SPDR
STATE STREET GLOBAL ADVISORS

2013 ETF & Investment Outlook:
Finding Opportunities in an Age of Uncertainty

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Based on headlines concerning the US, the Middle East, Europe and China over the last eleven months, one may expect to see global equity markets to be deeply in the red. But as of the end of November 2012, the MSCI ACWI IMI has delivered a very respectable 13.51% return in local currency terms, while the Barclays Global Aggregate Index has gained 4.66%.[1]

In 2012, markets have been resilient in the face of countless sources of uncertainty that seem to emanate from all corners of the world. In fact, looking forward, while there have been some recent resolutions with the US election and a fresh aid package for Greece, investing in an age of uncertainty seems likely to be a key theme for some time to come. But after a long bull market in bonds, will 2013 mark the beginning of a return to equities? Or will investors continue to prefer the relative safety of fixed income investments? In either case, the need to implement investment decisions on a precise basis remains paramount, and as a result ETFs will continue their momentum as the vehicle of choice for investors, large and small.

2012 ETP INDUSTRY HIGHLIGHTS

While 2012 has generally been a year in which risk has been rewarded, investors have continued to decrease their equity exposure, while increasing their allocation to fixed income investments. Recent flows into equity exchange traded products (ETPs) have been strong suggesting improved sentiment, but they have been dwarfed by the outflows from traditional equity mutual funds. Amidst this environment, the global ETP industry has seen nearly $200 billion of positive flows over the first eleven months of the year.

Within the ETP marketplace, the trend toward fixed income is alive and well. Through the end of November, investors have put $32.2 billion to work among US fixed income products. In addition, with the continued need for income in a low-yield environment, they have added nearly $12.6 billion to high yield fixed income. As noted, ETP investors rewarded equity products as well. In doing so, nearly $20.2 billion flowed to emerging markets equity, nearly $16.6 billion to US equity large cap blend and almost $8.9 billion to Europe equity large cap. In addition, among other categories in the top ten, investors put $13.8 billion to work with the precious metals category.

FIGURE 1: ETP CATEGORIES WITH THE LARGEST INFLOWS

CATEGORY	YTD FLOWS ($ MILLIONS)
US FIXED INCOME	32,194
EMERGING MARKETS EQUITY	20,178
US EQUITY LARGE CAP BLEND	16,590
COMMODITIES PRECIOUS METALS	13,843
HIGH YIELD FIXED INCOME	12,618
REAL ESTATE SECTOR EQUITY	9,586
EUROPE EQUITY LARGE CAP	8,889
US EQUITY LARGE CAP VALUE	8,713
GREATER CHINA EQUITY	8,282
JAPAN EQUITY	7,522

Source: Morningstar, SSgA, as of 30 November 2012.

Conversely, ETP investors moved away from select equity categories, such as parts of Europe, the utilities sector, Asia ex-Japan, Mexico, Taiwan and UK large caps. They also sold out of currency ETPs to the tune of $2.5 billion. Within other European asset classes, money markets lost $1.9 billion. To put this into perspective, only 24 categories experienced net outflows, while 68 experienced inflows, which makes direct comparisons somewhat challenging.

FIGURE 2: ETP CATEGORIES WITH THE LARGEST OUTFLOWS

CATEGORY	YTD FLOWS ($ MILLIONS)
OTHER EUROPE EQUITY	-4,281
CURRENCY	-2,463
UTILITIES SECTOR EQUITY	-2,032
OTHER EUROPE MONEY MARKET	-1,907
TAIWAN EQUITY	-876
ASIA EX-JAPAN EQUITY	-844
MEXICO EQUITY	-686
UK EQUITY LARGE CAP	-431
COMMODITIES AGRICULTURE	-431
COMMUNICATIONS SECTOR EQUITY	-295

Source: Morningstar, SSgA, as of 30 November 2012.

As of 30 November 2012, the global ETP industry has over $1.8 trillion in assets under management (AUM) comprised of 4,272 products. While the top ten sponsors account for 48% of the number of ETPs, they comprise over 85% of total assets under management. This indicates that while the industry continues to grow, it remains dominated by a handful of players. In fact, the top three sponsors (iShares, State Street and Vanguard) make up 22% of the products and 71% of the assets.

FIGURE 3: TOP TEN ETP FAMILIES

NAME	# OF ETPS	ASSETS ($ BILLIONS)
ISHARES	632	730
STATE STREET	174	336
VANGUARD	90	237
POWERSHARES	128	58
DB X-TRACKERS	233	45
LYXOR	192	39
ETFS	298	30
VAN ECK	50	28
NOMURA	39	24
PROSHARES	138	22

Source: Morningstar, SSgA, as of 30 November 2012.

Regionally, due to the dominance of the United States, the Americas are the largest market by region of domicile based on AUM. However, the EMEA market bests this when measured by number of funds. Most EMEA products are domiciled in Ireland, Jersey and Luxembourg. When looking at assets per number of funds, the Americas have the highest ratio, but EMEA and Asia are similar. This highlights that while the Asian market appears small comparatively, it remains on firm footing and should serve as a robust area of growth in the future.

FIGURE 4: ETP MARKETPLACE BY REGION

NAME	# OF ETPS	ASSETS ($ BILLIONS)
AMERICAS	1,750	1,352
EMEA	1,989	355
ASIA	537	95
GLOBAL	**4,276**	**1,802**

Source: Morningstar, SSgA, as of 30 November 2012

THE ETF INDUSTRY TURNS 20

In 2012, the ETF industry continued to grow at a robust pace as measured by both assets under management and net new flows. However, none of that would have been possible without the success of the first US-listed ETF, the SPDR® S&P 500® ETF [SPY US], which was launched on 29 January 1993. With the introduction of SPY, a new industry was born that brought the ability for both institutional and individual investors to gain access to the same areas of the market at the same price. Over time, ETFs gained momentum as investors recognised the inherent benefits of such a vehicle. Nearly twenty years since its launch, SPY remains the largest and most liquid ETF in the world. The humble beginnings of a fund that seeks to track the S&P 500 has led to the creation of an industry that provides a cost effective, transparent and liquid means of gaining exposure to asset classes around the globe as wide ranging as emerging market fixed income to corporate bonds and, more recently, tactical asset allocation within an ETF wrapper.

As shown through ETFs' behaviour during periods of market crises including market closures, constituent trading suspensions, market dislocations and natural disasters, the vehicle may offer more than just the ability to gain exposure to a given market or asset class. It could be said that ETFs have added an incremental source of liquidity to the market and are now a mechanism used by investors to uncover the true value of securities, particularly those that do not regularly trade on an exchange.

We expect that many of the industry drivers over the last twenty years will also contribute to strong growth over the next twenty. With the continued interest of retail and institutional investors alike, ETFs remain a preferred vehicle for investors looking to express short- and long-term investment views.

In 2013, product development should continue at a strong pace as an increasing number of investors use ETFs to implement their investment strategies. However, with the increased competition across the ETF landscape, ETF sponsors may need to be more discerning about the plans for future launches. At the same time, as the industry slowly begins to mature, ETF investors may see more fund closures like they witnessed in 2012. That being said, a maturing industry is not necessarily a bad thing for investors. Going forward, the most successful ETFs, whether they are passive or active, will need to be solutions oriented. In this regard, expect to see more unique fixed income products and active funds come to market.

Over the next twenty years, there will be multiple economic cycles that feature both rising and declining markets. In turn, there will be new and different stresses placed on financial markets and with the explosion of ETFs, investors now have a tool at their disposal to implement investment ideas.

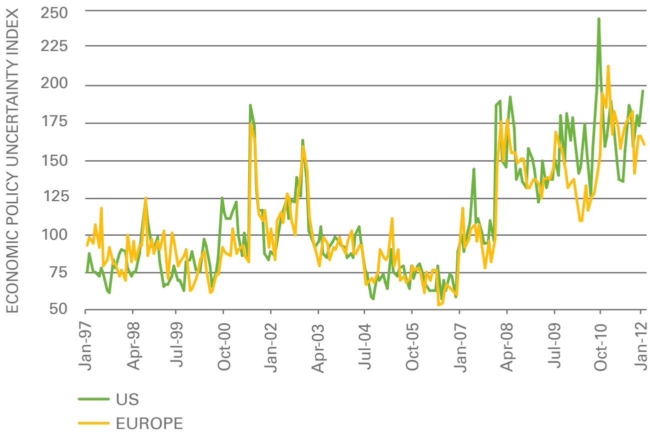
2012 INVESTMENT OVERVIEW

Heading into 2012, many market participants were decidedly bearish, especially in regards to how the sovereign debt crisis in Europe would unfold, and its potential impact on financial markets. Many would have certainly hoped for swifter resolutions to the challenges that are plaguing Europe, but both fiscal and monetary policymakers seem to have turned the corner over the last year and the marketplace seems to recognise that this may be a long road ahead. Under that backdrop, investors have remained focused on politics and policy to help guide them on potential market directions.

More recently the spotlight has moved to the US as politicians look to address the impending fiscal cliff and tackle the approaching debt ceiling debate. This economic policy uncertainty offers a big question mark for next year, which is one of the reasons why equity markets have pulled back a little from their September highs. Looking toward 2013, any progress toward resolutions will vastly improve sentiment..

We have also seen a historic leadership change in China that may now allow policymakers to focus on the specific needs of the region, shifting from an investment-driven economy to a consumption-driven economy. At the same time, Japan's upcoming election may serve as a long waited kick start to economic growth. Actions in these two countries bring politics and policy question marks across the Pacific and highlight a further place for investors to contemplate when they decide where the best investment opportunities may be.

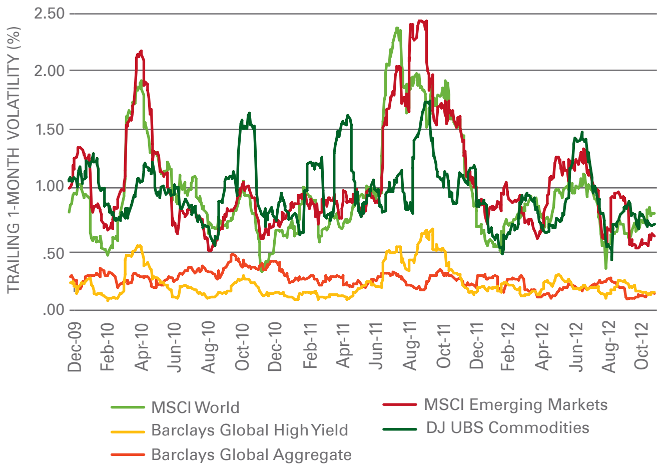
FIGURE 5: POLICY UNCERTAINTY HAS RECENTLY ABATED IN EUROPE, BUT SPIKED IN THE US



Source: Scott Baker, Nicholas Bloom and Steven J. Davis at www.PolicyUncertainty.com, SSgA, as of 30 November 2012.

Throughout the elections and political rhetoric, investors benefitted from positive moves made by policy makers and a flood of fresh liquidity from central banks around the globe in 2012. Thus in the face of an ambiguous policy environment, sluggish economic growth and slowing earnings, global equity markets have had very good results. Within equities, developed markets (13.53%) have generally outperformed their emerging market peers (12.55%). Regionally, the US, as represented by the S&P 500, returned 14.96% in local currency terms, which was slightly better than the MSCI Europe's 14.04% or the MSCI Pacific's 13.59% return. Within fixed income, credit has been a strong performer, but with less volatility than equities. The Barclays Global High Yield Index returned a stellar 17.21% in local currency terms in 2012, with investment grade corporates up 11.57%. The benefits to equities and credit have come at the expense of multi-sector fixed income and sovereign bonds. The Barclays Global Aggregate returned 4.66% and the Barclays Global Treasury, 2.81%. While commodities experienced lacklustre results of 1.59%, gold performed very well, up 12.74% through the end of November.[2]

FIGURE 6: VOLATILITY WAS VERY LOW FOR FIXED INCOME IN 2012



Source: FactSet, SSgA, as of 30 November 2012.

FIGURE 7: STATE STREET GLOBAL ADVISORS (SSGA) ECONOMICS SUMMARY OF REAL GDP GROWTH (ANNUAL PER CENT 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**	**3.1**	**3.5**
ADVANCED ECONOMIES (51.1)*	**2.8**	**1.6**	**3.3**	**1.6**	**1.3**	**1.6**
US (19.1)	3.5	1.6	3.0	1.7	2.3	2.0
EURO AREA (14.2)	2.1	1.0	2.0	1.5	-0.7	0.3
GERMANY (3.9)	1.6	1.1	4.0	3.1	0.9	1.2
FRANCE (2.8)	2.0	1.1	1.6	1.7	0.0	0.6
Italy (2.3)	1.6	0.2	1.8	0.5	-2.4	-0.5
JAPAN (5.6)	0.8	0.6	4.6	-0.7	2.4	1.5
UK (2.9)	3.1	1.4	2.1	0.7	-0.4	0.6
CANADA (1.8)	3.3	1.9	3.2	2.4	1.9	1.8
AUSTRALIA (1.2)	3.8	3.0	2.5	2.1	3.6	3.0
DEVELOPING ECONOMIES (48.9)	**3.9**	**6.5**	**7.5**	**6.2**	**5.0**	**5.5**
MEMO: G7 ECONOMIES (38.5)	*2.6*	*1.3*	*3.1*	*1.4*	*1.5*	*1.5*

Source: SSgA Economics Team, as of 14 September 2012.
*Values in parenthesis represent the "purchasing power parity" share weights of world output, Source: IMF World Economic Outlook, April 2012.

2013 INVESTMENT OUTLOOK

As previously noted, while not derailed in 2012, the global economic recovery certainly slowed from 2011 and especially 2010. According to the SSgA Economics Team, 2013 should bring about improved economic growth over 2012. Still, this reacceleration is off of a relatively low starting point and one that is not particularly robust by historical standards. The debt overhang combined with austerity in much of the developed world is likely to put a damper on economic growth and will contribute to continued divergence next year, with the developed world growing an estimated 1.6% and the emerging economies by 5.5%. Within the developed world, the SSgA Economics Team sees further deviations. They forecast the US will grow by 2.0%, but Europe to be a more modest 0.3%. Furthermore, they expect that Germany will grow by 1.2%, but France's output will only increase by 0.6% and Italy will contract by 0.5%. However, these forecasts are estimates based on certain assumptions and analysis made by SSgA. There is no guarantee that the estimates will be achieved.

Overall, the backdrop of slow growth combined with low inflation and easy monetary policy will remain in place for 2013. At the same time, while recent market activity may suggest otherwise, risks continue to appear skewed to the downside considering the US fiscal cliff, the ongoing need for resolutions in Europe and the impact of a Chinese slowdown. In turn, with support from central banks, 2013 may continue to be positive for investors with exposure to risky assets. However, with a state of uncertainty permeating the investment landscape, having a single-minded view on the future may not be as insightful as looking at three broad-based scenarios of future market direction. In addition, being nimble enough to take advantage of valuation dislocations as a result of risk-on, risk-off periods, should continue to benefit investors.

SCENARIO 1: BEAR CASE SCENARIO

Whether it is a bad outcome from the fiscal cliff and debt ceiling debates in the US, a reacceleration of the debt crisis in Europe, a harder than expected landing in China or a flaring of tensions in the Middle East, 2013 could see an event that derails the nascent global economic recovery. While each of these carries their own specific investment implications, what is consistent is that markets would likely see negative returns as a global flight to quality would take hold. With investors selling equities, they would seek out safety in government bonds, such as US Treasuries and German Bunds. Other traditional safe havens, such as the US Dollar, Japanese Yen and gold may benefit. Within equities and credit, companies with stable earning streams, strong balance sheets and less sensitivity to the economic cycle would be favoured.

SCENARIO 2: BULL CASE SCENARIO

Clear outcomes for any or all of the uncertainties listed above would be a welcome sign for global investors. With firm resolutions or credible signs toward addressing them, markets would likely witness a sizable rally. Even without resolutions, there is a possibility that global economic performance surprises to the upside. With equities currently trading at reasonable valuations to their expected earnings, particularly outside of the US, investors would likely throw caution to the wind and purchase assets that are most leveraged to the global economy. Within equities, investors would likely return to cyclical sectors, such as energy, industrials and materials. Other higher beta plays, such as emerging markets would also benefit. Fixed income investors would flock to high yield and other plays that would benefit from an environment that is friendlier toward future earnings growth.

At the same time, any increase in growth prospects may lead to the anticipation that monetary policy may move to an incrementally tighter stance. What may follow is that inflation expectations would increase and investors would look to assets, such as commodities, commodity-producing equities, real estate and inflation-linked bonds for protection against any signs of inflation.

SCENARIO 3: BASE CASE SCENARIO

With continued expectations for moderate economic growth, mild inflation and easy monetary policy, equity markets seem to be poised for decent results relative to bonds in 2013. In other words, next year could be a continuation of the current environment. This allows for a constructive view on risky assets, but one that suggests a tilt toward return of capital. This manifests itself in both equity and fixed income. Within the equity market, investors should continue to seek out dividends, but as opposed to simply the highest dividend payers, look to dividend growth and the potential to grow that dividend stream over time.

Within fixed income, spreads on investment grade and high yield corporate bonds may not look especially attractive relative to historical averages, but their yield advantages relative to sovereigns remain in place. Bearing this in mind, investors could look for exposure to the crossover bond space to pick up on any mispricing that occurs at the intersection of investment grade and high yield in the credit risk spectrum. In addition, short-duration corporates offer investors some protection from volatility driven by potential interest rate fluctuations. Investors may also consider looking to add exposure to emerging market local currency bonds for their pickup in yield, increasingly strong balance sheets and uncorrelated currency exposure.

With the continued willingness of central banks to expand their balance sheets and to engage in extraordinary monetary policy, alternatives to fiat currency, such as gold, will have support. In addition, uncertainties on fiscal policies will be additional catalysts for future price increases to the yellow metal. Investors may also consider other strategies that may provide a positive real return for both capital appreciation and diversification.

2013 SPDR ETF INVESTMENT THEMES

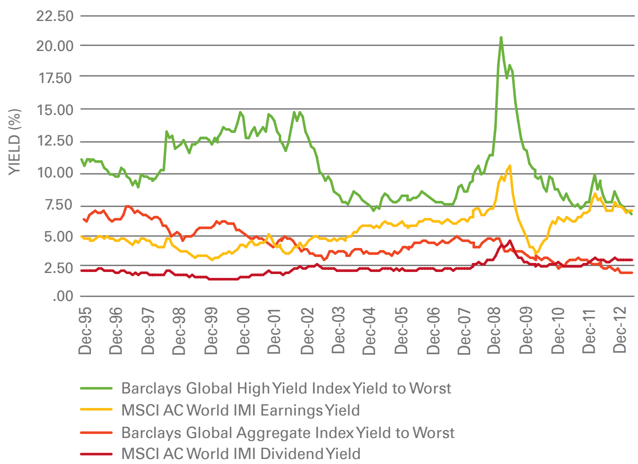
With these potential scenarios, we have identified two investment themes for global investors to consider as they look to trends and opportunities in 2013.

GOING GLOBAL FOR INCOME AND TOTAL RETURN

With many developed market interest rates near rock bottom for the past couple of years, investors have embraced innovative ways to meet their need for income in portfolios. Investors have ventured beyond government bonds and cash, turning to other income-producing assets such as investment grade and high yield corporate bonds, emerging market local currency bonds, dividend-paying equities and REITs. Thus, now that the investment community has embraced each of these asset classes on an individual basis, they need to consider what role each one should play in their portfolio and what that may look like going forward. Doing so, investors will be best served to consider income as a portion of their total return. In other words, while tilting toward income what asset will perform best from a total return perspective? This exercise in relative valuation will also help to avoid the pitfalls of chasing yield when certain asset classes have become overpriced relative to their historical averages.

In the same way that the economy and investment markets have become increasingly global, investors should also think about their income allocation from a global perspective. While US dividend equity and corporate bond ETFs have proved extremely popular, opportunities for income and total return are not limited to the US. In fact, broadening the search for yield to include European and emerging equities, either through regional or global investments, can potentially offer investors the prospect of significantly higher yields. In addition, globalising the fixed income portfolio to include non-dollar corporates and emerging market bonds also offers a significant pick-up in yield.

FIGURE 8: GLOBAL EQUITIES OFFER HIGHER YIELDS THAN GLOBAL BONDS

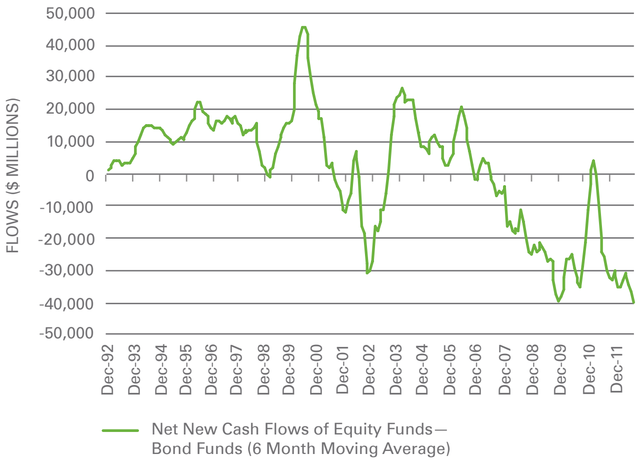


Source: FactSet, SSgA, as of 30 November 2012.

THE RETURN OF GROWTH: REFLATING WITH EQUITIES AND REAL ASSETS

While the consensus remains for subdued growth relative to historical averages over the next couple of years, most investors need to invest for the longrun. In doing so, they need to embrace the fact that just as the backdrop supports the need to tilt portfolios toward income, it also suggests investing with an eye on the future. Recently, investors have shunned equities for the perceived safety of fixed income, resulting in a potential over-allocation to 'lower-risk' fixed income investments in portfolios. However, it may not be as simple as buying stocks simply because they historically offered the best risk-return characteristics. At this stage, embracing what role equities and other assets that offer the best ability to provide positive real returns play is paramount. This focus can help to position for the continued road to recovery, while bearing in mind that this road may be subject to more pricing increases than we have witnessed in recent history. Furthermore, with structurally low interest rates and increased government spending in many countries around the world, the introduction of asset classes to a portfolio that have the ability to provide diversification and that balance out inflationary pressures will be important to consider.

FIGURE 9: INVESTORS HAVE PILED INTO FIXED INCOME AT THE EXPENSE OF EQUITIES

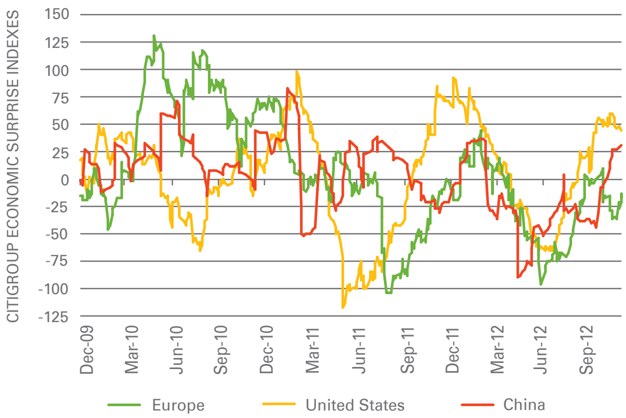


Source: ICI, FactSet, SSgA, as of 31 October 2012.

CONCLUSION

From an investment perspective, investors will need to remain vigilant in 2013 as markets remain under the specter of economic policy uncertainty. With that being said, it is clear that the ample liquidity central banks have provided and their continued willingness to improvise will remain supportive for a tone of cautious risk-seeking behavior. In support of this, one of the elements that we will be watching for in 2013 is whether investors reallocate towards equities in any meaningful way. Recently, economic performance has continued to surprise to the upside, but this is a similar pattern to what was witnessed in the past couple of years. With the potential for mean reversion, investors will need to watch to see how long this trend can continue. They may also need to be vigilant not to get caught in any traps of collective bullishness or bearishness. In such an environment, savvy investors may chose to utilise ETFs, which provide liquidity, transparency, precision and ease-of-use, to implement their particular investment strategies.

FIGURE 10: ECONOMONIC SURPRISES HAVE BEEN POSITIVE OF LATE



Source: Citi, FactSet, SSgA, as of 30 November 2012.

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† SPDR S&P 500® ETF (SPY US) is not registered for sale in Europe.
‡ As of 31.12.2012.

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[1] FactSet, SSgA, as of 30 November 2012.
[2] FactSet, SSgA, as of 30 November 2012.

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