

Russell Research / Ranks and Commentary

STATE STREET GLOBAL ADVISORS LIMITED

PRODUCT: CANADIAN BOND INDEX

ASSET CLASS Fixed Income	GEOGRAPHIC EMPHASIS Canada	CAP TIER -	DURATION RANGE Broad Market
STYLE Core	SUBSTYLE -	MARKET STATUS Developed Markets	

ACTIVITY DATE 09Jul2012	LOCATION Montreal, QC, Canada	ACTIVITY TYPE Research - Manager Office	PURPOSE Product Review
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OVERALL EVALUATION



We recommend that clients retain this manager.

Target Excess Return: 15 bp
Target Tracking Error: 40 bp
Time Period: 5 Years
Russell Assigned Benchmark: DEX BOND UNI

Manager Update

On July 10, 2012 Bilal Naqvi met with the key fixed income team members including Denis Senecal of State Street Global Advisors (SSGA) for an update on the firm's fixed income investment capabilities. This was our first on-site due diligence meeting since the change in team leadership to Denis. We are maintaining the rank of the Canadian Bond Index product at 'Retain (3)'.

On the global front, and specifically in the US, the firm has had staff reductions and realignments of some senior staff in the recent past. We were informed that they are mostly done with realignments and cut backs. Positively, the Canadian team was not affected. The firm's fixed income business assets are down 5% with aggregate actively managed assets at \$17 billion. Active assets have experienced bigger decline globally at 10%. Interestingly, assets for passive strategies are down significantly at 30% globally. We have viewed passive management as a key strength for this manager. They are experiencing better growth in Multi-Asset products. Canadian business has actually done better with assets up 3% - Passive growth is up 45% (one big client). Active style asset growth remains challenged for the manager.

SSGA's fixed income team consists of seven members including Denis. A key change on the fixed income team since our last meeting was the departure of Omar Slim, Credit Analyst, and the joining of Victor Grigore, Credit Analyst, in September 2011. We did not get to meet Victor but understand that he has sell-side research background from RBC. Certainly, with this change the firm's credit research capabilities have weakened further in our view. Denis Senecal joined the firm in



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February 2010 to replace Peter Lindley, President, who had taken charge on an interim basis following the sudden departure of previous head of fixed income.

As noted in our last research report, we had expected that Denis will restructure the firm's active product from a credit focused approach to a diversified approach. Denis has stronger interest rate management and global bonds background but limited credit markets experience. The new product structure has less credit beta and takes positions in global bonds. Denis sets a target for each position in terms of value added objective and a stop-loss. Bottom-up has been less significant in the last few years and hence a lower turnover Corporates portfolio. Overall, expect more tactical top-down strategies i.e. duration and sector. Denis is also only marginally active in using global rates. Global rates (yield convergence among G-7) strategies are implemented through the use of futures and currency is fully hedged. Alpha target for the active product is 75 bps. There are no changes in the investment process as it pertains to the passive investment management. We continue to believe that the firm's passive investment capabilities are stronger relative to active management.

Enhancements in the credit strategies include a more conservative selection criteria e.g. only liquid and large cap issuers. However, there are no credit quality constraints. Denis does not see a need to get aggressive in the credit sector unlike his predecessor. Corporates portfolio though is highly concentrated with only 5-6 issuers.

In terms of current portfolio positioning, Denis continues to lower credit risk by moving into lower beta names though still overweight the sector. He does not believe in a carry trade approach and accordingly, we do not expect them to run overweight credit portfolios across the cycle. Denis came across as a proponent of global bonds based on his view that 90% of the volatility in the Canadian markets comes from global markets. He finds Provincial bonds unattractive. On the interest rate positioning front, portfolio is presently neutral on duration. Denis commented that he plans be more active in the yield curve area while keeping duration within +/- 0.15 years (band). Top down views included a concern about Europe, US consumer and emerging economies. Hence, he expects low interest rate environment to continue for a while and yields to fall even further. He expected the Canadian curve to flatten. Overall, we heard a lot of views but none that was strong enough to reflect a key position in the portfolio.

In summary, SSGA now has a new investment approach to active fixed income management that is more diversified. As a result however, risk taking appears marginalized across these areas. If you should have any questions regarding this product or manager, please contact Bilal Naqvi at (416) 646-3035, or via e-mail at bnaqvi@russell.com.

Investment Staff ① ② ③ ④ ⑤

Denis Senecal, Head of Fixed Income, has been with the firm since February 2010. Denis has over 20 years of investment experience with direct experience in bond overlay strategies, global yield curve strategies and long/short strategies. Most recently he was Vice President at Caisse Centrale Desjardins, responsible for interest rate management for the treasury. Denis has stronger skills in interest management and global bonds. His experience in the credit markets is limited to top down views. Positively, Denis has broader exposure to different areas of the fixed income capital markets relative to his predecessor.

SSgA's fixed income team consists of seven members including Denis. Newest member of the team is Victor Grigore, Credit Analyst, who joined the firm in September 2011 from RBC sell-side research. We believe that the firm is weak in the area of credit research with only one junior level analyst.



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Within the senior management ranks, Peter Lindley is the President and Head of Investments for SSgA Canada. Peter has the dual roles of President and Head of Investments and accordingly reports to James Kase, Head of Global Sales and Marketing and Rick Lacaille, Global CIO. Peter has a fixed income background, which we view positively.

Organizational Environment ① ② ③ ④ ⑤

It appears that the last two years of substantial organizational and infrastructure changes are largely over. Importantly, SSgA remains committed to growing the Canadian business.

SSGA's Canadian-based operations are fairly autonomous from its US-based parent, with an independent President and a separate investment team. The firm's employee compensation consists of a competitive base salary, and a bonus that is two parts cash and one part in company stock.

As of March 31, 2012, Canadian fixed assets stood at \$10.5 billion. A breakdown of fixed income assets by mandates includes; Active Cash Collateral \$2.06 billion, Enhanced Bonds \$4.15 billion, Passive Bonds \$2.70 billion, Enhanced Cash, Active Bonds \$0.11 billion and Customized Bonds \$0.08 billion. Growth remains challenged in active mandates while strong in passive and enhanced passive type mandates.

Decision Making Structure ① ② ③ ④ ⑤

As the Head of Fixed Income, Denis Senecal is responsible for overseeing research, portfolio management and product development for all fixed income and cash strategies. As the Head of Investments and President, Peter does attend the Weekly Fixed Income meeting. Denis reports to Peter Lindley and Mark Marinella, Global Fixed Income CIO. Traditionally, decisions have been made based on consensus and we don't expect this to change especially in the area of Enhanced and Passive management, where Denis has limited experience.

Security Selection ① ② ③ ④ ⑤

The change in team leadership has weakened the area of security selection. Omar Slim left and now Victor Grigore joined in September 2011. We plan to meet Victor in our next on-site meeting. Though security selection is not as critical to alpha generation, research capabilities have weakened.

This product focuses on active trading strategies to exploit perceived inefficiencies, and profits from holding bonds with similar risk to those in the index, but with higher yield.



STATE STREET GLOBAL ADVISORS LIMITED**Sector Selection** ① ② ③ ④ ⑤

In order to minimize tracking error, sector allocation is tightly constrained around the benchmark on a duration-weighted basis. However, the firm will opportunistically allocate slightly more of the portfolio to sectors that provide a higher risk-adjusted return.

SSGA will not use non-index securities if their risk is deemed to be excessive. For example, real return bonds would not be considered, while Maple bonds will be.

Duration/Yield Curve Management ① ② ③ ④ ⑤

Given the tight risk controls of this product, portfolio duration is held to within +/- 0.15 years of the index.

The yield curve exposures undertaken to exploit small inconsistencies along the curve should add marginal amounts of value.

Quantitative Sophistication ① ② ③ ④ ⑤

Various vendor models are used to perform portfolio analytics and generate risk reports. Given the objectives of this product, we believe the amount of quantitative sophistication applied is adequate. Positively, the Canadian Team also utilizes advanced proprietary quantitative tools in use by the global team based in Boston.

Portfolio Construction ① ② ③ ④ ⑤

The firm is risk conscious and aims to construct portfolios that have a wide range of small active bets, which are not highly correlated. SSgA stratifies the index and its portfolio into 150 cells, based on characteristics such as term, sector, and credit quality. With each cell represented by one to three securities, the total portfolio has between 250 and 300 securities. This detailed breakdown of exposures should limit any unintended portfolio bets and keep the tracking error within objectives. Overall, SSgA's portfolio construction process appears robust.



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