly higher compared to the previous quarter. We have modestly increased our longer-term return expectations for Canadian government bonds and the broad universe of investment-grade bonds, to 2.1% and 2.5%, respectively. Our short-term return expectations for Canadian government and investment-grade corporate bonds have both declined. High-yield spreads again tightened over the second quarter, leading to a reduced short-term US high-yield forecast of 3.4% while our short-term US Treasury inflation-protected securities (TIPS) forecast increased to 2.0% based on inflation expectations and the most current available market yield data.

**Equities**

Our long-term Canadian equity forecasts have improved slightly while global developed equity forecasts came down slightly, particularly in the US compared to their international counterparts primarily due to lower forecast real earnings growth rates. As price-to-earnings (P/E) ratios remain broadly consistent with historical norms, we are not factoring in any expansion or contraction of this multiple over the longer-term. On a short-term horizon, our Canadian, US, and non-US equity forecasts have broadly increased from the previous quarter on improved quantitative model scores. We are forecasting one-year returns of 4.1% for large-cap US equities and 4.7% for Canadian equities, an increase of 0.8% over last quarter. Our forecast for small-cap US equities increased to 4.3%, up 1.8% from the previous quarter. Our forecast for developed equity markets outside the US rose to 4.7%, and emerging markets climbed to 5.6% reflecting improved tactical views.

**Alternative**

We continue to expect that over the longer-term, private equity will provide a modest illiquidity premium coupled with a higher long-term risk level comparable to that of small-cap equities. Over the shorter term, our outlook for private equity has strengthened from the previous quarter due to higher US small-cap return expectations. Our long-term forecast for global REITs has minimally increased from the first quarter while our short-term forecast has come down, reflecting our less-constructive tactical view on the asset class. Our long-term return forecast for commodities has marginally declined, to 5.2%, while our short-term forecast increased significantly due to improved model scores and a higher inflation forecast.

Figure 1: Forecasted Long-Term Annualised Returns (%)

<table>
<thead>
<tr>
<th>Asset Class</th>
<th>Long-Term (10+ Yrs)</th>
<th>Short-Term (1 Yr)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Canadian Equities</td>
<td></td>
<td></td>
</tr>
<tr>
<td>US Equities</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Global Developed Markets Equities</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Emerging Markets Equities</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Canadian Government Bonds</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Global Government Bonds</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Global Investment Grade Bonds</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Emerging Markets Bonds</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Global Real Estate (REITs)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Commodities</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Source: State Street Global Advisors (SSGA) Investment Solutions Group as of 06/30/2017.

Forecasted returns are based upon estimates and reflect subjective judgments and assumptions. These results were achieved by means of a mathematical formula and do not reflect the effect of unforeseen economic and market factors on decision-making. The forecasted returns are not necessarily indicative of future performance, which could differ substantially.

The positive tone taken by the Bank suggests that they are comfortable with growth prospects and that low inflation numbers will not prevent them from raising rates in the short term. Our current long-term forecast for inflation is 2.0% for the US and 2.2% for Canada.

**Cash**

Our long-term forecasts for global cash returns incorporate what we view as the normal real return that investors can expect to earn over time. Historically, cash investors have earned a modest premium over inflation; as such our long-term cash return forecast is 2.5% for the US, but by
design, current monetary policy priorities in many non-US
developed countries are dictating that cash returns stay
below or in line with expected inflation rates. We expect
that short-term interest rates will normalise, but without
certainty on the timing, our long-term cash return forecast
is 1.5% for the eurozone, reflecting a discount for the
eurozone on our long-term inflation projections. Our
long-term cash forecast for the US and eurozone remain
unchanged from the previous quarter. Our short-term
forecasts for cash returns derive from observed interbank
rates, which indicate a quicker pace of rate increases in the
US and continued active policy support in most non-US
developed countries for the foreseeable future. Led by the
Federal Reserve, global central banks continue to progress
from their long-standing accommodative environment
towards monetary policy normalisation, underpinned by
strong economic data. We updated our projections to reflect
a faster pace of convergence between our near-term cash
return expectations and our longer-term forecasts. This is
evident in our intermediate-term cash forecasts, which
increased by 0.1% over the second quarter. This comes as
we anticipate one additional rate increase in the US in 2017
after two already in March and June. We also anticipate
three increases during 2018, in line with the central bank’s
median forecast. In the UK we foresee one increase, either
at the end of 2017 or in early 2018.

Bonds
Our return forecasts for fixed income derive from current
yield conditions together with expectations as to how real
and nominal yield curves will evolve relative to historical
precedent. For corporate bonds, we also analyze credit
spreads and their term structures, with separate
assessments of investment-grade and high-yield bonds.

Our updated longer-term return expectations for fixed
income reflect slight upward adjustments to the shorter-
maturity bonds and downward adjustments to the longer-
maturity bonds from the first quarter, due to factoring in
changes in the yield curve, but increased reinvestment
income plays a more significant role over the long-term
forecast horizon. At shorter horizons we anticipate modestly
lower returns in Canada and the US from the first quarter
in longer-maturity bonds as we do not anticipate further
flattening of the yield curve. Over the second quarter, both
US Treasury and Canadian government curves flattened
while credit spreads decreased across maturities. Our
long-term and short-term return forecasts for non-US
developed bonds are up from the first quarter as we have
enhanced our forecasting process by incorporating country-
specific information on Italian bonds. As is the case with our
cash return forecasts, our shorter-term bond return models
incorporate the recent rise in short-term US yields as a
result of central bank rate increases.

Spreads on high-yield bonds declined further in the second
quarter. The yield on the Bloomberg Barclays US High Yield
Index fell to 5.62%2 at the end of June, 22 bps below the level
observed at the end of the first quarter. Corresponding yields
in Europe fell by 46 bps. Our short-term return projection
for US high-yield bonds decreased from the first quarter,
to 3.4%. Over longer horizons we are projecting a 4.8%
return for US high yield, consistent with the projection
from the first quarter.

In the near term, given low real rates and inflation, our
one-year return forecast for US TIPS is 2.0%. Over the
longest time frames, we are modeling increases in real
yields, but we expect that inflation protection will provide
enough income to produce a long-term return on US TIPS of
2.4%.

Equities
The foundation for our long-term equity market forecasts
are estimates of real return potential, derived from
current dividend yields, forecast real earnings growth
rates, and potential for expansion or contraction of valuation
multiples. Our forecasting method incorporates long-run
estimates of potential economic growth based on forecast
labor, capital, and productivity inputs to estimate real
earnings growth. Across both developed and emerging
markets, variation in labor, capital, and productivity levels
results in region-specific differences in our estimates for
real earnings growth, allowing for more region-appropriate
forecasts for both developed and emerging market equities.

Since the current dividend yield on the S&P TSX 60® is
3.1%2 and we anticipate a real earnings growth rate of
roughly 2.0%, we forecast a real return of 5.1% for large
cap Canadian equities. Combining this with our inflation
forecast, we estimate long-term equity returns of 7.3%.

The trailing price-to-earnings ratio for the S&P TSX 60®
declined from the first quarter to 17.5,3 a level that is
somewhat elevated though not extreme relative to historical
averages. We are therefore not factoring in any expansion or
contraction of this multiple over the long-term. We expect
real earnings may grow at a pace slower than long-term
historical averages. To envision a meaningful multiple
expansion from current levels, we would like to see an
improvement in long-term earnings growth potential.

Over the long-term, we expect US mid-cap and small-cap
markets each to earn a modest premium of 0.25% to 0.50%
respectively, over large-cap stocks. Non-US small-cap and
emerging markets should both provide higher earnings
growth rates than developed large-cap markets and we
therefore project that these asset classes will earn higher
returns. It is important to note that we are not making an
explicit currency call as part of our non-US forecasts. Over
the long-term, the effects of short-term currency
fluctuations should cancel out, producing a limited impact
on returns. Furthermore, for our forecasts to be useful
globally, we want to avoid a US-centric bias.

On a one-year horizon, our forecasts for Canadian and
US large-cap equities increased by 0.8% and for global
developed equities by 0.9% from the first quarter. We are
forecasting one-year returns of 4.7% for Canadian equities, 4.1% for large-cap US equities and 4.7% for developed equity markets outside the US.

**Advanced Beta**

The four advanced beta strategies begin with the MSCI World universe and are then reweighted toward selected factors. These strategies include value-tilted, quality-tilted, managed volatility (minimum variance), and an equal-weighted portfolio (to capture the historical ‘small-cap’ premium). Empirically, exposure to valuation, quality, low volatility, and small size have generated positive excess returns over the cap-weighted index; we continue to expect there will be a premium to owning these factors over the long-term.

Over a one- to three-year forecast horizon, we look to see how cheap each factor is relative to its own history. Specifically, we focus on book-to-price spreads for each factor and relate that to their subsequent returns. We find that valuation ratios are useful for forecasting market returns. Using these relationships, we forecast a short-term return premium of 0.20% for the value-tilted portfolio, 1.20% for the quality-tilted portfolio, 2.00% for the minimum-variance portfolio, and 0.40% for the equal-weighted portfolio.

**Private Equity**

Our long-term forecast for private equity is based upon past performance patterns of private equity funds relative to listed equity markets and our extrapolation of these performance patterns on a forward basis. According to several academic studies, the annualised rate of return of private equity funds over the long-term appears to be largely in line with that of listed equities, with outperformance relative to listed equities before fees, but relative underperformance after fees. Before fees, we believe that an average private equity fund can outperform large-cap listed equities by perhaps 0.5% over the long run. All else equal, this makes our long-term forecast for private equities reasonably comparable to our projections for small-cap stocks, but we also consider additional factors, including financial conditions and capital availability. Because private equity firms have enjoyed available and affordable capital, and have recently realised record-high valuation multiples, our return forecast continues to reflect a more competitive return environment. Since private equity funds tend to use ample leverage and are often much less liquid than publicly traded investments, we rate the long-term risk level of private equity as higher than that of small-cap equities.

**REITs**

REITs have historically earned returns between bonds and stocks due to their stable income streams and potential for capital appreciation. Our long-term forecasts for US and global REITs are 5.3% and 5.1%, respectively, and are reflective of the current low yield environment. In the shorter-term, our expected return models suggest that US REITs look less attractive, and while the appeal of their income features seems likely to foster some continued support, the asset class may face headwinds from expected rate increases.

**Commodities**

Our long-term commodity forecast is based on the level of world GDP, as a proxy for consumption demand, as well as on our inflation outlook. Additional factors affecting the returns to a commodities investor include how commodities are held (for example, physically, synthetically, or via futures) and the various construction methodologies of different commodity benchmarks. Our shorter-term forecasts are based on the approach and weightings used in the Bloomberg Commodity Index, which reflects investing through futures. Futures-based investors have the potential to earn a premium by providing liquidity and capital to producers seeking to hedge market risk. This premium is greatest when the need for hedging is high, driving commodities to trade in backwardation, with future prices that are lower than spot prices. When spot prices are lower, however, the market is said to be in contango, and futures investors may realise a negative premium. Our long-term return forecast for commodities is 5.2%.

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1 FactSet 6/30/2017.
2 Ibid.
3 Ibid.
## Canadian Long-Term Asset Class Forecasts

### Figure 2: SSGA Tactical/Strategic Asset Allocation Forecasts

<table>
<thead>
<tr>
<th>Asset Class</th>
<th>Short-Term 1 Year (%)</th>
<th>Intermediate Term 3–5 Years (%)</th>
<th>Long-Term 10+ Years (%)</th>
<th>Long-Term Risk (Std Dev) (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Canadian Equities</td>
<td>4.7</td>
<td>7.1</td>
<td>7.3</td>
<td>15.5</td>
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<tr>
<td>US Large Cap</td>
<td>4.1</td>
<td>6.2</td>
<td>5.8</td>
<td>15.5</td>
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<tr>
<td>US Mid Cap</td>
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<td>6.5</td>
<td>6.1</td>
<td>17.0</td>
</tr>
<tr>
<td>US Small Cap</td>
<td>4.9</td>
<td>6.7</td>
<td>6.3</td>
<td>19.0</td>
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<tr>
<td>Global Developed ex US</td>
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<td>6.1</td>
<td>6.1</td>
<td>15.5</td>
</tr>
<tr>
<td>Euro</td>
<td>4.8</td>
<td>6.3</td>
<td>6.3</td>
<td>18.0</td>
</tr>
<tr>
<td>Europe</td>
<td>5.0</td>
<td>6.6</td>
<td>6.6</td>
<td>15.5</td>
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<tr>
<td>Developed Pacific</td>
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<td>5.0</td>
<td>5.1</td>
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<tr>
<td>Global Developed ex US Small Cap</td>
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<td>6.9</td>
<td>6.9</td>
<td>19.0</td>
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<td>Global Developed (World)</td>
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<td>6.2</td>
<td>6.0</td>
<td>15.5</td>
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<tr>
<td>Global Equities (ACWI)</td>
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<td>6.6</td>
<td>6.2</td>
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<tr>
<td>Global Equities (ACWI) ex US</td>
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<td>6.9</td>
<td>6.7</td>
<td>16.0</td>
</tr>
<tr>
<td>Emerging Markets (EM)</td>
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<td>9.5</td>
<td>8.4</td>
<td>20.5</td>
</tr>
<tr>
<td>EM Asia</td>
<td>6.8</td>
<td>9.6</td>
<td>8.0</td>
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<tr>
<td>EM LatAm</td>
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<td>9.2</td>
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<td>EM EMEA</td>
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<td>9.6</td>
<td>10.0</td>
<td>20.0</td>
</tr>
<tr>
<td>Global Value Tilted</td>
<td>4.5</td>
<td>6.4</td>
<td>6.6</td>
<td>15.0</td>
</tr>
<tr>
<td>Global Quality Tilted</td>
<td>5.5</td>
<td>7.4</td>
<td>6.6</td>
<td>14.5</td>
</tr>
<tr>
<td>Global Equal Weighted</td>
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<td>6.6</td>
<td>6.7</td>
<td>16.0</td>
</tr>
<tr>
<td>Global Minimum Variance</td>
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<td>8.2</td>
<td>6.7</td>
<td>12.0</td>
</tr>
<tr>
<td>Canadian Government Bonds</td>
<td>1.0</td>
<td>1.1</td>
<td>2.1</td>
<td>5.0</td>
</tr>
<tr>
<td>Canadian Corporate Bonds</td>
<td>2.3</td>
<td>2.3</td>
<td>3.4</td>
<td>5.0</td>
</tr>
<tr>
<td>US Government Bond</td>
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<td>1.7</td>
<td>2.3</td>
<td>5.0</td>
</tr>
<tr>
<td>US Investment Grade Bond</td>
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<td>2.2</td>
<td>2.9</td>
<td>5.5</td>
</tr>
<tr>
<td>US TIPS Bond</td>
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<td>2.4</td>
<td>5.5</td>
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<tr>
<td>US High Yield Bond</td>
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<td>3.4</td>
<td>4.8</td>
<td>11.5</td>
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<tr>
<td>US Long Treasury STRIPS Bond</td>
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<td>1.8</td>
<td>2.5</td>
<td>20.5</td>
</tr>
<tr>
<td>Non-US Government Bonds</td>
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<td>0.2</td>
<td>1.3</td>
<td>5.0</td>
</tr>
<tr>
<td>Euro Govt Bonds</td>
<td>1.1</td>
<td>0.4</td>
<td>1.8</td>
<td>4.0</td>
</tr>
<tr>
<td>UK Govt Bonds</td>
<td>0.8</td>
<td>0.4</td>
<td>1.8</td>
<td>6.5</td>
</tr>
<tr>
<td>Japanese Government Bonds</td>
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<td>-0.3</td>
<td>0.2</td>
<td>3.5</td>
</tr>
<tr>
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<td>0.9</td>
<td>2.0</td>
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<td>Euro Corporate Bonds</td>
<td>1.2</td>
<td>1.1</td>
<td>2.7</td>
<td>4.0</td>
</tr>
<tr>
<td>UK Corporate Bonds</td>
<td>2.1</td>
<td>1.6</td>
<td>3.1</td>
<td>6.5</td>
</tr>
<tr>
<td>Japanese Corporate Bonds</td>
<td>0.3</td>
<td>-0.1</td>
<td>0.4</td>
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</tr>
<tr>
<td>Global Government Bonds</td>
<td>1.2</td>
<td>0.7</td>
<td>1.7</td>
<td>4.5</td>
</tr>
<tr>
<td>Global Corporate</td>
<td>1.7</td>
<td>1.5</td>
<td>2.6</td>
<td>6.0</td>
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<tr>
<td>Euro High Yield Bonds</td>
<td>1.8</td>
<td>2.1</td>
<td>3.0</td>
<td>12.0</td>
</tr>
<tr>
<td>Emerging Markets Bonds</td>
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<td>3.8</td>
<td>5.0</td>
<td>12.0</td>
</tr>
<tr>
<td>Hedge Funds (Market Neutral)</td>
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<td>5.6</td>
<td>5.8</td>
<td>6.0</td>
</tr>
<tr>
<td>Global Real Estate (REITs)</td>
<td>2.0</td>
<td>5.0</td>
<td>5.1</td>
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</tr>
<tr>
<td>Private Equity</td>
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<tr>
<td>Commodities</td>
<td>4.2</td>
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<td>5.2</td>
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<tr>
<td>US Cash</td>
<td>1.2</td>
<td>2.0</td>
<td>2.5</td>
<td>1.5</td>
</tr>
<tr>
<td>UK Cash</td>
<td>0.4</td>
<td>1.0</td>
<td>2.0</td>
<td>1.0</td>
</tr>
<tr>
<td>Eurozone Cash</td>
<td>-0.4</td>
<td>0.3</td>
<td>1.5</td>
<td>1.0</td>
</tr>
</tbody>
</table>

The forecasted returns are based on SSGA’s Investment Solutions Group June 30, 2017 forecasted returns and long-term standard deviations. The forecasted performance data is reported on a gross of fees basis. Additional fees, such as the advisory fee, would reduce the return. For example, if an annualised gross return of 10% was achieved over a 5-year period and a management fee of 1% per year was charged and deducted annually, then the resulting return would be reduced from 61% to 54%. The performance includes the reinvestment of dividends and other corporate earnings and is calculated in the local (or regional) currency presented. It does not take into consideration currency effects. The forecasted performance is not necessarily indicative of future performance, which could differ substantially.
Glossary

Commodities A generic, largely unprocessed, good that can be processed and resold. Commodities traded in the financial markets for immediate or future delivery include grains, metals, and minerals.

Credit Spreads The spread between Treasury securities and non-Treasury securities that are identical in all respects except for quality rating.

Nominal Bond Yield The annual income that an investor receives from a bond divided by the par value of the security. The result, stated as a percentage, is the same as the rate of interest the security pays.

Private Equity An umbrella term for large amounts of money raised directly from accredited individuals and institutions and pooled in a fund that invests in a range of business ventures.

REITs (Real Estate Investment Trusts) Publicly traded companies that pool investors’ capital to invest in a variety of real estate ventures, such as apartment and office buildings, shopping centers, medical facilities, industrial buildings, and hotels.

Smart Beta A rules-based investment strategy that seeks to capture specific factors in the marketplace that active managers have historically relied on to outperform. These include value, size, low volatility, quality and momentum.

Tactical Asset Allocation Models Illustrate a dynamic approach to asset management that emphasizes exposure to asset classes that are poised to enhance returns or control drawdowns.

ssga.com

State Street Global Advisors Worldwide Entities


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