Third Quarter 2023

SEI *Forward*.

James Smigiel

Chief investment officer

Tales of the tape (third quarter)*: U.S. equity -3.27%, Global ex-U.S. equity -3.77%, Global treasuries -4.17%, 10-year U.S. Treasury yield +0.74% to 4.57%, Commodities +4.71%*

Notables (third quarter)*: U.S. crude oil +28% to $90, U.S. Energy sector +12.22%, U.S. Technology sector -5.54%*

The story of the quarter was far and away the global rout in rates markets. We have been saying for some time now that we expect central bankers to remain hawkish keeping interest rates higher for longer—lingering supply and demand imbalances, combined with mixed, but positive leaning, economic news continue to support our view. Investors have seemingly come around to our way of thinking as Bloomberg data shows that bond yields reached multi-year highs this quarter. Further, policy makers—particularly in the U.S.—have successfully bullied markets into pushing out the potential timeline for any future rate cuts even as the tightening cycle approaches the finish line.

The 10-Year U.S. Treasury finished the quarter with the highest yield since 2007 (Bloomberg data). Looking more globally, the 10-Year German Bund reached a peak last seen in 2011, and even the 10-year Japanese Government Bond increased 0.37% to the highest level since 2013 (Bloomberg data). Despite the significant rise in interest rates and sentiment suggested that interest rates will continue to rise, inflation continues to run hot supported by crude oil prices. Saudi Arabia and Russia renewed commitments to production cuts leading to the biggest quarterly surge in oil prices since the start to the Russian/Ukraine conflict. Unsurprisingly, equity markets struggled with the potential reality of higher costs of capital and higher discounts rates for longer than anticipated challenged valuations.

In a word, our view is *cautious*.

Broadly, we expect that this unprecedented interest-rate hiking cycle will not be contained to the most interest-rate sensitive parts of the economy or the capital markets. We remain extremely skeptical that the 2% inflation targets of the past will be easily achieved in the future and, therefore, question the ability of central banks to quickly pivot towards more relaxed monetary policies. While we agree the global tightening cycle is nearing an end, we wouldn't be surprised with another rate hike from the U.S. Federal Reserve and some movement towards tighter monetary policy out of the Bank of Japan. That said, the bond investors did central bankers a huge favor by tightening financial conditions by forcing lenders to pay higher yields on bonds, making additional interest rate hikes from policy makers essentially a coin flip at this point. Regardless, we do expect yields to stay at the higher end of the recent range as inflation proves perhaps a bit more stubborn than markets anticipate and the supply of new debt remains extremely high.

Looking beyond interest rates and inflation, the employment situation remains a bit of a double-edged sword—a strong jobs market should help consumption, but tightness adds wage pressures into the mix. The artificial intelligence boom—or perhaps bubble—has valuations at still lofty levels, particularly in the U.S. and specifically amongst the "Magnificent 7" technology stocks (Amazon, Apple, Google (Alphabet), Meta, Microsoft, Nvidia and Tesla) that have driven so much of the market's gains recently. Meanwhile, credit spreads remain tight across the spectrum of investment-grade issues, reflecting a market trading a full valuations. The shocking expansion of armed conflict in the Middle East has further added to a growing list of concerns.

Within equities, we remain positioned for weaker markets into year-end. Rather than chasing returns in the highly concentrated the U.S. large-cap market, we prefer a much more diversified posture and remain focused on our favored Quality, Momentum and Value alpha sources. More broadly, our positioning leaves us typically preferring Industrials across regions and capitalizations,

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while in the U.S. we are leaning into materials and financials, but spurning mega-cap technology, consumer discretionary and communication services. This also leaves our typical equity positioning with lower interest-rate sensitivity than the broader market, which was clearly on display in September.

Regarding fixed income, our portfolios have maintained a yield advantage without sacrificing credit quality. This was achieved primarily with overweights in the securitized sectors, such as mortgage-backed securities (MBS) and collateralized loan obligations (CLOs). Interest-rate positioning remains modest, but slightly long in the near term given the back up in yields.

Commodities rebounded during the quarter and remain a preferred position. While China stimulus continues to disappoint, the steadfast stance of OPEC+ regarding production cuts and the resurgence in geo-political tensions keeps us overweight this asset class into year end.

With our macro views broadly becoming more accepted by the market, we remain confident in our positioning to close out 2023.

Summary Views

Macro/ Cross-Asset	• *Central Banks are at or near the end of this tightening cycle; however, cuts are likely off the table for some time.* • *Inflation remains well above targets and we expect it to stay stubborn.* • *Upward pressure on interest rates from hawkish central banks and supply/demand imbalances should continue.* • *U.S. equity market valuations remain lofty and overly concentrated; we are proceeding with caution, and prefer more diversified exposures.* • *Commodities remain focused on disciplined supply cuts, Strategic Petroleum, Reserve draw, and geo-political concerns.*
Equity	• *Strategic holdings are focused in value, quality, momentum, and low volatility.* • *We prefer value, particularly in U.S. Large Cap, with more equal positioning in other mandates.* • *Sector positioning broadly includes overweights in industrials and materials, with underweights in technology.*
Fixed Income	• *We remain active in corporates, but still favor securitized sectors including U.S. MBS and CLOs for attractive yield and credit profiles.*

Indexes

U.S. equity=S&P 500 Index, Global ex-U.S. equity=MSCI ACWI ex-U.S. Index, Global treasuries=Bloomberg Global Treasury Index, 10-year Treasurys=ICE BofA Current 10-year U.S. Treasury Index, Commodities=Bloomberg Commodity Index, U.S. crude oil=Brent Index, U.S. energy sector=S&P 500 Energy Sector Index, U.S. technology sector=S&P 500 Information Technology Sector Index

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