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Capital Market Assumptions Update: Lower Returns Expected

JANUARY 2021

Snapshot

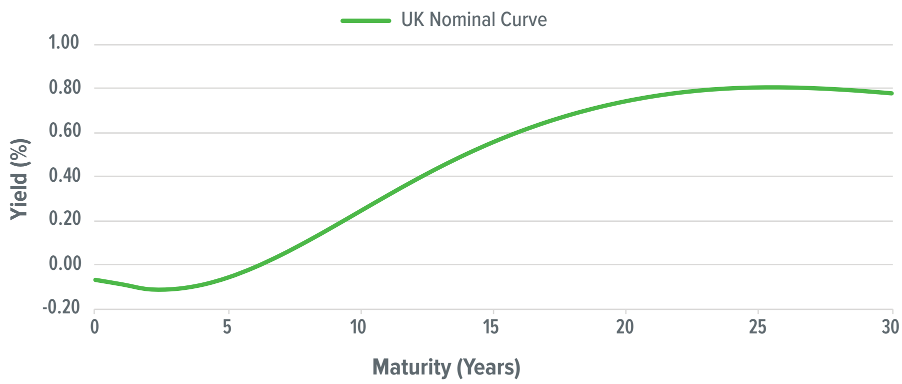
- Fixed-income return assumptions were lowered, reflecting below-average return expectations given low yields.
- Equity assumptions edged lower on a drop in return expectations for cash.
- The value of these assumptions is not in accurately predicting performance, but in having a better understanding of the relationships between assets classes—which enables us to help investors make well-informed decisions.

At SEI, we recently updated our capital market assumptions (CMAs) as part of our review and monitoring process. This brought our estimates for risk premiums over cash in line with our current expectations for capital markets (cash is used as a proxy for the theoretical return on a risk-free asset).

Fixed-income return expectations lowered

Central banks around the world have reacted swiftly and significantly in their efforts to prop up the global economy in light of the COVID-19 pandemic. Several have indicated their willingness to keep interest rates low and allow short-term rates to be anchored for an extended period of time. In our view, longer-term rates are also unlikely to move notably higher as there have been no signs that the global bond market expects inflation to run wild.

Exhibit 1: Yield Curve Projects Low Interest Rates



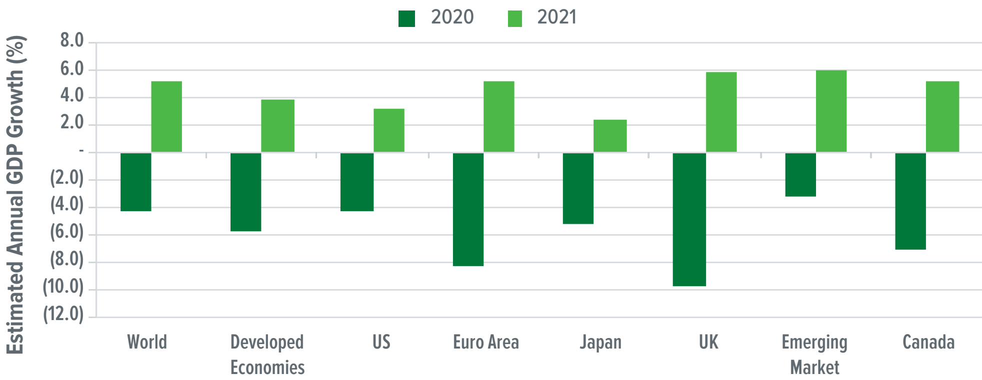
Source: SEI, Bank of England. Data as at 18/11/2020.

With low interest rates rising only gradually back to more normal levels, we expect fixed-income returns to be subdued for some time. Given roll-down return assumptions (falling yields and rising prices as a bond's maturity date approaches) and lower expected returns on cash, we do not see an improvement in risk/return ratios for bonds relative to equities. Accordingly, despite the low level of expected returns on bonds, this does not change our view that fixed-income investments have a role to play in investors' portfolios.

Global equity return expectations lowered

Based on current global central-bank policies implemented in light of the COVID-19 pandemic, our base-case view is a slow return of interest rates to more typical levels. Equity asset classes are still expected to deliver similar levels of risk premiums as they have historically; however, we anticipate lower absolute returns given the lower interest-rate environment.

Exhibit 2: Estimated Global Gross Domestic Product (GDP) Growth



Source: International Monetary Fund. Data as at 31/10/2020.

About SEI's capital market assumptions

At SEI, we develop forward-looking, long-term capital market assumptions about risk, returns and correlations for a variety of global asset classes, interest rates and inflation. Our assumptions are based on quantitative analyses of historical data and current market environments along with qualitative reasoning. We believe this approach allows for greater impartiality than methods that rely on historical data alone, which are often skewed by a single time period or event.

We aggregate our asset-class assumptions into a diversified portfolio, and then run Monte-Carlo simulations to develop scenarios across a wide variety of market environments that can provide insight into the potential impact of future market variability over time.

In our view, the value of these assumptions is ultimately not in their accuracy as point estimates, but in their ability to capture relevant relationships and changes in those relationships as a function of economic and market influences—and in our ability to help investors make well-informed decisions.

Please refer to our recent publication, *Developing Capital Market Assumptions*, for more detail about how we develop CMAs at SEI. Information regarding the actual assumptions that we use in a specific portfolio can be requested from your SEI representative.

CMAs are not predictions of how asset classes will perform or reliable indicators of future performance; instead, they are expected long-term characteristics of asset classes. The below figures are SEI's mean estimates for select asset classes. They do not represent all asset classes SEI analyses nor should they be considered projections for any SEI investment products. Different tools and models can simulate various market conditions using these assumptions as inputs. CMAs are used in the strategic asset allocation process, for asset/liability studies, and in proposal-generation systems. All assumptions are pre-tax and gross of any fees or expenses related to investing.

Exhibit 3: Capital Market Assumptions (Return and Risk in GBP)

Asset Class	Arithmetic Return (%)	Previous Arithmetic Return (%)	Difference (%)	Risk (%)
Equities				
UK Large Cap	5.31	7.19	-1.88	19.00
MSCI EAFE Large Cap	6.27	7.72	-1.45	21.26
Emerging-Market Equity	8.67	9.23	-0.56	31.02
US Large Cap	6.26	6.90	-0.64	21.42
Fixed Income				
UK Core Fixed Income	1.25	2.42	-1.17	7.50
Global Fixed Income Hedged	1.72	2.41	-0.69	5.70
Emerging-Market Debt	5.40	5.19	0.21	18.60
Liquidity				
UK Cash	0.35	0.92	-0.57	1.10

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