SEI New ways. New answers.®

SEI Strategic Portfolios:
Q4 2016 Quarterly Commentary

Stability-Focused SEI Strategic Portfolios

Fixed income markets fall while equities rally following the US presidential election; Stability-Focused SEI Strategic Portfolios provided a degree of downside protection in Q4 2016

Executive Summary

- The fourth quarter of the year delivered a mixed set of returns across asset classes as investors considered the impact of the US presidential election on the global economic landscape. Fixed income yields rose over the period, providing a meaningful headwind to securities with higher levels of interest rate sensitivity. Meanwhile, equity markets pushed on, reflecting the growing sense that the global economy will continue to move forward, if not potentially modestly accelerate.

- The investment-grade fixed interest investments primarily utilised in the Stability-Focused SEI Strategic Portfolios (the Defensive, Conservative, and Moderate Funds, collectively "the Funds") broadly outperformed their benchmarks (Sterling Institutional share class, in GBP, net of all fees) in Q4 2016; these investments' overweights to economically sensitive fixed income and short duration biases were key contributors to relative returns.

- Over the fourth quarter, Sterling-based fixed income, as measured by the BofA Merrill Lynch Sterling Broad Market Index, struggled as UK fixed income yields rose and declined by over 3.3%. In contrast, the Stability-Focused SEI Strategic Portfolios provided clear capital preservation benefits over the full period, delivering returns in line with expectations and allowing them to build on their earlier success in 2016.

- In terms of equity investments used in the Stability-Focused SEI Strategic Portfolios, these are primarily focused on the Global Managed Volatility Equity asset class. Given the nature of the approach, the investments in this asset class are biased towards more defensive stocks, seeking to provide a degree of capital preservation in adverse equity market conditions. In line with the expectation of this asset class, during periods of stronger rallies, this asset class is likely to lag the overall global developed equity market, as was the case in the fourth quarter.

Market Overview

- The final quarter of 2016 offered several landmark developments: a surprise outcome to a sharp-elbowed US presidential election handed firm control of the federal government to Republicans, bolstering a rally in equities and a downturn in bond markets; the UK's Brexit timeline and negotiating posture evolved from abstract to relatively firm; and the oil price recovery found solid footing as oil producing countries agreed to cut production.

- Major central banks made headlines, most notably with the Fed's rate increase and firmer policy-tightening projections for 2017. US labour market conditions improved as the unemployment rate decreased to 4.6% in November, while US consumer prices rose by 1.7% in the year-over-year. The final release of GDP revealed the US economy grew at a 3.5% annualised rate in the third quarter, stronger than prior estimates and a significant improvement over the second quarter's 1.4% growth.

- The ECB announced an extension of its asset purchase programme, further loosening its monetary policy stance. Eurozone inflation hit 1.1% in December, the highest annual rate in more than three years. Manufacturing data strengthened in December, indicating sharp improvements in output, new orders and employment. The latest third quarter GDP reading revealed 0.3% growth, in line with prior estimates and equalling second quarter growth.

- The BOE announced no changes while Governor Mark Carney quashed rumours of his resignation. The UK unemployment rate dipped to 4.8% in October, markedly lower than the 5.2% rate from a year earlier and the lowest level since September 2005. Year-over-year consumer prices in the UK climbed to 1.2% in November, the highest level since October 2014. Third quarter economic growth expanded in its final estimate, reaching 0.6% for the period.

Selected Asset Class Commentary

- Global Short Duration Fixed Interest Asset Class: A re-pricing of term premia resulted in steeper yield curves, meaning shorter dated bonds outperformed longer maturity securities. Although the Funds' investments in the asset class benefited from off-benchmark exposure to spread sectors and an allocation to inflation-linked bonds, this was more than offset by an overweight to US duration, Mexican local bonds and other currency positions. The top performing manager was Schroder Investment Management, benefitting from an overweight to inflation-linked bonds, while AllianceBernstein detracted due to an overweight to US duration.

- Emerging Markets Fixed Interest Asset Class: The US presidential election weighed on the asset class as the fourth quarter began, with Mexico bearing the brunt of this dynamic. The Funds' investments in the asset class were hurt due an overweight to local currency debt. Investec Asset Management was the top-performing manager benefitting from external debt security selection in Turkey and an underweight to South Korea local debt. Neuberger Berman was the top detractor as an overweight to local currency Mexico debt and security selection in Argentina external debt hurt.

- Global Managed Volatility Equity Asset Class: Over the quarter, the sharp rotation triggered by "Trumpflation" rally sent both the stock market and interest rates up, both being headwinds to the Managed Volatility strategy. This is consistent with the expectation of this asset class: providing downside protection, but lagging in market rallies. Within the Funds' investments in this asset class, LSV Asset Management delivered the best results for both the quarter and the year, helped by their less extreme rate sensitivity. A allocation bias towards LSV Asset Management ensured that the manager's success translated into the asset class results. Analytic Investors was the biggest laggard.

Outlook

- Two key aspects are most pressing on investor sentiment as we look forward in 2017; the detail of emerging US policy under the new administration and potential European political instability given pending elections in key Eurozone nations. Regarding the former, SEI expects the new US President to break down disincentives to hiring, bank lending, new business formation and investment, leading to higher growth, earnings and profitability, as well as higher inflation. On balance, tax and regulatory reform increase SEI's optimism that economic growth will accelerate, while up-ending trade agreements and confronting China, could be dangerous unless those changes are nuanced and focused, characteristics that have not been in evidence up to this point.

- Bond yields have soared in the aftermath of Trump's election victory, reflecting a pronounced rise in inflation expectations. Inflation in the US has been percolating beneath the surface for a while, hidden by a combination of dollar strength and energy price weakness. If the Federal Open Market Committee forecast assumes that real GDP growth will be constrained as the economy approaches full employment, one can question whether inflation can indeed be contained at or below 2%.

- Across the Atlantic, general elections will be held in the Netherlands, France and Germany in 2017. The French presidential elections would seem to have the greatest importance for investors. French voters are facing a binary decision: Thatcherite conservatism that promises to undo a portion of the welfare state but has the potential to be very positive for the French economy or a gamble on economic nationalism that could lead to the unravelling of the euro currency framework. Brexit negotiations will begin when Article 50 is invoked in March; in the meantime, the recent better economic numbers offer a welcome respite.

- Emerging markets had a negative reaction to the Trump election. Concerns about the new administration's stance on trade and resumption of the dollar's appreciation are the main factors for the setback. If emerging markets are to outperform their developed market counterparts on a sustained basis, the world needs to see a major step-up in economic growth and global trade. Faster growth in the US certainly helps, but the maintenance of open markets and strong trading relationships are also crucial.

- SEI believes the central global economic scenario remains one of continued global economic growth and reflation, potentially modestly strengthening compared to 2016. Positioning along these lines has played out well for the Stability-Focused SEI Strategic Portfolios in 2016 and major adjustments are unlikely. In fixed income, credit exposures are likely to be trimmed back but shorter-duration positioning is likely to be retained, as are the underlying funds' structural government bond holdings as a portfolio backstop against a deteriorating picture.

- As is always the case, uncertainty creates opportunity for active management and SEI would suggest that investors continue to apply a strategic approach to the core of their portfolios, conducting their investment activities with a discipline that seeks to ignore short term volatility and avoid knee-jerk reactions, while remaining on the ultimate objective: the achievement of their financial goals.

<u>Important Information on Performance</u>

Past Performance is not a guarantee of future performance. Standardised performance is available upon request. All data is as at 31 December 2016.

Asset class performance discussed is based on the majority SEI fund underlying the asset class. This does not include analysis of the manager pools, hedged share class investments within SEI Funds, additional SEI funds or any third-party funds within the Strategic Portfolios. As a result, performance for the total asset class allocation may vary. Not all asset classes discussed are included in all Strategic Portfolios. All asset class comparative performance is relative to the benchmark of the specific SEI fund representing the majority of the asset class investment.

Important Information

This document and its contents are directed only at persons who have been classified by SEI Investments (Europe) Limited as a Professional Client for the purposes of the FCA Conduct of Business Sourcebook.

This information is issued by SEI Investments (Europe) Limited, 1st Floor, Alphabeta, 14-18 Finsbury Square, London EC2A 1BR, which is authorised and regulated by the Financial Conduct Authority.

The SEI Strategic Portfolios are a series of the SEI Funds and may invest in a combination of other SEI and Third-Party Funds as well as in additional manager pools based on asset classes. These manager pools are pools of assets from the respective Strategic Portfolio separately managed by Portfolio Managers which are monitored by SEI. One cannot directly invest in these manager pools.

No offer of any security is made hereby. Recipients of this information who intend to apply for shares in any SEI Fund are reminded that any such application may be made solely on the basis of the information contained in the Prospectus.

This material represents an assessment of the market environment at a specific point in time and is not intended to be a forecast of future events, or a guarantee of future results. This information should not be relied upon by the reader as research or investment advice regarding the funds or any stock in particular, nor should it be construed as a recommendation to purchase or sell a security, including futures contracts.

Investments in SEI Funds are generally medium- to long-term investments. The value of an investment and any income from it can go down as well as up. Investors may not get back the original amount invested. The risks described below may apply to the underlying assets of the products into which the Strategic Portfolios invest:

- Investment in equity securities in general are subject to market risks that may cause their prices to fluctuate over time.
- Fixed income securities are subject to credit risk and may also be subject to price volatility and may be sensitive to interest rate fluctuations.
- Absolute return investments utilise aggressive investment techniques which may increase the volatility of returns. If the correlation between absolute return investments and other asset classes within the fund increases, absolute return investments' expected diversification benefits may be decreased.
- International investments may involve risk of capital loss from unfavourable fluctuation in currency values, from differences in generally accepted accounting principles or from economic or political instability in other nations.

The Funds are denominated in one currency but may hold assets priced in other currencies. The performance of the Fund may therefore rise and fall as a result of exchange rate fluctuations.

Whilst considerable care has been taken to ensure the information contained within this document is accurate and up to date, no warranty is given as to the accuracy or completeness of any information and no liability is accepted for any errors or omissions in such information or any action taken on the basis of this information.

SEI sources data directly from FactSet, Lipper, and BlackRock, unless otherwise stated.