STATE STREET GLOBAL ADVISORS
SPDR

STRATEGY ESPRESSO

10 December 2018 SPDR EMEA ETF Strategy Team

Flows

European-Domiciled ETP Segment Flows (Top/Bottom 5, $mn)

FI — US Government	→	271
Commodities/Alternatives/Others	→	261
Broad EM	→	209
FI — EM	→	175
FI — UK Debt Government	→	153
US Sectors	←	-139
FI — EMU Debt Government	←	-148
Europe Sectors	←	-158
World	←	-271
FI — US IG Corp	←	-320

European-Domiciled ETP Asset Category Flows ($mn)

Commodity	→	260
Fixed Income	→	158
Alternative	→	2
Mixed Allocation	→	0
Specialty	←	-1
Money Market	←	-42
Equity	←	-520

Sources: Bloomberg Finance L.P., for the period 23–30 November. This information should not be considered a recommendation to invest in a particular sector or to buy or sell any security shown. It is not known whether the sectors or securities shown will be profitable in the future.

THEME OF THE WEEK

Take Shelter with Euro Short-Dated Corporate Bonds

Global growth is forecast to slow in 2019 but remain relatively robust overall. With yields forecast to climb, particularly in Europe as market hurdles such as the Italian budget and Brexit are addressed, short-dated euro corporate bonds may mitigate some of the negative impact on returns.

Central Bank Rate Normalisation

Globally we have witnessed a sustained period of growth with slightly muted momentum in inflation. The expectation is for central banks to continue this policy normalisation into 2019. To date, we have witnessed some divergence between the US and Europe, but with the US increasing more likely to take pause we may see policy convergence as the EU steps up their attempts to normalise rates.

Quantitative Easing Guidance

The net buying of bonds by the European Central Bank's quantitative easing (QE) programme is forecast to finish at the end of December 2018. QE has provided sustained support for bond yields over the past few years, particularly for peripheral countries, and a removal of QE may cause yields to rise.

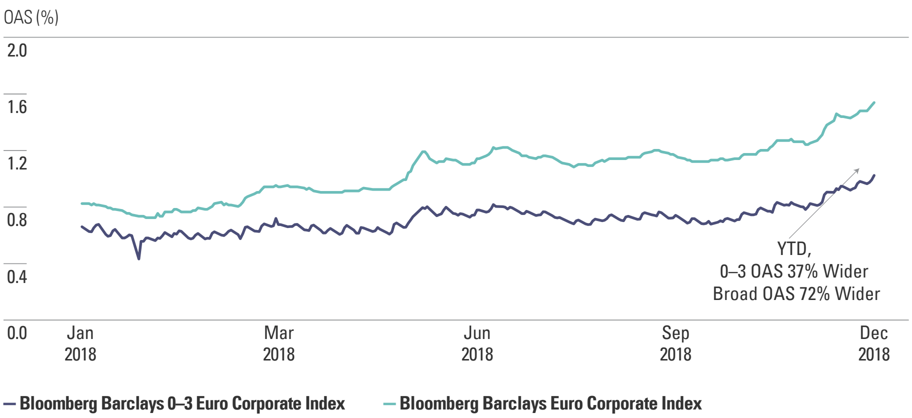
Geopolitical Risk

A number of political hurdles remain, such as the Italian government budget, Brexit and simmering trade tariff positioning. If some of these risks can be taken off the table it could prove positive for credit spreads. Credit spreads have widened year to date however Euro credit spreads at the short end of the curve have been less effected than those further out (see Figure 1 below).

Understanding ETF Benchmark Inclusion Criteria

SPDR's short-dated corporate bond range provides broad exposure to euro, US dollar and sterling corporate bond markets. However, some benchmarks tracked by other ETF providers provide less diversified exposures. Depending on the market environment, these differences can provide positive or negative returns. Euro floating rate corporate bond funds proved popular in the first half of 2018 for their short duration. However, due to the nature of the underlying market these funds are heavily weighted to financials, typically over 70% and this has weighed on performance. Benchmark characteristics, such as sector weights, should therefore be carefully assessed when comparing funds.

Figure 1: Short Duration OAS Has Widened Less



Source: State Street Global Advisors, as of 6 December 2018. Past performance is no indication of future returns.

Sectors

Total Returns (%)

Index	US	Europe	World
Consumer Discretionary	5.8	-1.2	3.9
Consumer Staples	2.9	0.1	1.4
Energy	3.5	2.3	2.5
Financials	3.9	1.1	2.4
Healthcare	6.0	1.9	4.7
Industrials	4.1	1.6	3.0
Technology	6.1	2.0	5.7
Materials	2.5	0.0	0.8
Telcommunications	5.5	4.8	4.0
Utilities	2.8	0.6	1.6

Source: Bloomberg Finance L.P. Returns are in base currency ($ for US and World, € for Europe) for the period 23–30 November. Universes for the sectors are: S&P 500 (US) and MSCI (Europe and World) indices. Past performance is not a guarantee of future results. Index returns are unmanaged and do not reflect the deduction of any fees or expenses.

Having to Wait a Bit Longer for the Santa Rally

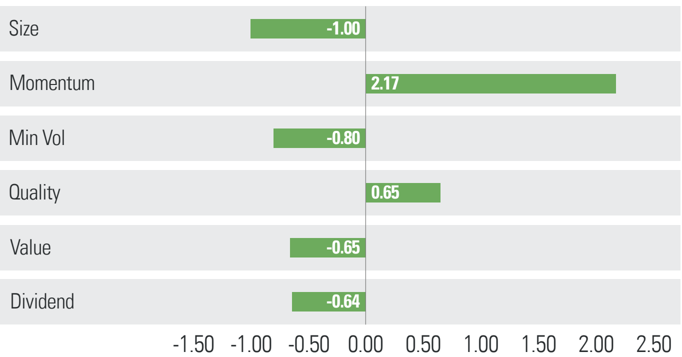
Financial markets experienced a volatile week, starting with a positive response by equities to the truce called on the US/Chinese trade war post the Trump/Xi meeting but then falling sharply as hopes of any ceasefire weakened. It is estimated that concern over trade tariffs has taken approximately $2.1 trillion in collective market cap from S&P 500 companies in the last few months; about the same amount that the proposed US tax cuts boosted the stock market at the start of the year.

Amongst specific sector responses to news flow, Fed chairman Powell's doveish comments have hit the US Financials sector which has a positive correlation with interest rates and European Financials have suffered from uncertainty surrounding the forthcoming British parliamentary vote on EU withdrawal. The Energy sector showed returns close to the market average despite very volatile crude oil prices as major oil-exporting nations negotiated at an OPEC meeting in Vienna.

Prices of Utilities companies benefited in all the regions from lower bond yields and defensive business models.

Smart Beta

Excess Returns versus MSCI World Index (%)



Source: Bloomberg Finance L.P. Returns are in base currency ($ for US and World, € for Europe) for the period 23–30 November. Universe: MSCI Factor Indices. Index returns are unmanaged and do not reflect the deduction of any fees or expenses. Performance of an index is not indicative of the performance of any product managed by State Street Global Advisors. Past performance is not a guarantee of future results.

Minimum Volatility Out on Top Again

Worries over slowing global growth as well as the inability for the British Prime minister to push her Brexit deal through Parliament next week led to another week of bearish sentiment, as we saw further rotation into low risk stocks and this is a reversal from the risk taking appetite from the previous week and a continuation of October's great style rotation.

Crowded positioning in Growth continued to exacerbate the selloff and it is for this reason that World Minimum Volatility factor continued to outperform the MSCI World benchmark significantly this week. Interestingly, unlike in previous weeks, Momentum did not fare poorly on a relative basis.

Fixed Income

Index	Yield (%)	Change in Yield (percentage points)			
		1 week	1 mth	3 mths	6 mths
US Treasury	2.93	-0.02	-0.15	0.18	0.22
Euro Treasury	0.86	-0.06	-0.08	-0.03	0.05
UK Gilts	1.47	0.04	0.00	0.10	0.17
US Corp IG	4.37	0.04	0.05	0.42	0.42
Euro Corp IG	1.30	0.02	0.16	0.30	0.30
UK Corp IG	3.12	0.06	0.20	0.39	0.43
US HY Liquid Index	7.17	-0.13	0.34	0.90	0.76
Euro HY Liq Scr	4.73	0.08	0.58	0.87	0.97
EM Local	5.97	-0.03	-0.12	-0.03	0.27
5y5y US Inflation	2.31	0.03	0.00	-0.06	-0.07
5y5y Euro Inflation	1.64	0.01	-0.05	-0.09	-0.11
5y5y UK Inflation	3.64	0.09	0.12	0.23	0.23

Source: Bloomberg Finance L.P., as of 30 November 2018. Past performance is not a guarantee of future results.

The Yield Has Turned Upside Down

As equities plummeted this week, fixed income enjoyed a strong rally, especially in the US, where yields continued to tumble across the curve. As yields fell, we saw a bear flattening of the curve, although 5-year yields fell the most and now sit below the yield on the 2-year.

Investors have begun analysing whether we will see a subsequent inversion of the 2/10 year spread; however, currently the gap still sits comfortably above 10bps.

Meanwhile, in the UK, as the likelihood of Theresa May's Brexit deal getting through parliament started to look slim, Gilts saw a significant rally, climbing more than 2% last week.

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