SEI UK Strategic Portfolios

SEI Strategic Portfolios April 2022 Monthly Commentary.

Fixed income and equity market tumbled in April 2022; SEI Strategic Portfolios provided downside protection.

Executive Summary

- April's market action extended the trends that shaped the first quarter. Equities and bonds tumbled, while commodities climbed. Global equities posted their largest one-month decline since March 2020 and most major equity markets delivered their poorest monthly performances of 2022. Developed-market shares fared worse than emerging markets.[1]

- So-called 'growth'-oriented equities tumbled by considerably more than value-oriented shares; this had a strong positive effective on relative returns for the equities allocations for the growth-focused SEI Strategic Portfolios. At the same time, global managed volatility allocations provided downside protection for the stability-focused SEI Strategic Portfolios.

- Government bond interest rates increased across all maturities in the UK, eurozone, and US during April. Generally, longer-term rates increased by more than short-term rates, resulting in steeper yield curves and partially reversing the flattening (and, in the case of US Treasurys, inversion) that had taken place in recent months.

- Bonds were universally negative in April as interest rates climbed (yields and prices have an inverse relationship). Inflation-indexed securities experienced relatively modest declines, while corporate bonds tumbled and emerging-market debt delivered the deepest losses.[2] Short duration allocations as well as short duration position biases within the fixed income allocations of the SEI Strategic Portfolios provided downside protection.

- On the equity side, it remains SEI's strong belief that the rotation into value stocks is just beginning; the metrics SEI uses to identify its preferred alpha source positioning continue to point strongly towards a bias toward valuation-focused managers. SEI feels that looking forward there remains a lot of potential for this positioning, even after an already strong start to relative performance in 2022.

Market Overview

- The Bank of England's (BOE) Monetary Policy Committee (MPC) did not meet in April. In mid-March, it increased the bank rate to 0.75% and began to reduce the size of its balance sheet by ceasing to re-invest proceeds from its asset-purchase programme and through corporate bond sales.

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[1] According to the MSCI ACWI Index

[2] According to data from FactSet and Lipper

- The UK consumer prices index climbed by 6.2% in the 12 months to March, an increase from 5.5% in February. UK's claimant count (which calculates the number of people claiming Jobseeker's Allowance) continued to improve in March—declining by about 47,000, with total claimants representing 4.3% of the population in March compared to 4.4% in February.

- UK manufacturing growth remained healthy in April, just above March's pace of expansion, but subdued relative to the more frenzied activity that defined conditions through most of 2021.[3] Services activity moderated to still-elevated levels in the UK during April after peaking at red-hot growth levels in March.[4]

- Following its mid-April monetary policy meeting, the European Central Bank (ECB) restated its commitment to winding down its Asset Purchase Programme, which will conclude in the third quarter following monthly net purchases of €40 billion in April, €30 billion in May and €20 billion in June.

- The eurozone unemployment rate fell to 6.8% in March, the lowest level since Eurostat began tracking the dataset in 1998, from an upward-revised 6.9% in February. Eurozone inflation increased by 0.6% in April (down from 2.4% in March) and 7.5% over the prior year (up from 7.4%).

- Eurozone manufacturing activity held in April at the moderate growth pace that prevailed in March after settling through early 2022.[5] The pace of expansion in eurozone services continued to accelerate during April, climbing to robust levels.[6]

- The eurozone expanded by 0.2% during the first quarter and 5.0% year over year, compared to 0.3% and 4.7%, respectively, in the fourth quarter of 2021.

- The US Federal Open Market Committee (FOMC) did not hold a meeting in April after voting to increase the federal funds rate by 0.25% in mid-March and concluding new asset purchases. At its early May meeting, the central bank increased the benchmark rate by 0.50%, the first hike of its size since 2000. The FOMC also announced it will begin to reduce its balance sheet in June, allowing Treasuries and mortgages to run off.

- US job openings and resignations climbed to their highest levels in decades during March, and new weekly claims for unemployment benefits fell to a 54-year low in April.[7] The US consumer-price index increased by 8.5% in the year through March, the highest level since 1981, after rising 7.9% in the year through February.[8]

[3] IHS Markit / CIPS UK Manufacturing PMI. 2 May 2022.

[4] IHS Markit / CIPS Flash UK Composite PMI. 22 April 2022.

[5] IHS Markit Eurozone Manufacturing PMI. 2 May 2022.

[6] IHS Markit Flash Eurozone Composite PMI. 22 April 2022.

[7] "Job Openings and Labor Turnover Survey News Release." U.S. Bureau of Labor Statistics. 3 May 2022.

[8] "Consumer prices up 8.5 percent for year ended March 2022." US Bureau of Labor Statistics: The Economics Daily. 18 April 2022.

- Manufacturing conditions in the US continued to recover during April after growth slowed in January before beginning to rebound.[9] US services growth slowed significantly in April after accelerating sharply from the beginning of the year.[10]

- The overall US economy contracted by an annualised 1.4% during the first quarter, representing the first decline since the second quarter of 2020. Net exports declined at an accelerating pace as imports continued to climb on high demand, private inventories decreased, and the withdrawal of fiscal spending all combined to offset continued strength in consumer and businesses outlays.

Selected Asset Class Commentary

- **Global Managed Volatility Equities Asset Class:** During the month, the asset class' favourable overweight to quality and value-oriented stocks enhanced performance. Strong stock selection within value further contributed to returns. The asset class' small-capitalisation bias and underweight to large-cap technology names also contributed. LSV Asset Management's value-orientation and underweight to large-cap IT aided performance. LSV's low volatility exposure further contributed to outperformance. Allspring Global Investments gained from its value-orientation and defensive positioning within healthcare, utilities and consumer staple. Allspring's underweight to large-cap IT names was a primary driver of outperformance in April.

- **Global Equities Asset Class:** The asset class gained ground in relative terms due to an overweight to value during the month. The asset class' overweight to financials and underweight to IT and mega-capitalization companies was especially helpful. Poplar Forest Capital, Towle & Co and Sompo Japan Nipponkoa Asset Management Co (SNAM) registered favourable performance due to its their value orientation. LSV Asset Management registered favourable performance during the month due to tailwinds from low volatility investing. Maj Invest suffered from weak security selection results. Maj Invest'd emphasis on higher quality, profitable companies with attractive valuations translated into a sizable allocation to semiconductors which hurt performance.

Manager Changes

- N/A

Outlook

- As was the case with the pandemic that hit with full force this time two years ago, no one knows how long the conflict in Ukraine will last or how extensive its impact will be on the global economy. However, investor's experience with COVID-19 and the economic and financial response to prior geopolitical events serve as a guide.

- Prior to the conflict, SEI were optimistic that global economic growth would remain solid as countries eased their COVID-19-related restrictions. Europe was expected to improve at least as fast as the US, if not faster. This is now a questionable assumption. Instead of seeing a normalisation of activity with fewer supply-chain delays and easing COVID-19 restrictions, we are witnessing a conflict that is expected to extend and exacerbate the "everything shortage."

[9] IHS Markit US Manufacturing PMI. 2 May 2022.

[10] IHS Markit Flash US Composite PMI. 22 April 2022.

- Although Russia's gross domestic product amounted to just 1.8% of the world's total in 2020 (about the same as Brazil), its importance as a commodity exporter cannot be denied. Disruption to the supply of several globally traded commodities has had a predictable result: yet another leap in commodity-price inflation.

- While supply-chain pressures eased in January and February, they were still at exceptionally high levels relative to history. SEI believes the odds favour a return to their previous peaks as freight carriers suspend Russian bookings and increase rates in response to pileups, higher energy costs, and hazardous geopolitical conditions. COVID-19-related disruptions in Asia also remain an ever-present threat.

- It is fortunate for the advanced economies that households and businesses were in mostly good financial shape coming into the crisis. Year-over-year growth in employment was continuing to accelerate heading into 2022 despite the Omicron outbreak. The US, Canada, France, and Italy have been recording gains well ahead of their longer-term trends. Job growth in Germany and the UK is still at (or slightly above) the pre-pandemic trend.

- Despite this labour-market vibrancy, workers' wages have begun to fall behind the high inflation rates recorded in the US and elsewhere. One would think that a contraction in real compensation is a sure sign that an economic recession is already underway. Yet that is not the case.

- While wage gains are lagging inflation at the upper quartiles, higher-income groups have benefited from the boom in home prices and the long bull market in financial assets; they also hold the bulk of excess saving that built up during the pandemic.

- Although incomes are not keeping up with inflation, SEI anticipates that households will draw down savings and increase debt in an effort to maintain living standards. In the US, the household saving rate has already fallen to 6.3% of disposable income from an average of 7.5% over the 2014-to-2019 period. Between 2005 and 2007, by contrast, the saving rate averaged less than 4%. Today, each percentage-point drop in the saving rate would translate into a 4% gain in nominal GDP.

- Businesses face a similar scenario. The long period of ultra-low interest rates has allowed companies to engage in a refinancing boom. Earnings before interest and taxes in the US non-financial corporate sector cover interest expense 7.9 times, the highest ratio in more than 50 years.[11]

- Meanwhile, the conflict in Ukraine has placed government leaders in the US, Europe and other advanced countries in a quandary. They have been tasked with responding urgently to the crisis by providing support while simultaneously pulling back on monetary and fiscal excesses that are partially to blame for the worst inflation in decades.

- By contrast, the US fiscal response to inflation is likely to be far less robust as it remains bedevilled by political gridlock. Not only has the US registered one the largest increases in emergency spending among the major economies over the last two years, it also has one of the worst inflation problems at a time when the domestic political environment is in an extremely fractious state.

- There is no denying that these conditions present major challenges for financial assets beyond the uncertainties caused by war. This is especially so for long-duration assets such as growth-oriented equities that trade at higher price-to-earnings ratios and longer-maturity bonds.

[11] According to data from Ned Davis Research Inc.

- Value stocks have held up relatively well in the year to date, led by a large absolute price gain in the energy sector and better-than-benchmark performances in financials, utilities, industrials, materials and health care (as measured by the S&P 500 Index). Meanwhile, technology companies and equities with high valuations have suffered as earnings multiples contracted amid the climb in bond yields, while the decline in the bond market itself is especially notable.

- Periods of crisis and instability are worrying for all investors, particularly as the turn of events in the short term can be difficult to predict. We saw this in the first weeks following Russia's invasion of Ukraine, as impacts from the crisis overwhelmed more traditional market drivers.

- During times like these, one of the greatest mistakes an investor can commit is to panic and indiscriminately make changes for fear of losing money. In periods of unusual stress, a clear philosophy and process can guide calm, rational, long-term decision making.

- SEI urges our long-term investors to continue look past the challenging relative returns of the 2019 and 2020 period and notice how the positioning has started to play out much better in 2021 and 2022 in terms of relative returns.

- Inflation, rising rates, potential increased levels of regulation around big tech, increased levels of market volatility are all themes that are likely to support the positioning in the SEI Strategic Portfolios.

- It is SEI's view that this positioning will not only continue to continue to provide downside protection as the market rotates away from growth stocks where the growth story is fading rapidly and is more volatile due to the conflict in Ukraine, but also offers sustained long term relative performance potential.

Important Information on Performance

Past Performance is not a reliable indicator of future results. Standardised performance is available upon request. All data is as a 30 April 2022.

Asset class performance discussed is based on the majority SEI fund underlying the asset class. This does not include analysis of the manager pools, hedged share class investments within SEI Funds, additional SEI funds or any third-party funds within the Strategic Portfolios. As a result, performance for the total asset class allocation may vary. Not all asset classes discussed are included in all Strategic Portfolios.

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- Absolute return investments utilise aggressive investment techniques which may increase the volatility of returns. If the correlation between absolute return investments and other asset classes within the fund increases, absolute return investments' expected diversification benefits may be decreased.
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