

SPDR® ETFs European Market Update: Sink or Swim?

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Based on market performance, volatility and flows, 2011 has often been referred to as a year of two halves. As we approach the midpoint of 2012, can this year be called a first half of two parts?

During the first quarter of the year risk assets performed extremely well, helped in large part by intervention from the European Central Bank (ECB), solid corporate results and surprisingly resilient economic data. Yet risk aversion returned in April and May as investors became spooked by on-going eurozone sovereign debt problems, less than stellar jobless claims in the US and weak industrial production numbers from China.

As we close the book on the first half of 2012, where do investors stand and what is the outlook for exchange traded funds (ETFs)? Will we see a sharp recovery in market performance as witnessed in 2010 or will investors be best served by more defensive positioning as in 2011?

PUTTING IT ALL IN PERSPECTIVE – ASSET CLASS PERFORMANCE AND THE EUROZONE DEBT CRISIS

Before we move on to a detailed review of the performance, investment themes and asset flows within the ETF world, it is worth adding some context to the last several months, indeed the last several years.

Figure 1 depicts the performance of bonds, cash and equities – both global and eurozone – since the beginning of 2010, around the time widespread concern started to emerge about the long-term sustainability of Greece's sovereign debt. Since then, other eurozone countries have also found themselves in the firing line, with Ireland, Portugal and now Spain receiving financial assistance from the IMF and the European Union.

This chart tells an interesting story. Eurozone equities, as one might expect given the region's economic travails, have declined more than 15% since the beginning of 2010. Global bonds have performed strongly, advancing 31%, while global equities – large and small, developed and emerging – have gained 23%. These double-digit gains for global equities and bonds may surprise some European investors who find themselves heavily exposed to eurozone equities. True, much of the return can be attributed to the weakness of the euro but, even in US dollar terms, bonds have gained 13% and equities have advanced 6%. In the low interest rate environment of the last few years, returns generated by cash have been meagre – only 2% cumulative since the beginning of 2010 and negative in real terms.

The message of this simple chart is clear. Even in the very difficult environment of recent years, investors who remained entirely in cash have seen the value of their investments decline in real terms, while those who have taken on a little risk through a diversified

global portfolio of stocks and bonds have generated reasonable returns. With interest rates likely to stay low for the foreseeable future – and below the rate of inflation – investors who remain largely in cash face the prospect of an extended period of negative real returns.

FIGURE 1: EQUITIES, BONDS AND CASH – CUMULATIVE RETURNS SINCE JANUARY 2010 (% IN EURO)



Source: Morningstar Direct, SSgA, 1 January 2010 – 31 May 2012. Cumulative total return in euros. Asset classes are represented by the following indices: MSCI ACWI IMI Net Return (Equities), Barclays Multiverse Total Return (Bonds), Euribor 1 month (Cash) and MSCI EMU Net Return (Eurozone Equities).

The serious economic problems and imbalances plaguing the global economy have been long in the making, and, as German Chancellor Angela Merkel is fond of saying, they will not be resolved quickly. While some may argue that European policymakers have been slow to take action, one must acknowledge the sheer scale of the challenge ahead. The restructuring programmes required are further complicated by the fact that most decision makers are ultimately elected officials, accountable to populations increasingly tired of the austerity measures implemented over the last several years. The inability of Greek politicians

to form a government in May, which required another poll six weeks later, and the election of Francois Hollande as President of France highlight the difficult position facing elected leaders – they must ultimately maintain the support of their people if they are to gain any traction in efforts to deal with the crisis. There does seem to be the will to ensure that no existing member state is forced out of the euro, but such an outcome is no longer out of the question. This overhang, combined with generally lacklustre economic growth seemingly being made worse by private sector deleveraging and public sector austerity, has contributed to a particularly uneasy market environment prone to bouts of volatility. Meanwhile, investors have swung from optimism – backed up by low equity valuations, extraordinarily loose monetary conditions, and generally strong corporate performance – to extreme pessimism, which has contributed to a volatile and largely range-bound equity market.

2012 INVESTMENT PERFORMANCE

During the first quarter of 2012, equities and other risk assets built on the positive momentum that developed towards the end of 2011, rallying sharply as investors discounted a range of potentially negative economic developments including a double-dip recession in the US and a hard landing in emerging markets. Above all else though, it was the perception that European policymakers were moving towards a sustainable long-term solution for the restructuring of Greece's sovereign debt that buoyed investor sentiment. The ECB's Long-Term Refinancing Operations (LTROs) also proved successful in lowering the funding costs for banks, reducing immediate systematic risks, and lowering bond yields in some of the more troubled sovereigns such as Spain and Italy. As depicted in Figure 2, the aggressive sell-off in May dragged down the performance of the major equity indices to the extent that, year to date, the broad European indices are roughly flat on the year.

Some indices, however, have recorded positive returns. The MSCI ACWI IMI Index, one of the broadest measures of global equity markets, covering all market capitalisations across both developed and emerging markets, gained 6% in euro terms (year to date ending 31 May) – admittedly driven by the euro's weakness rather than local currency market appreciation. US equities also performed well in euro terms but, again, currency was a

significant factor in this result. After a strong first quarter, emerging market equities retreated as the 'risk-off' environment led investors to pull back their exposure.

In addition, the UK, US and Euro High Yield Dividend Aristocrats Indices tracked by SPDR ETFs offered a measure of downside protection, evidenced by their outperformance relative to comparable broad market indices in April and May. With negative real government bonds yields in the US, UK and Germany, it was somewhat surprising that these segments of the bond market continued to perform well. But with the eurozone seemingly on the brink, investors are clearly still willing to sacrifice return for security.

In line with high yield bonds, other 'riskier' segments of the bond market have also performed strongly year to date, with corporate and emerging market bonds gaining ground, particularly in euro terms. Investors have poured money into these segments of the bond market this year, attracted by the relatively wide spreads to Bunds, Treasuries and Gilts. As always, the impact of currency should not be overlooked when evaluating bond market performance. For example, while high yield bonds retreated in the two months ending 31 May, in euro terms the Barclays Capital Global High Yield Index (dominated by US dollar issues) actually gained 5.1% over the period. Gold also sold off in US dollar terms, but in euro terms is up almost 6% year to date.

WHAT DOES ALL THIS MEAN FOR THE TYPICAL EUROPEAN INVESTOR?

An investor with a simple portfolio of 70% global equities and 30% global investment grade bonds would have generated a return of approximately 6% during the first five months of 2012.¹ Not at all bad, particularly in the context of the on-going eurozone debt crisis, sub-par economic growth and record low interest rates. Look a little deeper though, and it becomes clear that the depreciation of the euro rather than strong risk asset performance is largely behind the solid investment results generated by this hypothetical portfolio. We can also see that, like last year, 2012 to date has been a year of two halves – strong market performance until the end of the first quarter followed by a bout of risk aversion and quite severe equity declines.

¹ Hypothetical portfolio of 70% invested in MSCI ACWI IMI (NR) Index and 30% in Barclays Capital Global Aggregate Index (TR). In EUR.

FIGURE 2: MAJOR ASSET CLASS PERFORMANCE IN 2012

ASSET CLASS	INDEX	2012 YTD (%)	Q2 TO DATE (%)	Q1 2012 (%)
Fixed Income				
Global High Yield	Barclays Global High Yield (TR)	10.00	5.14	4.62
Euro High Yield	Barclays Liquidity Screened Euro High Yield (TR)	8.82	-1.90	10.93
GBP Investment Grade	Barclays Sterling Aggregate (TR)	7.77	7.98	-0.19
USD Investment Grade	Barclays US Aggregate Bond (TR)	7.44	9.88	-2.23
USD Treasuries	Barclays US Treasury (TR)	6.94	11.14	-3.78
Emerging Markets (Local Currency)	Barclays EM Local Currency Liquid Government (TR)	6.34	1.23	5.04
Global Investment Grade	Barclays Global Aggregate (TR)	6.06	7.86	-1.67
EUR Investment Grade Corporates	Barclays Euro Aggregate Corps (TR)	5.96	0.25	5.70
EUR Investment Grade	Barclays Euro Aggregate Bond (TR)	5.05	1.01	4.00
EUR Government	Barclays Euro Aggregate Treasury (TR)	4.81	1.02	3.75
Equity				
Real Estate	DJ Global World Real Estate (TR)	13.94	3.16	10.45
US Mid Cap	S&P MidCap 400 (NR)	10.81	0.54	10.21
US Large Cap	S&P 500 (NR)	10.10	0.48	9.58
Emerging Markets Small Caps	MSCI EM Small (NR)	9.36	-3.81	13.69
US Small Caps	S&P SmallCap 600 (TR)	8.81	-0.32	9.17
European Small Caps	MSCI Europe Small Cap (NR)	7.74	-6.86	15.68
Emerging Markets Asia	MSCI EM Asia (NR)	7.49	-2.67	10.43
US Dividends	S&P High Yield Dividend Aristocrats (NR)	6.72	3.55	3.07
Global All Cap (including Emerging Markets)	MSCI ACWI IMI (NR)	6.00	-3.03	9.31
Global (including Emerging Markets)	MSCI ACWI (NR)	5.71	-3.07	9.06
Emerging Markets	MSCI EM (NR)	5.06	-5.52	11.20
UK Dividends	S&P UK High Yield Dividend Aristocrats (TR)	3.59	-2.35	6.09
Japan	MSCI Japan (NR)	2.99	-5.04	8.46
UK All Caps	FTSE All Share (TR)	2.49	-3.62	6.34
Emerging Markets Latin America	MSCI EM Latin America (NR)	0.58	-9.96	11.71
Emerging Markets Europe	MSCI EM Europe (NR)	0.01	-14.03	16.33
Eurozone Dividends	S&P Euro High Yield Dividend Aristocrats (NR)	-0.14	-9.28	10.08
Europe Large Caps	MSCI Europe (NR)	-0.39	-7.66	7.87
Emerging Markets Dividends	S&P EM Dividend Opportunities (NR)	-2.21	-7.92	6.20
Eurozone Large Caps	MSCI EMU (NR)	-3.23	-11.80	9.72
Commodities				
Gold	London Fix Gold PM (PR)	6.84	0.93	5.85
Commodities	DJ UBS Commodity (TR)	-4.16	-2.55	-1.66

Source: Morningstar Direct, SSgA, as of 31 May 2012. Return in EUR. TR = total return, NR = net return, PR = price return. Past performance is no guarantee of future performance.

2012 ETF INDUSTRY HIGHLIGHTS

At the end of May this year, European-domiciled ETFs accounted for around €250 billion in assets under management.

Equity ETFs remained the dominant category at roughly 55% of total ETF assets. Within this, German, US, Eurozone and emerging market equity ETFs each contained more than €10 billion in assets at the end of May. European, global, UK and Japanese equity ETFs were also among the largest categories.

The proportion of ETF assets under management allocated to equities has continued to shrink as

investors embrace fixed income and commodity ETFs. Commodity ETFs, mainly those tracking the performance of gold, totalled more than €58 billion at the end of May, representing 23% of European-domiciled ETF assets, while fixed income ETFs represent around 17% of the overall market.

With much of the innovation in the mutual fund industry taking place within the ETF world, new launches continued at a high, albeit slightly slower, pace. Around 100 ETFs were launched in the first five months of 2012, covering the full gamut of asset classes from broad market equities to more esoteric assets such as volatility and hedge fund beta replication strategies.

FIGURE 3: ETF ASSETS UNDER MANAGEMENT

BROAD ETF CATEGORY	AUM (€ BILLION)
Equity	137.8
Commodity	58.0
Fixed Income	41.7
Alternatives	9.1
Money Market	4.1
Asset Allocation	0.9

ETF CATEGORY	AUM (€ BILLION)
Commodities – Precious Metals	48.1
Germany Large-Cap Equity	19.9
US Large-Cap Blend Equity	18.3
Eurozone Large-Cap	16.0
Global Emerging Markets Equity	11.4
EUR Government Bonds	9.9
EUR Corporate Bonds	8.0
Europe Large-Blend	7.5
Global Large-Cap Blend	7.3
UK Large-Cap Blend	6.7

Source: Morningstar Direct, SSgA, as of 31 May 2012. Estimated assets under management for European domiciled ETFs.

Long-term European-domiciled ETFs gathered approximately €3.6 billion in new assets in the first five months of the year. Following significant outflows in 2011, investors returned to emerging market ETFs during the first quarter. Despite modest outflows in April and May, year to date, emerging market equity inflows totalled €900 million, while ETFs tracking emerging market bonds – both US dollar and local currency – have attracted €800 million in new assets. Broad emerging market equity ETFs gathered the lion's share of the flows, but investors also allocated to region-specific emerging market ETFs, most notably those that track Latin American indices. Within the SPDR ETFs range, both emerging market Asia and dividend ETFs saw solid flows.

From a European investor's standpoint, the trade of 2011 was to 'buy Germany'. ETFs that track the DAX experienced inflows of more than €12 billion last year. Year to date in 2012, however, while there was significant volume traded in DAX ETFs they have experienced outflows of almost €1 billion.

Corporate bonds – both high yield and investment grade – attracted significant investor interest in the first five months of 2012 with inflows of more than €2 billion, thanks to favourable spreads and generally solid corporate results. Dividend-based investment strategies

continue to prove popular both in the US and in Europe, with investors attracted to the defensive qualities and the yield potential of high-quality dividend-paying stocks. Within the SPDR ETFs range, the SPDR S&P US Dividend Aristocrats ETF saw the highest level of inflows, approaching €200 million year to date.

Europe's problems have certainly been reflected in ETF flows so far this year. Of the top 10 outflow categories, all but one represent European assets in one form or another, from eurozone government bonds to eurozone equity ETFs, highlighting the acute lack of confidence in the region's current prospects.

FIGURE 4: TOP 10 ETF CATEGORIES BY 2012 INFLOWS AND OUTFLOWS

ETF CATEGORY WITH TOP INFLOWS	ESTIMATED NET FLOWS (€ MILLION)
EUR Corporate Bonds	1,619
Global Emerging Markets Equity	892
GBP Government Bond	598
Alternatives (Volatility, Currency etc.)	482
Global Emerging Markets Bonds	457
USD High Yield Bonds	432
Global Large-Cap Blend Equity	397
Europe Large-Cap Blend Equity	384
US Large-Cap Blend Equity	381
Global Emerging Markets Bond – Local Currency	343

ETF CATEGORY TOP OUTFLOWS	ESTIMATED NET FLOWS (€ MILLION)
Eurozone Large-Cap Equity	-1,945
EUR Money Market	-1,259
Germany Large-Cap Equity	-952
Switzerland Large-Cap Equity	-444
France Large-Cap Equity	-409
Sector Equity Communications	-232
Asia ex-Japan Equity	-207
Sector Equity Healthcare	-192
EUR Government Bond	-164
UK Large-Cap Blend Equity	-155

Source: Morningstar Direct, SSgA, as of 31 May 2012. Estimated net European domiciled ETF flows. Morningstar uses the estimated monthly method for calculating ETF category flows for European domiciled ETFs which involves using beginning total net assets, ending total net assets and the market return.

EUROPEAN SECTOR PERFORMANCE AND SECTOR ETF FLOWS

Sector performance is a useful gauge of market sentiment and aggregate economic expectations. Generally speaking, cyclical sectors, such as materials, industrials and consumer discretionary, outperform when investors are positive about the prospects for the economy, while defensive sectors, such as

telecoms and utilities tend to lead when expectations are more subdued. Based on current flows, investors seemed to view the turn of the year as something of an inflection point in the cycle, with ETFs that track financials, industrials, materials and technology sectors experiencing the highest demand. But looking at performance, the story was mixed, with consumer discretionary and industrials stocks outperforming together with stocks in the more defensive consumer staples and health care sectors. Despite the problems facing Europe's banks, ETFs tracking the financials sector once again attracted the highest volume of inflows, potentially reflecting a perception of reduced risks following the ECB's LTRO initiated towards the end of 2011. It may also indicate that some investors view individual stock risk as too high, so are choosing to maintain exposure to the sector via financials ETFs.

FIGURE 5: EUROPEAN SECTOR PERFORMANCE AND SECTOR ETF FLOWS

EUROPE SECTOR PERFORMANCE	RETURN (% IN EUR)
Consumer Discretionary	10.22
Consumer Staples	5.01
Health Care	2.54
Industrials	2.27
Technology	1.16
Materials	-0.77
Financials	-3.06
Utilities	-5.75
Energy	-8.00
Telecom	-8.24

EUROPE SECTOR FLOWS	ESTIMATED NET FLOWS (€ MILLION)
Sector Equity Financial Services	120
Sector Equity Industrial Materials (Industrials and Materials)	68
Sector Equity Technology	16
Sector Equity Utilities	-22
Sector Equity Consumer Goods & Services (Consumer Staples and Discretionary)	-59
Sector Equity Energy	-141
Sector Equity Healthcare	-192
Sector Equity Communications (Telecoms)	-232

Source: Morningstar Direct, SSgA, as of 31 May 2012. Estimated net European-domiciled sector ETF flows. Morningstar uses the estimated monthly method for calculating ETF category flows for European domiciled ETFs which involves using beginning total net assets, ending total net assets and the market return. Sector performance is based on MSCI Europe sector indices (NR).

SPDR ETFS FLOWS

Flows into SPDR ETFs were strong during the first five months of the year, totalling approximately €875 million and representing nearly 25% of net new industry-wide asset growth. As noted earlier, the SPDR S&P US Dividend Aristocrats ETF proved most popular with net new asset growth of almost €200 million, illustrating the appeal of high-quality dividend-based equity strategies.

As the first emerging market local currency bond ETF in Europe, the SPDR Barclays Capital Emerging Markets Local Bond ETF continued to experience solid demand with inflows of more than €160 million. With on-going weakness in the euro, an increasing number of investors are looking towards emerging market local currency bonds as a way to benefit from any further currency depreciation while also raising the yield profile of their fixed income portfolio. The recently launched SPDR Barclays Capital Sterling Corporate Bond ETF has also experienced inflows of more than €100 million year to date.

In line with the rest of the industry, the SPDR ETFs with the largest outflows were euro bonds and equities. Flows in and out of the SPDR MSCI Europe Sector ETFs were rather modest year to date, with the telecoms and materials ETFs seeing outflows of €7 million each.

FIGURE 6: TOP 5 SPDR ETFS BY INFLOWS AND OUTFLOWS

TOP 5 INFLOWS	NET FLOWS YTD 2012 (€)
SPDR S&P US Dividend Aristocrats ETF	194
SPDR Barclays Capital Emerging Markets Local Bond ETF	166
SPDR Barclays Capital 1-5 Year Gilt ETF	131
SPDR Barclays Capital Sterling Corporate Bond ETF	100
SPDR S&P 400 US Mid Cap ETF	67

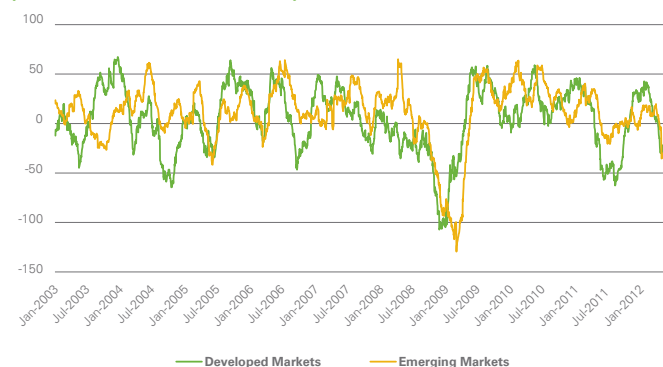
TOP 5 OUTFLOWS	NET FLOWS YTD 2012 (€)
SPDR Barclays Capital Euro Aggregate Bond ETF	-30
SPDR AEX ETF	-9
SPDR MSCI Europe Telecommunications Services SM ETF	-7
SPDR MSCI Europe Materials SM ETF	-7
SPDR MSCI ACWI ETF	-5

Source: Morningstar Direct, SSgA, as of 31 May 2012.

2012 INVESTMENT REVIEW

A staggering reversal of market momentum occurred in early 2012, with the worst performers of 2011 recording the best returns during the first quarter of this year. Strong economic results helped market sentiment in the first three months of 2012, as quantified by the Citi Economic Surprise Indices (see Figure 7). This was especially true in the US. Heading into the year, it appeared that economists and strategists were too bearish, with reported numbers coming in better than most expected. However, these series have a tendency to revert back to their mean and have fallen considerably from their highs. It would seem that markets have been comfortable reacting positively to better-than-expected economic news, but have generally reacted badly when data has been in line with or worse than expectations.

FIGURE 7: CITIGROUP ECONOMIC SURPRISES INDICES (JANUARY 2003 – MAY 2012)



Source: FactSet, SSgA, as of 31 May 2012.

The Citigroup Economic Surprises Indices are quantitative measure of economic news. They are defined as weighted historical standard deviations of data surprises. A positive reading suggests the latest economic data has been better than consensus, while a negative reading suggests data has been worse than consensus.

Another important driver of returns earlier in the year, and arguably since the financial crisis of 2008, has been the very loose monetary policy stance held by central banks around the world. In the US, we have seen a base rate of 0-0.25%, quantitative easing (QE) and 'Operation Twist', while in the UK, the base rate remains at an historical low of 0.5% and the Bank of England has undertaken large scale QE. In Europe, the ECB's LTRO seemed to take some short-term contagion risks off the table as well as reducing bank funding pressures and, temporarily, sovereign yields in Spain and Italy. Monetary authorities seem willing to take more action, but have emphasised that monetary policy alone will not solve the current economic crisis. Emerging market growth is another key driver of market sentiment, and nervousness persists about signs of a hard landing in Latin America and Asia. The likelihood that China will

experience a hard landing seems to have diminished for now, as the government seeks to engineer a modest and manageable slowdown in its economy, but this remains a key risk for the global economy in 2012 and 2013.

ASSET CLASS POSITIONING REVIEW

As outlined in our outlook at the start of 2012, we were relatively constructive on the equity market due to low valuations, solid corporate performance and very loose monetary conditions, but noted that markets were likely to remain volatile and highly correlated. Against that backdrop, we encouraged investors to think about maintaining a relatively cautious stance within the developed markets by tilting towards higher-quality, dividend-paying stocks. We also had an eye towards divergences in economic growth, with certain countries and regions seeing some dispersion in growth data. In addition, we suggested that investors may choose to seek out emerging markets for their stronger growth prospects and the generally favourable fiscal positions of their governments. In the first quarter, emerging markets certainly benefited from investors' increased risk appetite and the stronger growth prospects they offer relative to their developed counterparts. However, emerging markets, which are prone to bouts of volatility when market participants look to reduce risk, have suffered of late with investors moving towards markets with more defensive characteristics.

With the persistence of a low interest rate environment, we also thought investors could be well served by looking for opportunities to increase their yield within fixed income. Thus far, relative to Treasuries, high yield and investment grade corporate bonds have proven to be a strong place for investment. With improved balance sheets and the lack of attractive yields from sovereign bonds, this performance trend may continue.

2012 MID-YEAR INVESTMENT OUTLOOK

Earlier this year, the SSgA Economics Team indicated that global growth is likely to be relatively muted, slowing from 3.9% in 2011 to 3.2% in 2012. Figure 8 highlights these 2012 forecasts for growth across selected countries and regions. In the developed world, it is worth noting that the US is expected to grow 2.2%, an increase over 2011 growth of 1.7%. However, eurozone growth is expected to contract mildly, down 0.5%. Among Europe's largest countries, Italy is forecast to fare the worst in 2012, contracting 1.7%. The developing world is expected to slow from 6.2% growth in 2011 to 5.2% in 2012.

FIGURE 8: SSGA ECONOMIC SUMMARY OF REAL GDP GROWTH (ANNUAL PERCENTAGE CHANGE)

REAL GDP (ANNUAL PER CENT CHANGE)						
	TEN-YEAR AVERAGES		HISTORY		FORECAST*	
	1992-2001	2002-11	2010	2011	2012	2013
World Growth	3.2	3.8	5.3	3.9	3.2	3.7
Advanced Economies (51.1)*	2.8	1.6	3.2	1.6	1.4	1.8
US (19.1)	3.5	1.6	3.0	1.7	2.2	2.0
Euro area (14.2)	2.1	1.1	1.9	1.5	-0.5	0.8
Germany (3.9)	1.6	1.0	3.6	3.1	0.9	1.5
France (2.8)	2.0	1.1	1.6	1.7	0.4	0.9
Italy (2.3)	1.6	0.2	1.8	0.5	-1.7	0.0
Japan (5.6)	0.8	0.6	4.5	-0.7	2.2	1.6
UK (2.9)	3.1	1.4	2.1	0.7	0.2	1.4
Canada (1.8)	3.3	1.9	3.2	2.4	2.0	2.2
Australia (1.2)	3.8	3.0	2.5	2.1	3.4	3.0
Developing Economies (48.9)	3.9	6.5	7.5	6.2	5.2	5.7
<i>Memo: G7 Economies (38.5)</i>	<i>2.6</i>	<i>1.3</i>	<i>3.1</i>	<i>1.4</i>	<i>1.5</i>	<i>1.6</i>

Source: SSGA Economics Team, as of June 2012.

*Values in parenthesis represent the "purchasing power parity" share weights of world output, Source: IMF World Economic Outlook, April 2012. The above forecasts are estimates based on certain assumptions and analysis made by SSGA. There is no guarantee that the estimates will be achieved.

With the first half of 2012 under our belts and these forecasts as background, we continue to believe that our base-case scenario of modest global economic growth remains the most likely outcome over the medium-term horizon. While the extreme market moves experienced in the early part of the year made it tempting to alter course and adopt a more constructive outlook, we were hesitant to interpret this as a signal that all was clear on the horizon. Likewise, the escalation of the eurozone crisis and deteriorating economic data and market confidence in recent months has certainly buffeted confidence, but we are reluctant to recommend a significantly more defensive posturing.

As always, diversification – across asset classes and regions – should be front and centre in most investors' minds. Where appropriate, we believe investors should continue to emphasise high-quality dividend paying stocks

within their equity portfolios and move up the risk curve a little through investments in corporate bonds within fixed income. It would seem that emerging markets will almost certainly remain volatile, but we believe the investment case for local currency bonds and emerging market equities is secular in nature and remains compelling. Certainly, the risk of a dramatic eurozone exit has increased with the difficulties Greece has faced in forming a government and the hard line currently being adopted by its creditors. But while Greece leaving the euro would not now be a surprise, a disorderly exit with all its resulting uncertainties would likely have a devastating impact on market confidence. The worrying rise of bond yields in Spain and Italy of late has further dented confidence but, as noted earlier, the will seems to be there to maintain the current membership of the euro and increasingly, there is acknowledgement that growth in the region is ultimately going to help get the region back on its feet.

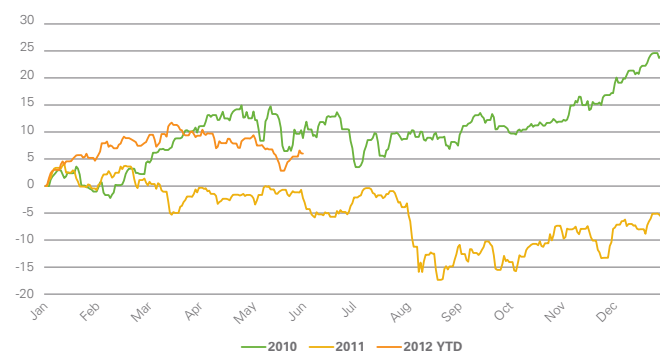
CONCLUSION

Figure 9 illustrates the performance dynamics of equities, represented by the MSCI ACWI IMI Index, over the last two years, overlaid with equity performance year to date. As we move into the second half of the year, investors can be forgiven for sensing a bit of déjà vu. Will this year end up much like the last, with equities starting well, before selling off aggressively over the summer period as worries about the state of the global economy return? Or will investors be rewarded for holding their nerve throughout what is likely to be another action-packed summer?

With so much macro uncertainty on the horizon, the temptation to maintain significant cash balances until the global economy fully recovers is high, but with interest rates at record low levels – and in many cases negative in real terms – one must also accept that such strategies are not without costs and risks of their own. We believe investors should acknowledge the serious challenges the global economy faces, but continue to maintain a broadly diversified portfolio across a

range of assets and regions. When the current macro uncertainty starts receding, hopefully by year end, navigating financial waters should become easier. In the near term, however, it's still not clear whether smooth sailing is on the horizon or if there are storms ahead.

FIGURE 9: MSCI ACWI IMI PERFORMANCE (% CUMULATIVE RETURN IN EUROS, 2010, 2011 AND 2012 YTD)



Source: Morningstar Direct, SSgA, as of 31 May 2012. MSCI ACWI IMI (NR) cumulative performance in euros. Past performance is no guarantee of future performance.

ABOUT SPDR ETFs

Offered by State Street Global Advisors (SSgA), SPDR ETFs provide professional investors with the flexibility to select investments that are precisely aligned to their investment strategy. Recognised as an industry pioneer, SSgA created the first ETF in 1993 (SPDR S&P 500® ETF – ticker SPY US).¹ Since then, each new member of the SPDR ETFs family has been built to reflect our intimate knowledge of the ETF market and over 30 years of indexing experience. Today we manage more than \$305B in over 160 ETFs worldwide.²

We believe ETFs are about finding simple solutions to precisely meet investors' needs. This belief is reflected in every member of the SPDR ETFs family. All of our ETFs are physically backed, providing a simple, transparent way to access each market segment.

SSgA is a global leader in asset management. The firm is relied on by sophisticated investors worldwide for its disciplined investment process, powerful global investment platform and access to every major asset class, capitalisation range and style. SSgA is the asset management business of State Street, one of the world's leading providers of financial services to institutional investors.

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