

# A Letter From Our CIO

## Systematic Equity Update

**John A Tucker, CFA**

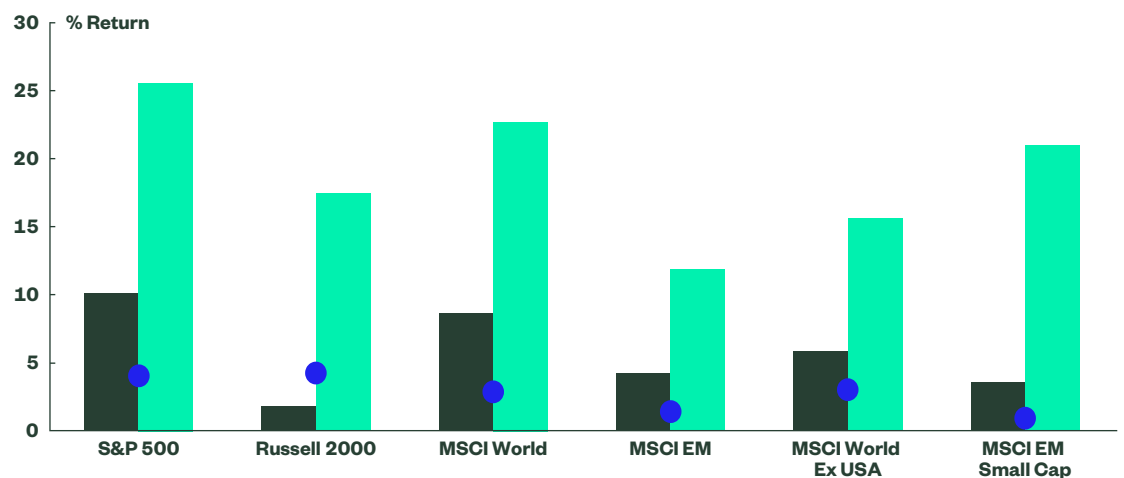
CIO, Systematic Equity

Equity markets continue their robust rally in 2024, despite a protraction of further Fed rate cuts and ongoing economic uncertainty. Against the backdrop of shifting market dynamics, we believe that our process, platform, and integrated team position us well to address the ever-evolving needs of our clients.

In spite of the extension of Fed rate cuts, equity markets have continued their upward march. US large cap stocks continue to dominate equity market performance and flows in 2024, a continuation of their leadership in 2023. Our index equity assets under management (AUM) reached a high water mark of \$2.78T at the end of March, buoyed by the S&P 500 Index up over 10% and the MSCI World ex US Index up over 5% year-to-date on top of the double-digit performance generated from both indexes in 2023 (Figure 1).

Figure 1  
**Recent Equity  
Market Performance**

■ YTD  
■ 1Y  
● 1M



Source: FactSet, State Street Global Advisors, S&P, MSCI, FTSE Russell. As of May 31, 2024. 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.

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## Noteworthy Happenings in Equity Indexing

Over the last six months we have also witnessed interesting side effects from the frothy equity market. For example, the concentrated nature of the rally has shined a light on certain cap-weighted index methodologies, in particular sector indexes and name-constrained indexes that have guardrails in place to ensure compliance with IRS diversification rules. These guardrails, designed to safeguard investors, ironically have been the cause for a few substantial index rebalances which have resulted in additional trading costs incurred to the funds that track them. Furthermore, persistently higher interest rates associated with the strong economy have negatively impacted the cost of index futures contracts, a primary tool for cash equitization in index funds. This development has also served as a catalyst to reevaluate the optimal amount of cash to maintain for balances as well as the most efficient instrument used to equitize that cash.

Unrelated to the strong market, it is also worth noting that US trade settlement period moved from a T+2 to a T+1 settlement in May. This is a generally welcome change for investors, but one which has implications for global strategies which may include countries with misaligned settlement cycles.

Fortunately, our systematic equity portfolio management team is one of the most experienced in the industry and is supported by a global trading team that transacts over \$2 trillion in notional value. As a result, the team continues to deliver the most efficient indexed products on the market with over 99% of our portfolios tracking within their assigned tolerance band.

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## What We Are Hearing From Clients

Client needs are ever-evolving and the nature of our engagements continue to change. However, over the last six to twelve months, overwhelmingly, we have received consistent client inquiries on three topics in particular:

- Emerging markets, and more specifically, China
- US large cap performance concentration
- Liquid real assets

While emerging markets (EM) equities have underperformed developed market (DM) equities in recent years, the case for investment remains strong in EM both as an opportunity to generate alpha and to take advantage of high relative economic and demographic growth rates. We have engaged with numerous clients on how best to approach the asset class from an active/passive perspective. Furthermore, as the weight of China within EM has expanded in parallel with the country's geopolitical tensions, more clients have been seeking guidance on the treatment of China. Generally speaking, we have found clients in one of three camps in this conversation on China:

- 1 Seeking explicit divestment options
- 2 Seeking alpha within China
- 3 Seeking control over the weight of China within their EM allocations

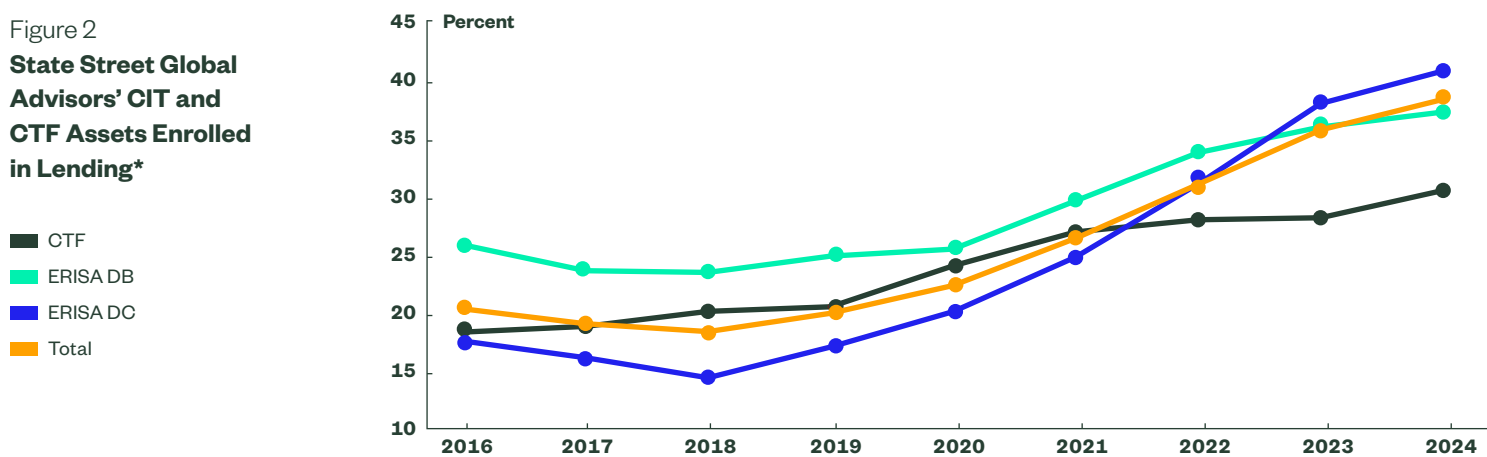
As a result of these discussions we continue to see flows into our Emerging Markets Equity and Emerging Markets Ex-China Equity Strategies.

With regard to US equities, as mentioned earlier, the somewhat concentrated, AI-driven rally has caused many clients to question the nature of their US large cap core index allocations and in particular whether or not a cap-weighted approach is still optimal from a diversification perspective. While there is a case to be made for alternative weighting schemes, it has been a perennial challenge to beat the cap-weighted index. Correspondingly, most institutional clients have cap-weighted policy benchmarks and to replace a cap-weighted strategy for that part of the allocation would constitute a substantial active bet—one that has not paid off for many years. For these reasons, we have seen continued inflows into core, cap-weighted US large cap equity exposures and relatively limited interest in alternatives such as equal-weighted and factor strategies.

Finally, liquid real assets such as listed exposures to REITs, commodities, infrastructure, and natural resources, have been of great interest to clients recently. Given the inflationary environment that dominated in 2022 and has somewhat persisted (despite predictions of easing inflation) to present, clients continue to show interest in these strategies as liquid and cost-effective exposures to inflation hedging assets.

The last point worth mentioning here from a trend perspective, is that clients are looking for additional means to enhance their index allocations in alternative ways. One of those is by way of lending, where we have seen almost a two-fold increase in client allocations to lending vehicles in less than 10 years. Lending has become a terrific way for clients to enhance their index return profile without materially impacting the risks associated with their investment. The other method is by way of crossing, where State Street Global Advisors leverages its own internal liquidity in order to mitigate external transaction costs and implicit market impact. In 2023 we crossed over \$100 billion in equity securities and saved clients an estimated \$35 million in trading costs.

Figure 2  
**State Street Global Advisors' CIT and CTF Assets Enrolled in Lending\***



Source: State Street Global Advisors. As of March 31, 2024.

\* CIT refers to collective investment trust and CTF refers to common trust fund.

## Closing Thoughts

While market dynamics change and client interests evolve, we have structured the team in an agile way to optimally support our clients and to deliver results. Our focus remains to provide a broad menu of products to our clients with the tight tracking across the entire suite. However, as our clients demand more bespoke solutions, our platform has evolved to engage those conversations and support those needs. In the meantime, we appreciate the responsibility entrusted in us, and we look forward to advancing relationships as a trusted partner and solutions provider for our clients.

## 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. As pioneers in index and ETF investing, we are always inventing new ways to invest. As a result, we have become the world's fourth-largest asset manager\* with US \$4.42 trillion† under our care.

\* Pensions & Investments Research Center, as of December 31, 2023.

† This figure is presented as of June 30, 2024 and includes ETF AUM of \$1,393.92 billion USD of which approximately \$69.35 billion USD is in gold 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.

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