From the Horses' Mouths: Manager Insights

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SEI New ways. New answers.®

- We asked a handful of the many specialist investment managers that we work with at SEI to share their perspective on recent market events.
- The consensus expectation is for a sharp recession followed by a sharp recovery.
- While low-valuation provides protection, markets thus far continue to reward expensive growth stocks. Our managers think it's time to get greedy.

We asked a handful of the many specialist investment managers that we work with at SEI to share their perspective on recent market events. Here is what they had to say:

SEI Investments (Europe) Limited: SGIF Global Select Equity Fund, SGMF Factor Allocation Global Equity Fund, SGMF Global Managed Volatility Fund

What is your current outlook?

The faster the market goes down, the faster it can go up. In fact, typically recoveries are two-to-four times faster than meltdowns. Selling now and waiting for better times could be an expensive strategy. There will likely be a sharp, but short recession.

The fiscal stimulus has started. Once people stop panicking, the subsequent spending splurge should have an unprecedented impact: Inflation of everything is to be expected. Value stocks (cheaper multiples) should be the primary beneficiaries.

An oil-price recovery is harder to predict; but once people start flying on commercial airlines again, oil prices will rise. Russia can't last for too long at a $30 price point.

What are you doing in response to current market conditions?

Our value managers (and optimizer, in the case of factor funds) are buying cheaper names through their own trading, so SEI's portfolio managers have no need to add more to value. Such additions would be excessive, as we already have plenty of value.

As new assets flow into our global equity portfolios, we will look to reduce the more expensive managed volatility allocations. We are not invested in the expensive growth stocks, so there is nothing to cut there.

Our allocation to the momentum alpha source is also low, so there's not much room to cut without breaching our risk bands. In our Factor Funds, we will look to reduce momentum slightly.

How might your strategy withstand a global recession?

We are holding our nerve and trying to calm some long-term investors. We expect to see one-to-two years of lost earnings in the equity market. At the moment, investors are trading on fear as a result of the novel coronavirus (COVID-19). In our view, this is a short-term phenomenon.

Arcus (Japan Equity): SGIF Global Select Equity Fund

What is your current outlook?

We expect the short-term impact of COVID-19 to ease within the next two months. There will likely be short-term disruptions, but businesses should readjust and governments appear ready to support short-term cash-flow problems.

Low interest rates and government actions are expected to stimulate recovery, which may be strong in the second half of 2020.

Nikkei 225 Index valuations were at historical low extremes as of March 13, 2020, so we believe that we are near a bottom on a medium-term view.

Value is close to a long-term turning point, as are long-term interest rates.

What are you doing in response to current market conditions?

We plan to keep doing what we always do: Recycle outperforming stocks into increasingly-undervalued holdings. Recent examples include taking profit in the outperformance of ORIX Corporation and adding to our

T&D Insurance Group holdings, which recently sold off to be the cheapest life-insurance company in the sector (as measured by price-to-enterprise value). We also lightened our position in Mitsubishi Chemical Corporation after its sector outperformance, and added a new position in AIR WATER INC.—which was underperforming but undervalued, in our view, as it has a sensible domestic-acquisition strategy that should help its long-term business growth.

How might your strategy withstand a global recession?

As of yesterday (12 March) the portfolio average valuations were price-to-book (P/B) 0.52x and price-to-earnings (P/E) 6.3x. These will likely move lower as the market continues to fall, but we are now below the lows of the worst point of the global financial crisis in 2008. On 8 October 2008, our portfolio valuations were P/B 0.65x and P/E 6.0x. Of course, from that point, earnings collapsed during the global financial crisis recession (so the prospective P/E is not a reliable indicator). Similarly, like before, all companies should be affected if the world enters recession, but the current portfolio valuation is discounting a considerably worse outcome than a global-financial-crisis-level event.

Maj Invest: SGIF Global Select Equity Fund, SGMF Global Equity Fund

What is your current outlook?

We will likely enter a short recession. It should be somewhat unique because it is both a supply-side and demand-side shock to the system. We do not expect the experience in the US to resemble that of the 2008 global financial crisis; but Europe may have a more dramatic shock due to Italy's weakened position. The market has already reacted heavily to the news—and by the time the recession moves from speculation to reality, markets may already have bottomed out.

What are you doing in response to current market conditions?

We are actively buying into names we have had on our radar for some years—and reducing more defensive holdings as the market drops. We are not buying into European banks because we view them as too risky. However, we will (and have) added to positions in our life insurance holdings as well as to Goldman Sachs. We also have positions in Tractor Supply Company, Lowe's Companies, Inc. and Carnival Corporation & plc (which we believe will make it through the crisis).

How might your strategy withstand a global recession?

According to our initial calculations, our portfolio constituents outperformed the MSCI World Index by 10% during the 2008, 2001 and 1990 calendar years, which all witnessed periods of recession.

Towle & Co: SGIF Global Select Equity Fund, SGMF Global Equity Fund

What is your current outlook?

The American public is just coming to grips with the crucial measures required to slow the spread of COVID-19 and mitigate its impact on our healthcare system. As the full extent of the challenge becomes more apparent, US consumers will likely curtail spending significantly and self-quarantine at home, prompting a deep recession over the next quarter or two. Economic data, COVID-19 case count, and guidance revisions should get worse before they get better. In the interim, a bi-partisan-supported fiscal-stimulus package and targeted monetary support by the US Federal Reserve (Fed) will likely bolster the economic outlook and stabilise markets. As long as society makes a concerted effort to beat COVID-19, such a policy response should restore the public trust in the financial markets, lead to a second-half 2020 recovery, and reignite beaten-down cyclical equities.

What are you doing in response to current market conditions?

We eliminated highly-levered balance sheets from the portfolio, trimmed overweight positions, and raised cash to nearly 10%. The dramatic selloff, triggered by COVID-19 and the Organization of the Petroleum Exporting Countries (OPEC) minister breakdown, has substantially increased the deep-value opportunity set. As such, we are scouring the market for new positions with significant upside into the next cycle. While it's impossible to call the bottom, we are thrilled to have the opportunity to refresh the portfolio. We're also being responsible citizens—working from home, cancelling all non-essential travel, and buckling down both personally and professionally.

How might your strategy withstand a global recession?

We believe that our strict thesis adherence, improved credit underwriting, and avoidance of capital-intensive companies has greatly improved the credit quality and survivability of the current portfolio relative to any other downturn in our history. Although portfolio multiples were already deeply discounted prior to the virus outbreak, we are now at rock-bottom valuations with a median price-to-sales of 0.17x. With an official recession likely on the horizon, we believe current prices in the portfolio already reflect this probability.

Jupiter Asset Management: SGIF Global Select Equity Fund, SGMF Fundamental U.K. Equity Fund, SGMF Global Equity Fund, SGMF U.K. Equity Fund

What is your current outlook?

Our main concern from a stock-market perspective is that the valuation of the US market at the start of these worries was the second highest on record (as measured by the Shiller P/E ratio. Leverage and valuations are also high in relation to history, particularly in the US. In contrast, we have tried to construct a portfolio of holdings with valuations at their lowest in recent history as well as balance sheets that can cope with shocks.

What are you doing about it?

We have no first-order exposure to industries impacted by COVID-19, including airlines, hotels, cruises, sporting events, airports or conference organisers. We also hold some hedges, such as cash, gold, and volatility beneficiaries—such as positions in global technology trading firms TP ICAP and Flow Traders. That positioning has been helpful in the short-term.

How might your strategy withstand a global recession?

The key issue in a recession is not whether a company's earnings will fall, but whether the company will need new capital and how much the share-price valuation was discounted at the onset. The balance sheets of our holdings are strong; it is difficult for us to imagine any of them needing new equity to survive a downturn. The starting valuations are also remarkably low.

It is surely the case that a downturn is, in part, already anticipated in the more cyclical areas of the market. This is in stark contrast to the 2008-to-2009 downturn, which caught the market off-guard (with highly-leveraged banks, high valuations for cyclicals and weak balance sheets). It is fair to say, however, that low valuations are currently providing no defence and that investors prefer the safety of high valuations for businesses currently experiencing strong momentum.

The second question is how will governments try and allay the impact of a recession. In recent recessions, the answer has been to cut interest rates to help companies and individuals service their debts and stimulate demand. The Bank of England already acted, but with little room to cut further; many think governments will have to address the demand-shock of coronavirus through fiscal expansion. That would be quite different from anything seen in the recent past, and it is unclear what the impact would be. If (and this is a big "if") this triggers inflation, that may be positive for value as a style.

The main defence our strategies have against a global recession is low starting valuations, strong balance sheets and widely-diverse portfolios with exposure to a range of industries. It is fair to say that such positioning provides little protection in the stock market's eyes at the moment—but we find it hard to imagine it carrying on in this manner for an extended period of time: Otherwise, financial-market history will be turned on its head.

AS Trigon Management: SGIF Global Select Equity Fund

What is your current outlook?

We think our region (New Europe) was in pretty good shape going into this crisis. Macro balances were relatively solid; the banking sector was among the strongest globally, overcapitalised with low loan-to-deposit ratios. The region has been among the worst performers globally in this virus-driven crisis, primarily on a lack of domestic institutional buyers in Poland. Unfortunately, we do not anticipate a substantial change in terms of flows (at least in Poland). Valuations and dividends should remain the best hedge and defence for the region, as many banks offer dividend yields already above 10% and non-banks offer between 5% and 8%. Turkey and Russia are different cases. Russian outlook depends a lot on an eventual compromise with Saudis, which we believe will eventually come; there is still one year before parliamentary elections in Russia. We may consider re-entering Russian oil and gas names given these levels.

While there is extreme panic today in the market, we think equities have been punished too much from already-low valuation levels; the question is how long this will last. The peak of negative virus-related headlines will likely come in the next week or two. For me, it seems a bit like the 1987 one day drop, which could be followed by nice recovery backed by "lack of alternatives" attitude.

What are you doing in response to current market conditions?

We feel comfortable with the balance sheets of the companies within our portfolios and therefore do not see an urgent need to exit any positions. That said, we have purchased some companies on an assumption that margins will recover toward historical-average levels, which now might be delayed. That triggers changes in our fair-value models. At the same time, some other sectors such as oil and gas, tourism and financials, as well as small- and medium-sized enterprises have been significantly hurt, so we are also looking at those names in order to add to existing positions or to swap with other companies with adverse risk-reward ratios.

How might your strategy withstand a global recession?

We hope it will behave well due to the companies' relatively strong balance sheets, high earnings and dividend yield. Global value has continued to underperform growth counterparts, further widening the valuation gap. We believe that this difference will eventually start to shrink.

Metropole Gestion: SGMF European Ex-UK Equity Fund, SGIF Global Select Equity Fund, SGMF Global Equity Fund

What is your current outlook?
It is hard to gauge the repercussions of COVID-19 on the real economy. We think it is likely this health crisis triggers a debt crisis that turns into a global recession as severe as in 2009. As a consequence, we cannot exclude that the freefall in equity markets has further to go.

What are you doing about it?

We take the opportunity of a falling equity market to gradually reinforce positions or introduce new companies whose share price already priced in the worst-case scenario with a strong balance sheet (that is, stocks that boast the highest revaluation potential with limited financial risk). Since the peak of the market, we have already turned over 6% of our portfolios.
We will pursue this strategy gradually and systematically, with a target to switch up to 25% of the total portfolio if the European equity market falls to 2009-levels.

How might your strategy withstand a global recession?

The companies we hold are excessively undervalued, showing healthy balance sheets with established track records of generating positive cash flow at the bottom of the cycle—enabling them to weather the most severe crises.

Rhicon Currency Management (Currency Overlay): SGIF Global Select Equity Fund, SGMF Global Equity Fund

What is your current outlook?

The current outlook on FX markets should see volatility remain well-supported while repercussions of COVID-19 on the global economy continue to feed through financial markets. There has been a significant jump in volatility, both realised and implied; while liquidity is not as good as it was previously, this is more than offset by a much larger trading opportunity-set. We anticipate conditions to prevail for some time to come. Things may subside in the short-term, but we do not envisage a return to low-volatility markets.

What are you doing about it?

With an increased opportunity-set, we have been more active in the markets recently, particularly in the intra-day and short-term books. We have reduced our leverage somewhat, as the higher volatility requires wider stops in the market. Nonetheless, we are still risking the same per trade, and the risk/reward on trades remains the same or better. We continue to carefully monitor liquidity and how we access it, while focusing on the strongest technical setups.

How might your strategy withstand a global recession?

While the impact of a recession on FX is not direct, a widening of credit spreads (which is likely to occur) should result in sustained or higher FX volatility. Differing economic responses across regions, as well as potential unwinding of funding positions, should also provide further differentials across currencies. Overall, we believe that a continued unwinding of risk-asset positions would provide us with a wider trading opportunity-set.

Poplar Forest Capital, LLC: SGIF Global Select Equity Fund, SGMF Global Equity Fund

What is your current outlook?

We anticipate a 2020 recession that primarily impacts the second quarter and some of the third quarter; this is assuming that the key variable is the growth of new COVID-19 cases is and that we see a peak (improving first derivative) in the next four to eight weeks. The emergence of effective treatment protocols in coming weeks or months will be important for sentiment and the bottoming process. On that front, multiple therapies will be reporting-data from Chinese trials during late March to April.

The duration of the oil-price war is a bit of an open question, though we do not believe that $30 is sustainable in the intermediate term. We expect central-bank actions to try to minimise the economic damage of the virus and the oil-price war. The Fed has already cut its target interest rate to near zero in an effort to support the economy during the coronavirus pandemic[1]; it can still add liquidity into the financial markets. All of this likely sets up a very strong recovery in the fourth quarter and beyond—provided we don't get a second wave of the virus in fall and winter. We assume the market will experience a bounce and then a retest before moving fully into recovery.

What are you doing about it?

We have been monitoring the data closely; our investment team now meets daily as opposed to weekly. We are paying heavy attention to the virus's impact on business and liquidity of the stocks we own. In our view, this bear market is an opportunity to buy businesses that we should be excited to own for next five years. We are a bit more active now, but have been using smaller orders and limits far more than normal. We have done and will continue to do some tax-loss harvesting.

Portfolio turnover is higher than normal as we use size to our advantage in a market where liquidity is an open question. We have not yet cut back defensive holdings to buy economically-sensitive stocks, as we are looking for signs of bottoming before recovery. We are watching to see if oil prices hold at $30/barrel and are looking for stability in 10-year Treasury yields. At the individual stock level, we are paying more attention to relative price action than we have historically. We are currently are running approximately 3.0% to 3.5% cash.

How might your strategy withstand a global recession?

We believed that many of our stocks were priced at levels that more-than-amply compensate for recession risk, but valuations have busted through the lows of the global financial crisis (especially in the case of energy stocks). Our credit profile is supportive, with only 7% non-investment grade compared to a 15% limit. While we expect a couple credits to be downgraded, we don't see default risk in the portfolio. The investment process we use to build the portfolio has produced less downside capture in past bear markets (2000-2002 and 2008-2009), but has not yet proved defensive in the first stage of this bear market as investors have been focused on flight-to-safety trades. As the second stage of the bear market develops in response to recession, we expect investors to shift to an offensive mind-set; and our strategy should be positioned to benefit.

INTECH Investment Management: SGIF Global Select Equity Fund, SGMF Global Equity Fund

What is your current outlook?

While we've observed a substantial increase in market volatility, we do not make predictions about market events or future movements.

What are you doing about it?

We embed risk controls throughout our process that have been tested over time under a wide range of market drawdowns. For example, we look for the value of parameters that protect versus tail events the best over the long-term during the design of our process. Our process is embedded in relative volatility and correlations to provide the highest diversification potential through a disciplined approach, but also the uncertainties that accompany those estimates of volatility and correlations. The process is engineered to adapt to changing levels of volatility in order to control active risk and achieve excess returns, which helps the portfolio in periods of heightened volatility.

How might your strategy withstand a global recession?

We have not deviated from our systematic investment process. This will help protect against overreacting in periods of market strain. Additionally, risk management is at the heart of our investment philosophy and embedded throughout our process as stock-price volatility and correlations are used as both a source of alpha and risk control. Our risk controls are designed to be robust under a wide range of market volatility, regardless of the reasons for the volatility. For over 30 years since our inception, we have faced several substantial market drawdowns and recession periods, which our portfolios have navigated while staying within our tracking-error expectations.

Lazard Asset Management, LLC: SGMF Emerging Markets Equity Fund, SGIF Global Select Equity Fund, SGMF Global Equity Fund

What is your current outlook?

Our investment process does not attempt to forecast macro conditions (economic growth) as part of the decision-making process. Instead, we control exposures (country, sector, capitalisation and beta) to resemble the market.

[1] https://www.federalreserve.gov/monetarypolicy/files/monetary20200315a1.pdf

What are you doing about it?

We continue to participate in extensive conversations with our fundamental colleagues in an attempt to identify potential areas of risk that are not typically reflected in a quantitative approach. We expect that the shift in market risk will be increasingly reflected in our risk models in the weeks ahead.

We do not expect to implement any top-down themes to boost alphas in companies that may benefit from the virus (home healthcare, in home entertainment, blue-chip companies[2]) finding that market sentiment (analyst upgrades/news) will reflect such opportunities. We have taken limited action directly in our portfolios due to the sharp volatility in the equity market; trading has been limited to maintaining portfolios in line with client guidelines.

How might your strategy withstand a global recession?

We also recognise that market risk has changed meaningfully in the past few weeks and we are beginning to see evidence of such a transition in our risk models. Momentum is shifting even further into defensive territories while moving away from distressed companies and highly-levered companies. Unless there is a sudden and lasting change in market direction, which might happen if the pandemic crisis is resolved earlier than expected, we would expect momentum to continue to provide some defence against market falls.

Sompo Japan Nipponkoa Asset Management Co., LTD (SNAM): SGMF Asia Pacific (Ex-Japan) Equity Fund, SGMF Japan Equity Fund

What is your current outlook?

The main reasons for the current global equity selloff are the spreading contagion outside of China and the US travel restrictions. Given that it is difficult to gauge the short-term economic impact of these restrictions, we expect the turbulent stock-market conditions to persist for the short-term.

This will likely translate into a slump in real-economy terms. However, we believe that coordinated monetary and fiscal efforts from global central banks will preserve the integrity of the global financial system, meaning that damage on the scale of the 2008 global financial crisis should be avoided. In China, several weeks of stringent controls on movement within the country seem to have effectively stemmed new infection cases; we believe the situation in other countries will likely begin to follow a similar path. Going forward, stocks are expected to gradually recover as signs become apparent that the pandemic is abating.

What are you doing about it?

While the pandemic has triggered recession fears, we do not think there has been much change to the intrinsic values of stocks. We believe that our alpha-ranking system will continue to demonstrate effectiveness going forward by accurately projecting the long-term earnings trend of individual companies. From a portfolio-construction standpoint, we will continue to control the portfolio's level of macro sensitivity—looking to achieve a balance of risk and return by incorporating names with compelling stock-specific catalysts.

How might your portfolio withstand a global recession?

We maintain our overweight to financials, materials, and autos. Supported by low interest rates, growth and earnings momentum, plays have become considerably overvalued. On the flipside, cyclical value is already extremely undervalued relative to earnings potential—leaving limited room for further downside in valuations. We therefore expect cyclical value to outperform going forward, even amid a recessionary scenario.

[2] Blue-chip companies are multinational, well-established, financially sound firms that are believed to maintain strength in adverse economic environments.

Index Definitions

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. The Index consists of 24 developed-market country indexes.

The **Nikkei 225 Index**, more commonly called the Nikkei, is a stock market index for the Tokyo Stock Exchange. It has been calculated daily by the Nihon Keizai Shinbun newspaper since 1950.

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