SEI New ways. New answers.®

1st Floor, Alphabeta
14-18 Finsbury Square
London EC2A 1BR
seic.com

14 January 2021

Dear Client,

Kevin P. Barr

Head of SEI's Investment Management Unit

The 2020s began with a roller-coaster ride. The global equity market set record highs in February as economic growth gained steam before COVID-19 resulted in an economic shutdown. The forced recession resulted in a typical overreaction, causing shares to plunge. As we learned more about the virus, investors saw opportunities.

Overall, the year was characterised by a polarised equity market. High-flying technology companies shared the spotlight with businesses that benefited from the pandemic. In both cases, a narrow band of extraordinarily high-priced shares led the market higher as reasonably priced, fundamentally sound businesses languished. In this environment, SEI maintained a disciplined approach to investing. Rather than seeking to time the market, we remained focused on quality companies selling at reasonable valuations—a long-term approach that was not the best-performing short–term strategy (as is often the case).

Financial markets adjusted to the pandemic, helped by the fast action of central banks and a big assist from government appropriators. Equities climbed rapidly, and fixed-interest spread sectors recovered almost without interruption from late March through the end of the year, spurred on by reopening economies and positive developments in therapeutics and vaccines.

Economic forecasts were an early casualty of the COVID-19 pandemic, and ours were no exception. Rather than review our expectations from last year as a set of hard predictions like we've done in the past, we can use them as a guide to track significant developments in 2020.

- We expected international markets to outperform US shares given the disparity in equity market valuations, but US equities continued to outpace major developed markets. American companies dominated the stay-at-home economy; the slowdown in business activity was comparably shallower in the US than in most other countries and the eventual rebound was stronger.
- On the geopolitical front, we expected rationality to prevail in the pursuit of a Brexit trade deal. It took until the final hours of the year, but a deal was reached. As for US presidential politics, Joe Biden's candidacy—predicated on a relatively moderate policy platform—helped ensure minimal election-related volatility in financial markets.
- We predicted that China's economy would stabilise and improve. Our frame of reference a year ago centred on the Phase One trade-war deal with the US and a steady progression of fiscal and monetary stimulus measures. As it turned out, the pivotal factor in China's world-beating equity market performance was its government's ability to orchestrate highly effective lockdowns in the early months of the pandemic.
- The US dollar weakened, as we anticipated, although not before taking a detour in March when early news of the pandemic drove investors to the perceived safety of US currency. An alphabet soup of Federal Reserve (Fed) liquidity facilities, central bank swap lines, and the multitrillion-dollar CARES Act vastly increased the availability of dollars. This flood of greenbacks pushed the value of the dollar lower versus a trade-weighted basket of foreign currencies as the year progressed.

- Our expectation that value shares would outpace growth shares was dashed for most of 2020. The key requirements for supporting value—modest improvement in global economic growth, and a tendency for inflation and interest rates to move higher—were taken off the table by COVID-19. However, the record disparity in valuations between the most expensive equities and the least expensive only grew wider. We saw an early glimpse of how this valuation spread can act like a coiled spring—ready to snap back on evidence of inflation—when positive news about vaccines bolstered value shares.

- Perhaps our most consequential forecast centred on stretched valuations: "Even at low interest rates, we would consider a forward-earnings multiple on the S&P 500 Index of more than 20 times as a danger sign. Another stellar year for US equities in 2020 would be a source of concern rather than celebration." While we did not anticipate the path that markets would take, US shares ultimately delivered above-average performance in 2020, and the S&P 500 Index finished 2020 with a 12-month forward P/E ratio of 22.1, according to FactSet. While this ratio appears elevated, averages can be misleading. A few companies with astronomical ratios overshadowed a large number with far lower multiples. In any case, low interest rates supported elevated valuations, but future US equity returns are likely to be muted.

Global Asset Class Performance in 2020

		Total Return (%)		
Asset class	Representative index	USD	GBP	EUR
Developed-market equities	MSCI World (Net)	15.90	12.32	6.33
Global fixed income	Bloomberg Barclays Global Aggregate	9.2	5.83	0.18
UK equities	FTSE All Share	-6.94	-9.82	-14.63
UK gilts	ICE BofA UK Gilts All Stocks	11.75	8.3	2.53
UK credit	ICE BofA Sterling Non-Gilt	11.4	7.96	2.20
European equities	MSCI Europe (Net)	5.38	2.13	-3.32
European fixed income	Bloomberg Barclays Euro Aggregate Bond	13.41	9.91	4.05
Emerging-market equities	MSCI Emerging Markets (Net)	18.31	14.65	8.54
EMD (external currency)	JPMorgan EMBI Global Diversified	5.26	2.01	-3.43
EMD (local currency)	JPMorgan GBI-EM Global Diversified	2.69	-0.48	-5.79
US large companies	Russell 1000	20.96	17.23	10.97
US small companies	Russell 2000	19.96	16.26	10.05
US high-yield debt	ICE BofAML US High Yield Constrained	6.07	2.8	-2.69
Commodities	Bloomberg Commodity Total Return	-3.12	-6.10	-11.11
US fixed income	Bloomberg Barclays US Aggregate	7.51	4.19	-1.37

One-year net total returns through 31 December 2020. Source: SEI Data Portal; returns based on index provider data. EMD denotes emerging-market debt. Past performance is not a reliable indicator of future results.

2020 Performance

Globally, emerging-market shares edged out developed markets for the year. China led among major markets, masking weaker performance in other emerging countries, particularly Brazil. The US set the pace for major developed markets, while the UK delivered a loss. We highlight the performance of our equity strategies with this in mind:

- Our active international developed-market equity strategies outperformed their respective benchmarks for the year, improving on the above-long-term average performance of developed markets in 2020. Our emerging-market equity strategies narrowly trailed the benchmark with absolute returns that were higher than the longer-term average emerging-market performance.

- Our core active US equity strategies trailed their benchmarks but produced positive absolute returns in line with longer-term average market performance. A limited group of the largest, most expensive US shares were the top performers. Our large-cap strategies were generally underweight these shares on account of their excessive valuations, which detracted from relative performance.

- Our US small-cap strategies favoured higher-quality, lower-beta equities. These companies have stronger balance sheets, generate cash and pay dividends, but they were outpaced by loss-making companies that now represent more than 35% of the Russell 2000 Index market cap. This is a record market share for capital-burning companies over a historical baseline in the 15%-to-18% range.
- Historical returns show that expensive, larger, and loss-making companies haven't outperformed over the long term. We believe a normalisation of the economic growth rate in 2021 could serve as a catalyst for the market to revert to the long-term drivers of investment returns: earnings, fundamentals and fair valuations. This would boost the relative performance of the less expensive and higher-quality shares that we've overweighted in our active US equity strategies.
- The performance of our factor-driven global equity strategies was restrained primarily by their strategic allocations and tactical overweights to the value factor. At a sector level, this translated into losses from positions in less expensive cyclical sectors that were directly impacted by COVID-19 disruption. As noted with our US equity strategies, we anticipate that normalization of economic growth will accrue to the benefit of our positioning, both strategic and tactical.
- Similar to the themes responsible for underperformance elsewhere, our UK, Europe and Asia-focused strategies lagged their benchmarks during the year. Economic normalization can be expected to favour less expensive, cyclically sensitive sectors, which we believe would benefit the positioning within these strategies.
- Our managed-volatility strategies achieved meaningful volatility reduction versus the broad markets in 2020, but lagged at a distance in terms of total returns. Low volatility was out of favour with investors during the year's advancing market environment and provided less downside mitigation than expected during the early-year selloff as traditional defensive sectors (utilities, consumer staples) underperformed stay-at-home shares. We don't foresee a repeat of this outcome because the COVID-19 market crisis was caused by an unpredictable, exogenous development that fell far outside the bounds of how markets usually react to risk-off shocks.

Central bank interventions succeeded in restraining a rapidly developing financial crisis in early 2020. Their actions—ensuring ample liquidity across markets and driving borrowing costs downward—created opportunities in rates markets, fixed-interest spread sectors and inflation-sensitive asset classes. We highlight the performance of our fixed-interest and multi-asset strategies with this in mind:

- Our core fixed-interest strategy improved on the aggregate US fixed-interest market's already-elevated 2020 returns (relative to the benchmark's long-term average performance).
- The performance of our multi-asset strategies was challenged by similar dynamics within their equity allocations as those that held back the relative performance of our active US equity strategies. Additionally, their commodities allocations struggled deeply during the early-year selloff, before mounting a strong but partial recovery. We see conditions shaping up for a global reflationary environment in 2021, which we believe would benefit the positioning within our multi-asset equity and commodity allocations.
- Our dynamic asset allocation strategy performed well during 2020, outpacing its US equity market benchmark. Timely rotations into commodities, particularly gold, were responsible for the majority of relative outperformance, but positioning for a steeper yield curve also contributed.

> **“We believe a normalisation of the economic growth rate in 2021 could serve as a catalyst for the market to revert to the long-term drivers of investment returns: earnings, fundamentals and fair valuations.”**

2021: Our View

Since September, shares that had been outpacing the market took a pause, and we saw a rebound by those that had been left behind. Value shares outpaced their growth counterparts to varying degrees across geographies and market capitalisations (most notably within US large caps). While we have observed signs of potential normalization that seem to support the prospects for a style regime change, it is probably too early to tell if this is the beginning of a major secular shift in equity investment themes. Still, we remain confident that the divergence in performance that was a hallmark of the past decade will be reconciled.

Within the geopolitical realm, the last-minute Brexit deal succeeded in removing a measure of uncertainty in financial markets, although challenges remain as the deal addressed the transfer of goods but not commerce in services. Post-Brexit, UK prices will likely end up being a bit higher, gross domestic product a bit lower, and supply chains a bit more unreliable. UK equity valuations, in our opinion, reflect much of the bad news.

Like so many other relationships in the equity market, the underperformance of eurozone equities has been going on for a long time. The European economy is more cyclical, value-oriented and less dynamic than the US economy. But that certainly does not prohibit a rebound in performance against the US equity market at a time when the latter appears to be excessively tilted toward technology shares, the dollar is weakening and a global economic recovery is at hand.

While the pandemic finally forced Germany and other like-minded conservative countries to allow an expansion in fiscal policy, we think that there is greater need for other countries outside the eurozone to regain control of their finances. If those countries fail to do so, Europe could be the beneficiary of investment flows that would further prop up the euro and equity valuations.

Emerging-market equities have been racing higher since they bottomed out last March. However, the MSCI Emerging Markets Index is still just above its previous high-water mark recorded in January 2018. Frontier markets did not fare as well. The MSCI Frontier Emerging Markets Index (total return) has yet to surpass its most recent pre-pandemic high level recorded last January.

Fortunately, the combined efforts of global central banks prevented a liquidity crisis and drove borrowing costs down to near-record lows even as total emerging-market debt exceeded 200% of gross domestic product (GDP). As the world returns to normal, countries may need to raise rates in order to attract sufficient investment inflows to sustain their fiscal and current-account positions.

A weak US dollar is an important catalyst for emerging-market performance. We expect that the coming year will see emerging equities relative performance improve, partly because the dollar should continue to weaken.

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Our Focus

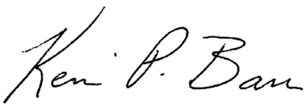
No one was expecting last year to turn out the way that it did, but we retain our conviction in SEI's approach to investment management. We believe diversification is a prudent approach to pursing financial goals in all market environments. Disciplined investing almost never produces the most admired performance in any given year, but we are confident that it will be rewarded in the long term.

We're all looking forward to a better 2021. Investors appear ready to shrug off the likely prospect of more bad news during the difficult months ahead, which could include slowdowns or pauses in vaccine manufacturing, distribution, administration and uptake. Globally, we expect to see signs of a recovery reveal themselves as COVID-19 abates and economic activity normalises.

In the meantime, fiscal spending and accommodative global central bank policies should sustain GDP growth and eventually cause inflation to rise. As investors price in these developments, "long-duration" assets such as bonds and equities with high valuations should come under pressure. Momentum investors are likely to rotate into new themes, potentially adding fuel to the value rally that has emerged.

As always, we remain committed to our long history of innovation by continuing to explore innovative investment solutions. **We thank you for your ongoing support and wish you a prosperous New Year.**

Sincerely,



Kevin P. Barr
Head of SEI's Investment Management Unit

Standardised Performance

Asset class	Representative index	Total Return (%) in GBP				
		1 year to 31/12/2020	1 year to 31/12/2019	1 year to 31/12/2018	1 year to 31/12/2017	1 year to 31/12/2016
Developed-market equities	MSCI World (Net)	12.32	22.74	-3.04	11.8	28.24
Global fixed income	Bloomberg Barclays Global Aggregate	5.83	2.71	4.94	-1.9	21.77
UK equities	FTSE All Share	-9.82	20.85	-9.47	13.1	16.75
UK gilts	ICE BofAML UK Gilts All Stocks	8.3	6.96	0.53	1.82	10.15
UK credit	ICE BofAML Sterling Non-Gilt	7.96	9.47	-1.57	4.34	10.6
European equities	MSCI Europe (Net)	2.13	18.99	-9.57	14.64	18.8
European fixed income	Bloomberg Barclays Euro Aggregate Bond	9.91	0.05	1.53	4.7	19.7
Emerging-market equities	MSCI Emerging Markets (Net)	14.65	13.85	-9.27	25.4	32.63
EMD (external currency)	JPMorgan EMBI Global Diversified	2.01	10.59	1.69	0.71	31.39
EMD (local currency)	JPMorgan GBI-EM Global Diversified	-0.48	9.09	-0.38	5.24	31.14
US large companies	Russell 1000	17.23	26.35	1.13	11.15	33.66
US small companies	Russell 2000	16.26	20.68	-5.48	4.72	44.7
US high-yield debt	ICE BofAML US High Yield Constrained	2.8	9.99	3.81	-1.82	40.14
Commodities	Bloomberg Commodity Total Return	-6.10	3.56	-5.73	-7.1	33.32
US fixed income	Bloomberg Barclays US Aggregate	4.19	4.52	6.23	-5.42	22.4

One-year net total returns through 31 December 2020. Source: SEI Data Portal; returns based on index provider data. EMD denotes emerging-market debt. Past performance is not a reliable indicator of future results.

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