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MONTHLY MARKET COMMENTARY | OCTOBER 2018

Selloff Scare Hits Markets Everywhere

Monthly Snapshot

- Capital markets almost universally posted dismal performance in October (in US dollar terms). Recent top performers such as US growth shares suffered the steepest declines, while global fixed-income securities were also hurt by the poor market environment.
- Brexit negotiations continued past the October deadline; in the US, mid-term elections occupied the public's attention as healthcare and immigration became defining issues.
- While investors may feel uncomfortable maintaining exposure to risk assets amid such market declines and geopolitical uncertainty, mistiming entries and exits into and out of equities can be costly. We therefore believe, as always, that investors are best served by remaining focused on their long-term strategy.

Economic Backdrop

Capital markets almost universally posted dismal performance in October. The straightforward countercyclical environment meant that recent top performers such as U.S. growth shares suffered the steepest declines. The most cyclically-oriented sectors (consumer discretionary, energy and industrials) were hit the hardest, while classic defensive sectors (consumer staples and utilities) were positive. Asia-Pacific stock markets were also down sharply, particularly China. Latin America shares gained—presumably on ballot-box expectations for Jair Bolsonaro, Brazil's conservative pro-business president-elect.

Fixed income was not spared in October's selloff; higher-risk segments—like high yield and emerging-market debt—fared worst, but investment-grade bonds also declined. Government bond yields declined in the UK and EU, but increased in the US. West Texas Intermediate crude-oil prices peaked at the beginning of October before descending more than 14% by the end of the month; the trend was largely similar in other commodities.

Brexit negotiations continued past the 17 October deadline, days after Prime Minister Theresa May suggested at an EU summit to extend the post-divorce transition period. The proposal reportedly earned a warm reception; although EU leaders have since continued to develop no-deal contingency plans. Negotiations appear to hinge on the EU's insistence that the withdrawal agreement allow Northern Ireland to remain in its single market and customs union; the UK prefers a temporary customs arrangement while negotiating a more permanent customs union between the EU and the entire UK during the transition period.

A late-October report revealed that May had negotiated the right of UK-based financial services companies to continue operating in EU markets after Brexit (although the prime minister's office characterised the report as speculative). The deal would establish a relationship based on the principle of equivalence (that is, the premise that the financial regulatory frameworks of the two areas are in broad alignment)—which is what currently governs the EU-US relationship, for example. German Chancellor Angela Merkel announced she would not stand for re-election as leader of the Christian Democratic Union later this year or as chancellor in 2021 amid poor regional election results for her governing coalition.

All references to performance are in US dollar terms unless otherwise noted. See Standardised Performance for more information.

Key Measures: October 2018

Equity	
Dow Jones Industrial Average	-4.98%
S&P 500 Index	-6.84%
NASDAQ Composite Index	-9.16%
MSCI ACWI Index (Net)	-7.49%
Bond	
Bloomberg Barclays Global Aggregate Index	-1.12%
Volatility	
Chicago Board Options Exchange Volatility Index PRIOR MONTH: **12.12**	21.23
Oil	
WTI Cushing crude oil prices PRIOR MONTH: **$73.25**	$65.31
Currencies	
Sterling vs. US dollar	$1.28
Euro vs. US dollar	$1.13
US dollar vs. yen	¥112.86

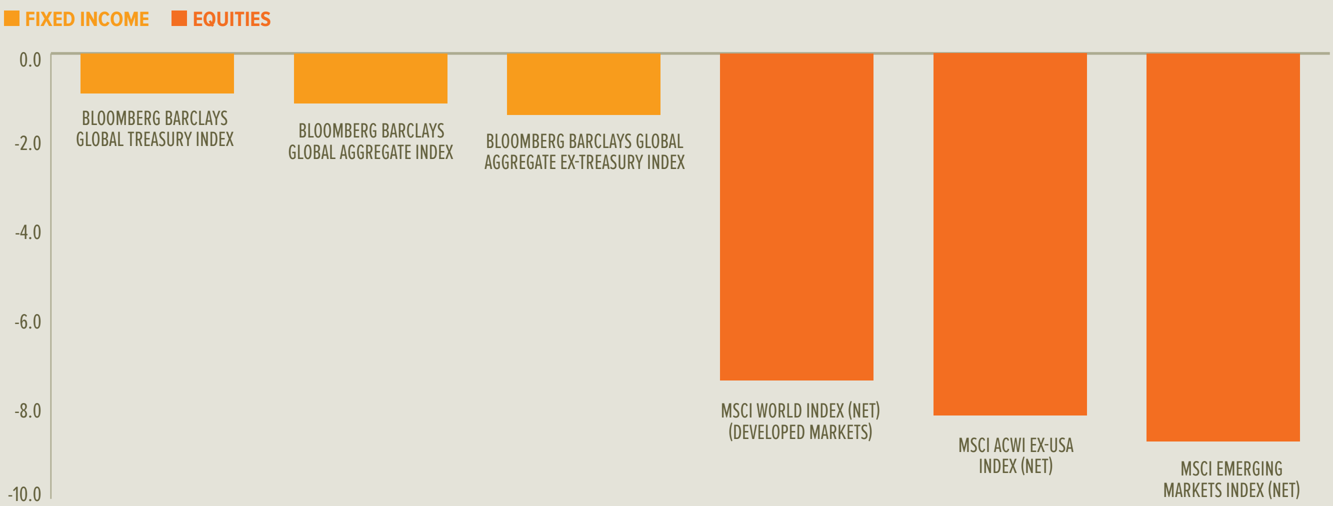
Sources: Bloomberg, FactSet, Lipper

In the US, mid-term elections occupied the public's attention as healthcare and immigration became defining issues while the economic landscape remained broadly appealing. The country's trade policy was marked by worrying ultimatums (as US President Donald Trump's administration continued to threaten tariffs on essentially all China imports) in addition to a hopeful outlook for interpersonal progress (with an end-of-month phone call between the leaders of these two major trading partners). Mexico committed to abstaining from signing the US-Mexico-Canada Agreement (a revised trade deal intended to replace the North American Free Trade Agreement) until the US exempts Canada and Mexico from steel and aluminium tariffs.

The Bank of England's Monetary Policy Committee announced no new actions following its meeting on 1 November, and lowered economic growth expectations for 2018 and 2019. The European Central Bank (ECB) and Bank of Japan made no changes at their respective late-October meetings. The US Federal Open Market Committee had no official meeting during October—but minutes released from its September meeting explained that the word "accommodative" was removed from the committee's statement about monetary policy, to avoid giving a "false sense of precision" regarding interest-rate expectations. The US Federal Reserve (Fed) proposed rolling back banking regulations in late October, spurred by Congress' passage of the Economic Growth, Regulatory Relief, and Consumer Protection Act earlier this year. The proposal sought more flexible capital requirements and less frequent stress tests for smaller and lower-risk firms; lower standardised requirements for medium-sized firms; and no relief for the largest and highest-risk firms.

UK manufacturing growth dropped in October from the prior month's downward-revised report, registering the slowest expansion in 27 months. Construction growth remained below its long-term average in October, but accelerated to its second-best growth rate since mid-2017. Labour-market conditions were nearly frozen in the latest report, with the claimant-count unemployment rate holding at 2.6% in September. The June-to-August unemployment rate was also unchanged from its prior reporting period,

Major Index Performance in October 2018 (Percent Return)



Sources: FactSet, Lipper. See "Corresponding Indexes for Major Index Performance Exhibit" in the Index Descriptions section for more information.

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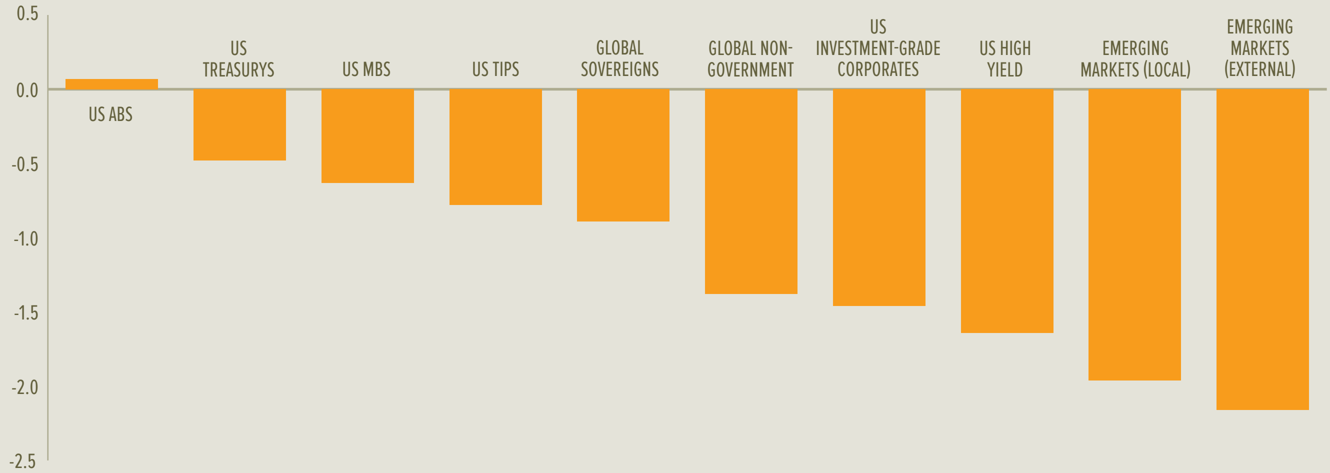
Fixed-Income Performance in October 2018 (Percent Return)



Sources: FactSet, Lipper. See "Corresponding Indexes for Fixed-Income Performance Exhibit" in the Index Descriptions section for more information.

registering a rate of 4.0%, while average year-over-year earnings growth edged upward to 2.7% over the same three-month period.

The eurozone's manufacturing expansion cooled in October for the ninth time in the past 10 months, falling firmly into slow-growth territory. Services growth also moderated but remained at healthier levels. The unemployment rate held at 8.1% in September, with almost no net change across the eurozone; although Italy saw a sharp uptick in joblessness that was partially offset by gains in Spain. A preliminary report of overall economic conditions showed eurozone gross-domestic product expanding by 0.2% in the third quarter and 1.7% year over year, representing a deceleration over both periods and the slowest quarterly pace since the three-month period ending September 2014.

US manufacturing was depicted in mixed reports as still healthy but modestly softer in October; services-sector growth appeared to accelerate in preliminary reporting. The core personal consumption expenditures price index held at 2.0% in September, remaining at the Fed's target inflation level. Payrolls expanded convincingly in October, and average hourly earnings grew by 3.1% year over year, contributing to the latest evidence of a trend toward higher wage growth. The US economy grew at a slower but still-strong 3.5% annualised rate for the third quarter, according to preliminary reports.

China's currency has fallen sharply not only against the dollar but also against a broader basket of currencies. The weaker currency partially offsets the impact from tariffs imposed by the US.

Our View

The ratcheting-up of trade-war tensions between the US and China has become the #1 preoccupation of investors. And with good reason: Whatever happens between the two countries has global implications. China and the US together accounted for 42% of world nominal gross domestic product (GDP) last year.

China's currency has fallen sharply not only against the dollar but also against a broader basket of currencies. The weaker currency partially offsets the impact from tariffs imposed by the US. The competitiveness of

All references to performance are in US dollar terms unless otherwise noted. See Standardised Performance for more information.

Chinese exporters against other countries has also improved as a result of this year's devaluation.

On the downside, the weak Chinese currency makes it almost certain that the Trump administration will increase the tariff rate to 25% at the beginning of January. It also could raise the ire of other big importers of Chinese goods, perhaps making it easier for the US to enlist the support of other World Trade Organization (WTO) members in its attempt to sanction China over unfair trading practices.

The US is in strong shape economically. Although nobody wins in a trade war, even White House advisors with a pro-trade bias believe that the US will be the least hurt of the two countries.

Despite a near-term view that is fraught with uncertainty, we continue to believe in diversifying portfolios with emerging-market exposure. The alpha opportunities (that is, the ability to achieve returns in excess of benchmarks) also are much greater, given the economic and political idiosyncrasies inherent in the asset class. The price-to-earnings ratio for the MSCI Emerging Markets Index is running at about a 30% discount to that of the MSCI USA Index (as at 30 September 2018), near attractive relative valuation levels last seen in early 2016.

As the trade war with China heats up, the Trump administration has turned more conciliatory toward other countries with which it has picked fights. Broad agreement has been reached with Mexico and Canada on the new trilateral USMCA, which replaces NAFTA (notwithstanding Mexico's stipulation of being exempt from steel and aluminium tariffs). The threat of tariffs on European and Japanese autos and auto parts has also been taken off the table. This may be a temporary truce, but we are hopeful that it represents a realisation by the White House that it's better to gain allies in its battle against China than fight on multiple fronts.

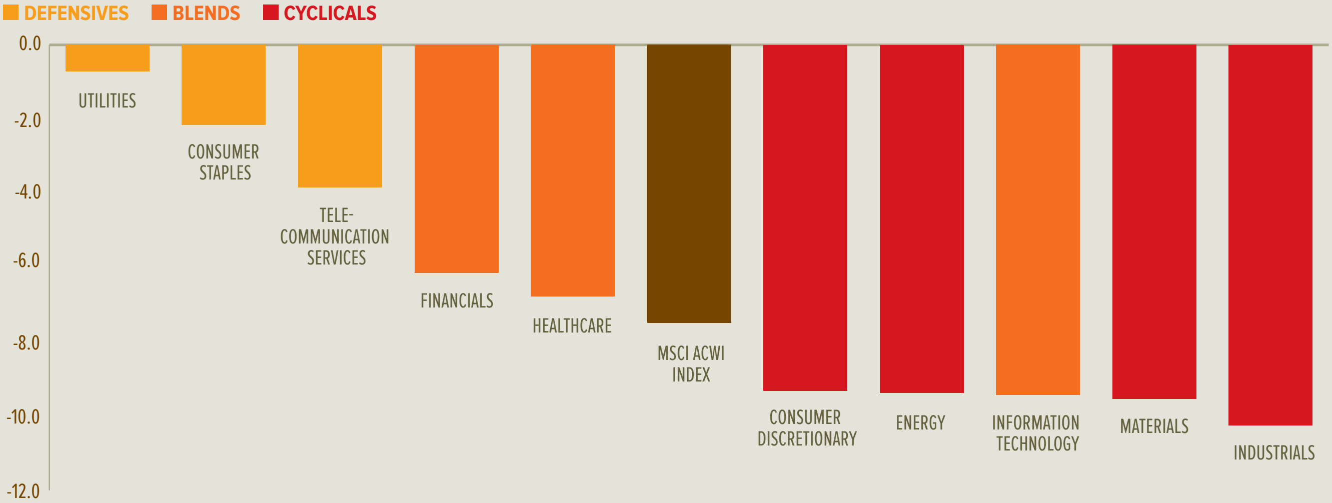
In Europe, there are business-as-usual problems: sluggish economic growth, still-high unemployment and the never-ending disagreements over how expansive monetary policy should be. Europe also faces trade tensions of its own. The UK is far more dependent on the EU as an export

Regional Equity Performance in October 2018 (Percent Return)

Sources: FactSet, Lipper. See "Corresponding Indexes for Regional Equity Performance Exhibit" in the Index Descriptions section for more information.

All references to performance are in US dollar terms unless otherwise noted. See Standardised Performance for more information.

Global Equity Sector Performance in October 2018 (Percent Return)



Sources: FactSet, Lipper. MSCI ACWI Index Sector Components (Cyclicality determined by SEI).

market than the other way around. A "hard" Brexit would therefore severely affect the UK's export of financial and other services (keep in mind that manufacturing accounts for only 10% of the UK's GDP nowadays, while services account for 80%).

Although a last-minute agreement or a mighty kicking of the can down the road is possible, widespread fear of a hard Brexit is apparent in the economic data. The Organisation for Economic Co-operation (OECD) and Development's leading economic indicators show that the UK has experienced deteriorated more dramatically than any of the world's other major developed economies.

As if the future departure of the EU's second-largest member isn't bad enough, Italian government-bond yields have risen sharply higher this year as the Lega/Five-Star coalition pushes to make good on some of its campaign promises. Italy is the third-largest eurozone economy, and has the fourth largest debt-to-GDP ratio in the world. To say the least, a debt crisis in Italy would not be as easy to handle as the Greek one (which wasn't all that easy).

A complicating factor for Italy and other highly-indebted countries is the tapering of asset purchases by the ECB. Since the program's inception, the ECB's purchases of Italian bonds equate to 53% of the country's cumulative deficit (as at 30 September 2018), according to the Centre for European Economic Research (ZEW), a German think tank. Italy will be losing a large price- and risk-insensitive buyer of its bonds at an inopportune time. The ECB is set to finish its taper at the end of the year.

Tax cuts, deregulation and strong revenue growth have provided an ideal backdrop for US equities to appreciate, but performance could be constrained if earnings estimates fade in light of increasing tariffs on tradable goods. Valuations also could fall if interest rates climb at a faster-than-expected pace. That said, we still think it's premature to turn negative on the near-term US outlook given today's mosaic of economic fundamentals. In our view, the risks to the US stock market are evenly balanced.

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The multi-year persistence of high US corporate profit margins is very unusual. Margins have spiked higher in the past two quarters, reflecting the impact of the US tax cut and the acceleration of sales growth. In the latter stages of an economic expansion, margins normally contract on a sustained basis as higher costs for labour, interest-expense and depreciation take a larger slice of the pie.

Besides rising trade tensions with China, we see the Fed as another, more traditional, major potential threat to the US equity bull market. The question is how high the federal funds rate will ultimately go, and whether that level proves to be sufficient to keep inflation near the central bank's 2% target or turns out to be overkill. We agree with the Fed's view that the federal funds rate is still below the so-called neutral rate of interest. Additional rate increases appear appropriate, as long as the Fed doesn't keep hiking after reaching the neutral rate—a level that has historically seen the stock market run into real trouble.

One can argue about whether the valuations embedded in the US equity market are high, especially when measured against other global stock markets, although earnings growth in the latter has been less robust. The extreme appreciation in some large technology companies also suggests that the US stock market could be subject to a sharp rotation from previous winners to the laggards somewhere down the road. SEI equity strategies certainly tilt in the direction of more value-oriented companies and industries.

Predicting the future is a hazardous venture most of the time. In view of the uncertainties presently facing investors, the prediction game is, perhaps, even more challenging. Accordingly, we believe in a diversified approach to investing. Although maintaining exposure to risk assets may feel uncomfortable, we believe that investors with long time horizons should know that mistiming entries and exits into and out of equities can be costly. Today, mistiming an exit is the greater concern.

Standardised Performance

		1 year to 31-Oct-18	1 year to 31-Oct-17	1 year to 31-Oct-16	1 year to 31-Oct-15	1 year to 31-Oct-14
Key Measures						
Dow Jones Industrial Average		9.87%	32.07%	5.49%	4.06%	14.48%
S&P 500 Index		7.35%	23.63%	4.51%	5.20%	17.27%
NASDAQ Composite Index		9.74%	31.13%	3.97%	10.39%	19.58%
MSCI ACWI Index (Net)		-0.52%	23.20%	2.05%	-0.03%	7.77%
Bloomberg Barclays Global Aggregate Index		-2.05%	1.18%	5.59%	-3.07%	0.22%
Major Index Performance						
Bloomberg Barclays Global Aggregate ex-Treasury Index		-2.43%	3.31%	4.26%	-2.45%	2.20%
Bloomberg Barclays Global Aggregate Index		-2.05%	1.18%	5.59%	-3.07%	0.22%
Bloomberg Barclays Global Treasury Index		-1.72%	-0.60%	6.72%	-3.62%	-1.45%
MSCI ACWI ex-USA (Net)		-8.24%	23.64%	0.22%	-4.68%	0.05%
MSCI Emerging Markets Index (Net)		-12.52%	26.45%	9.27%	-14.53%	0.64%
MSCI World Index (Net)		1.16%	22.77%	1.18%	1.77%	8.67%
Fixed-Income Performance						
US Treasury Inflation-Protected Securities (TIPS)	Bloomberg Barclays 1-10 Year U.S. TIPS Index	-0.61%	0.14%	4.67%	-1.24%	0.60%
Global Non-Government	Bloomberg Barclays Global Aggregate ex-Treasury Index	-2.43%	3.31%	4.26%	-2.45%	2.20%
Global Sovereigns	Bloomberg Barclays Global Treasury Index	-1.72%	-0.60%	6.72%	-3.62%	-1.45%
US Investment-Grade Corporates	Bloomberg Barclays U.S. Corporate Investment Grade Index	-3.02%	3.46%	7.23%	1.05%	6.29%
US Asset-Backed Securities (ABS)	Bloomberg Barclays U.S. Asset-Backed Securities Index	0.52%	0.95%	2.35%	1.64%	1.84%
US Mortgage-Backed Securities (MBS)	Bloomberg Barclays U.S. Mortgage-Backed Securities Index	-1.52%	0.53%	3.27%	2.50%	4.08%
US Treasurys	Bloomberg Barclays U.S. Treasury Index	-1.97%	-0.69%	3.32%	2.39%	2.78%
US High Yield	ICE BofAML US High Yield Constrained Index	0.86%	9.14%	10.18%	-2.03%	5.85%
Emerging Markets (External)	JPMorgan EMBI Global Diversified Index	-4.39%	6.32%	11.70%	0.39%	8.55%
Emerging Markets (Local)	JPMorgan GBI-EM Global Diversified Index	-6.58%	5.18%	11.04%	-17.42%	-2.68%
Regional Equity Performance						
United Kingdom	FTSE All-Share Index	-5.19%	23.33%	-11.29%	-0.58%	0.61%
EM Latin America	MSCI Emerging Markets Latin America Index (Net)	-2.43%	10.14%	33.28%	-34.83%	-5.68%
Europe ex UK	MSCI Europe ex UK Index (Net)	-9.72%	29.15%	-6.30%	1.32%	-1.83%
Pacific ex Japan	MSCI Pacific ex Japan Index (Net)	-6.17%	18.53%	9.70%	-14.90%	1.64%
United States	S&P 500 Index	7.35%	23.63%	4.51%	5.20%	17.27%
Japan	TOPIX, also known as the Tokyo Stock Price Index	-4.13%	19.70%	4.97%	10.61%	-0.29%
Global Equity Sector Performance						
MSCI ACWI Index		-0.52%	23.20%	2.05%	-0.03%	7.77%
MSCI ACWI Consumer Discretionary Index		2.57%	21.19%	-2.80%	12.50%	3.14%
MSCI ACWI Consumer Staples Index		-0.69%	8.03%	3.78%	6.78%	5.92%
MSCI ACWI Energy Index		4.18%	9.59%	5.28%	-22.66%	-1.50%
MSCI ACWI Financials Index		-6.16%	30.40%	-0.14%	-3.48%	6.02%
MSCI ACWI Healthcare Index		7.43%	18.98%	-7.46%	6.05%	23.22%
MSCI ACWI Industrials Index		-5.95%	25.92%	5.16%	-0.49%	4.99%
MSCI ACWI Information Technology Index		3.91%	40.22%	10.60%	7.61%	20.10%
MSCI ACWI Materials Index		-8.14%	27.77%	12.23%	-12.72%	-4.10%
MSCI ACWI Telecommunication Services Index		-4.37%	4.61%	0.30%	-3.15%	4.09%
MSCI ACWI Utilities Index		-2.98%	14.27%	5.70%	-6.05%	12.84%

All references to performance are in US dollar terms unless otherwise noted. See Standardised Performance for more information.

Glossary of Financial Terms

Bull market: A bull market refers to a market environment in which prices are generally rising (or are expected to do so) and investor confidence is high.

Federal funds rate: The federal funds rate is the interest rate at which a depository institution lends immediately available funds (balances at the US Federal Reserve) to another depository institution overnight in the US.

Fundamentals: Fundamentals refers to data that can be used to assess a country or company's financial health such as amount of debt, level of profitability, cash flow or inventory size.

Index Descriptions

MSCI World ex USA Index: The MSCI World ex-USA Index is a free float-adjusted market capitalization weighted index that is designed to measure the equity market performance of developed markets, excluding the US.

Shenzhen Stock Exchange Composite Index: The Shenzhen Stock Exchange Composite Index tracks performance of A share stocks (which are denominated in renminbi, the local currency) and B share stocks (which are denominated in Hong Kong dollars, an offshore currency) on China's Shenzhen Stock Exchange.

Corresponding Indexes for Key Measures Exhibit

Dow Jones Industrial Average	The Dow Jones Industrial Average is a widely followed market indicator based on a price-weighted average of 30 blue-chip New York Stock Exchange stocks that are selected by editors of The Wall Street Journal.
NASDAQ Composite Index	The NASDAQ Composite Index is a market-value-weighted index of all common stocks listed on the National Association of Securities Dealers Automated Quotations (NASDAQ) system, representing a subset of the US equity market.
MSCI ACWI Index	The MSCI ACWI Index is a market-capitalization-weighted index composed of over 2,000 companies, and is representative of the market structure of 46 developed- and emerging-market countries in North and South America, Europe, Africa and the Pacific Rim. The Index is calculated with net dividends reinvested in US dollars.
Bloomberg Barclays Global Aggregate Index	The Bloomberg Barclays Global Aggregate Index is an unmanaged market-capitalization-weighted benchmark that tracks the performance of investment-grade fixed-income securities denominated in 13 currencies. The Index reflects reinvestment of all distributions and changes in market prices.
Chicago Board Options Exchange Volatility Index (VIX)	The Chicago Board Options Exchange Volatility Index (VIX) tracks the expected volatility in the S&P 500 Index over the next 30 days. A higher number indicates greater volatility.

Corresponding Indexes for Major Index Performance Exhibit

MSCI ACWI ex-USA Index	The MSCI ACWI ex-USA Index includes both developed- and emerging-market countries, excluding the US.
MSCI Emerging Markets Index	The MSCI Emerging Markets Index is a free float-adjusted market-capitalization-weighted index designed to measure the performance of global emerging-market equities.
MSCI World Index	The MSCI World Index is a free float-adjusted market-capitalization-weighted index that is designed to measure the equity market performance of developed markets.
Bloomberg Barclays Global Aggregate Index	The Bloomberg Barclays Global Aggregate Index is an unmanaged market-capitalization-weighted benchmark that tracks the performance of investment-grade fixed-income securities denominated in 13 currencies. The Index reflects reinvestment of all distributions and changes in market prices.
Bloomberg Barclays Global Aggregate ex-Treasury Index	The Bloomberg Barclays Global Aggregate ex-Treasury Index is an unmanaged market index representative of the total return performance of ex-Treasury major world bond markets.
Bloomberg Barclays Global Treasury Index	The Bloomberg Barclays Global Treasury Index is composed of those securities included in the Bloomberg Barclays Global Aggregate Index that are Treasury securities.

Corresponding Indexes for Fixed-Income Performance Exhibit

US High Yield	BofA Merrill Lynch U.S. High Yield Master II Constrained Index
Global Sovereigns	Bloomberg Barclays Global Treasury Index
Global Non-Government	Bloomberg Barclays Global Aggregate ex-Treasury Index
Emerging Markets (Local)	JPMorgan GBI-EM Global Diversified Index
Emerging Markets (External)	JPMorgan EMBI Global Diversified Index
US Mortgage-Backed Securities (MBS)	Bloomberg Barclays U.S. Mortgage Backed Securities Index
US Asset-Backed Securities (ABS)	Bloomberg Barclays U.S. Asset-Backed Securities Index
US Treasurys	Bloomberg Barclays U.S. Treasury Index
US Treasury Inflation-Protected Securities (TIPS)	Bloomberg Barclays 1-10 Year U.S. TIPS Index
US Investment-Grade Corporates	Bloomberg Barclays U.S. Corporate Investment Grade Index

Corresponding Indexes for Regional Equity Performance Exhibit

United States	S&P 500 Index
United Kingdom	FTSE All-Share Index
Pacific ex Japan	MSCI Pacific ex Japan Index (Net)
Japan	TOPIX, also known as the Tokyo Stock Price Index
Europe ex UK	MSCI Europe ex UK Index (Net)
EM Latin America	MSCI Emerging Markets Latin America Index (Net)

All references to performance are in US dollar terms unless otherwise noted. See Standardised Performance for more information.

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Data refers to past performance. Past performance is not a reliable indicator of future results.

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