SEI UK Strategic Portfolios

# SEI Strategic Portfolios Q4 2022 Quarterly Commentary – Growth Focused.

**2022 finished with a strong quarter in fixed income and equities; SEI Growth-Focused Strategic Portfolios provided substantial drawdown protection in 2022 despite challenging markets**

## Executive Summary

- Most equity markets finished in positive territory during the fourth quarter of 2022, trimming their losses for the full calendar year. Developed-market stocks marginally outperformed their emerging-market counterparts. Regionally, emerging markets in Europe generated the world's strongest equity gains over the quarter, while developed markets in Europe and the Asia-Pacific region also performed well.[1] Conversely, the North American market lagged as US stocks posted relatively smaller gains.[2]

- Despite the upturn in the fourth quarter, both fixed-income and equity markets chalked up big losses for the full 2022 calendar year, almost regardless of region or style. US long-duration bonds, as represented by the Bloomberg Long US Government/Credit Index, endured a stunning decline of 27%, exceeding the sharp losses sustained by US and international equities. While emerging-market equities and bonds fared relatively better, the only asset class to post a positive absolute return for the year was commodities.

- Yields on US Treasury securities rose in the short and long parts of the curve over the quarter and declined modestly in the intermediate segment (yields and prices have an inverse relationship). Short-term yields increased by a larger margin than long-term yields. Consequently, the 2-to-10-year yield curve inverted further (short-term yields exceeded long-term yields), widening by 0.14% to 0.53%. UK gilt yields decreased across the curve during the reporting period. Eurozone government bond yields increased for all maturities, particularly at the short end of the curve.

- Both SEI's Global Equity asset classes remain strongly positive (Vs MSCI World) for the year and are ahead for this current quarter, that despite a negative November – Global Managed Volatility continues to protect and preserve capital for investors and Global Equity continues to help the more aggressive portfolios outpace the benchmark.

- SEI has started to adapt the allocations in the Global Equity asset class with the overweight to value coming down in favour of Momentum, Momentum managers are now (in SEI's opinion) in fairer value sectors and no longer chasing the trend in expensive names – Quality is still underweight due to the fact it's still very expensive.

[1] According to the MSCI Emerging Markets Europe, MSCI Europe and MSCI Pacific indexes.

[2] According to the MSCI North America and MSCI USA indexes.

- SEI have always said that the extended outperformance that we had been anticipating would not be delivered in a straight line, and that there will be short periods of reversal, however it remains our strong conviction to stay with this investment discipline.

- Even after the strong recent returns of the last two years, it continues to be SEI's strong belief that the rotation into value stocks is nearer to its start than to its end; 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 already strong relative performance in 2022.

**Market Overview**

- The Bank of England (BOE) raised its benchmark interest rate by 0.75% to 3.0% in early November before increasing by 0.5% to 3.5% in December. After the December hike, the BOE noted that global supply- chain constraints have eased, but global inflation is still elevated. Although labor demand has begun to ease, the labor market remains tight.[3]

- Consumer prices in the UK increased in November, but decelerated by 0.3% to 0.4% for the month and by 0.4% to 10.7% for the 12-month period.[4] According to the Office for National Statistics, UK GDP decreased by 0.3% in the third quarter of 2022 (revised slightly lower from the initial estimate of a 0.2% decline). Growth in education, professional, scientific and technical activities, and public administration and defense were offset by declines in wholesale and retail trade, other services activities, and arts, entertainment and recreation.

- UK manufacturing activity contracted for the fifth consecutive month in November.[5] The contraction resulted from reduced inflows of new business, supply-chain disruptions, and ongoing shortages of numerous components in international markets. Activity in the UK services sector increased in December, with the Flash UK Services PMI Business Activity Index rising 1.1% to 49.9%, after falling sharply in October and remaining steady in November.[6]

- The European Central Bank (ECB) boosted its benchmark interest rate to 2.0% after implementing increases of 0.75% and 0.5% in October and December, respectively. Following its most recent hike, the ECB commented, that interest rates will still need to rise significantly at a steady pace to reach its 2% medium-term target.[7]

[3] "Monetary Policy Summary, December 2022." Bank of England. 15 December 2022.

[4] According to the UK Office of National Statistics. December 2022.

[5] S&P Global/CIPS UK Manufacturing PMI. 1 December 2022.

[6] S&P Global/CIPS Flash UK Composite PMI. 16 December 2022.

[7] "Monetary policy decisions." European Central Bank. 15 December 2022.

- Inflation in the eurozone slowed in the 12-month period ending November by 0.6% to 10.0%.[8] Energy and food prices saw the largest increases for the month. Eurozone economic growth slowed in the third quarter to 0.4% from 0.8% over the three-month period and to 2.3% from 4.3% year over year.[9]

- Eurozone manufacturing activity remained in contraction territory during the fourth quarter, although the S&P Global Eurozone Manufacturing PMI reached a three-month high of 47.8 in December.[10] Services activity in the eurozone declined for the fifth consecutive month in December after expanding for 17 straight months from March 2021 to July 2022.[11]

- The Fed raised the federal-funds rate by 0.50% in December following a 0.75% increase in November, bringing its benchmark rate to a range of 4.25% to 4.50%. This has resulted in higher borrowing costs for consumers and businesses. In a December statement, the US central bank's stated it expected further increases in an effort to reduce inflation to the Fed's 2% target over time and will adjust monetary policy in order to meet its objectives.

- Inflation (as measured by the Department of Labor's consumer-price index) also improved in November; it eased to a lower-than-expected 0.1% after increasing by 0.4% for the second straight month in October, and it registered the slowest year-over-year increase since December 2021 with an annualized 7.1% rate versus 7.7% for the previous month.

- The US employment situation remained robust. The Department of Labor reported that nonfarm payrolls gained 263,000 in November—beating the 200,000 estimate, but slowing from October's upwardly revised 284,000. The unemployment rate ticked up 0.2 percentage points to 3.7%, while the labor-force participation rate (the percentage of the population aged 16 or older and employed or actively seeking employment) dipped by 0.2% to 62.1%.

- The US economy continued to improve in the third quarter, expanding at an annualized rate of 3.2% (up sharply from the Commerce Department's initial estimate of 2.6%), after contracting at annualized rates of 1.6% in the first quarter and 0.6% in the second quarter.

- The Institute for Supply Management's Purchasing Managers' Index (PMI) of US manufacturing activity was down 0.6 to 48.4 in December, its second straight monthly decline following 29 consecutive months of expansion. A PMI reading below 50 indicates contraction in the manufacturing sector in the US[12].

**Selected Asset Class Commentary**

- **Global Managed Volatility Equities Asset Class:** During the quarter, the asset class gained from its value and low volatility exposure as investors avoided growth stocks and IT. The asset class' managers registered favourable performance due to value tilts and allocations to defensive and low-volatility sectors. LSV Asset Management was propelled from its allocation to value within the

[8] According to Eurostat. 16 December 2022.

[9] According to Eurostat. 7 December 2022.

[10] S&P Global Eurozone Manufacturing PMI. 16 December 2022.

[11] S&P Global Flash Eurozone Services PMI. 16 December 2022.

[12] December 2022 Manufacturing ISM® Report On Business. 3 January 2023.

low-volatility area of the market. Allspring Global Investments' value tilt and allocations to defensive sectors, such as consumer staples, was also beneficial. Acadian Asset Management's broad multifactor model was also positive during the quarter.

- **Global Equities Asset Class:** The asset class outperformed due to its allocation value and low volatility. Outperformance took place due to an underweight to information technology and solid stock selection. An overweight to financials and underweight to consumer discretionary also enhanced returns. Poplar's underweight to mega-cap IT stocks and stock selection within energy and financials was additive. StonePine Asset Management recorded favourable performance due to strong security selection and an underweight to volatile mega-cap stocks. Momentum-oriented Lazard Asset Management suffered due to sector allocation effects and negative security selection. Lazard's exposure to IT and small-cap stocks detracted.

**Manager Changes**

- RWC Asset Advisors was removed from the Emerging Markets Equities Asset Class. SEI removed the RWC to consolidate assets among the highest-conviction alpha-source-oriented managers within the Fund. The assets in RWC's strategy were transferred to KBI Global Investors (value), Robeco Asset Management (value) and JO Hambro Capital Management (momentum). SEI believes the removal of RWC will improve the Fund's manager line-up and enhance its exposure to our desired alpha sources.

- Fiera Capital Corporation was removed from the Global Equities Asset Class and StonePine Asset Management was added. StonePine Asset Management, Inc. is a new firm led by Nadim Rizk, the former Head of Fiera's Global Equity Team. Initially, after StonePine was established, StonePine provided investment research and portfolio construction, while Fiera provided asset management infrastructure, which included client relationship management, compliance, global trade execution, operations, risk management, performance measurement and reporting services, as well as technology support to StonePine investors. Now, StonePine is able to provide all of these services without assistance from Fiera.

- INTECH Investment Management LLC was removed from the Global Equities Asset Class. SEI removed INTECH to consolidate assets among the highest-conviction alpha-source-oriented managers within the Fund.

- Maj Invest's Global Stable Value Equity strategy removed from the Global Equities Asset Class. SEI removed Maj Invest in order to implement quality and value alpha sources through higher-conviction managers within the current manager line up.

**Outlook**

- First, the good news for investors: 2022 is over. Now for the bad news: 2023 is shaping up to be another challenging year. Further volatility is expected across asset classes as investors face familiar headwinds: inflation rates exceeding the targets of major central banks; interest-rate increases potentially continuing throughout the first half of the year; quantitative easing shifting to quantitative tightening; and, for many countries, stagnant or recessionary economies through 2023, and perhaps, into 2024.

- SEI are projecting a less robust global economy in 2023 than the one witnessed in the past year. "Stagnation" is probably the best word for it, while "recessionary" almost certainly will apply in some countries and regions. It is not at all clear to us whether the US will be one of those countries, although surveys of economists published by the Federal Reserve (Fed) Bank of Philadelphia, the Wall Street Journal, and the National Association of Business Economics suggest a greater than 50% chance of recession.

- Do a degree this may be the most anticipated recession in the history of recessions. Wages are down in inflation-adjusted terms, the housing market is suffering a severe contraction, and some industries (notably within IT) are now losing a significant number of jobs. However, the overall economy still isn't declining in a pronounced, pervasive, and persistent manner—the so-called "three Ps"—that characterize a typical recession.

- With regard to inflation, there is good reason to believe that inflation rates have peaked for most countries. Still, we view it as a mistake to assume that prices will fall as precipitously as they have risen, or that they will make their way back to the 2% target that central banks of advanced economies set for themselves. This is especially true in the US and other countries challenged by exceptionally tight labor markets and already-high wage inflation.

- Moving on to monetary policy, even though Fed Chair Jerome Powell and other members of the Federal Open Market Committee retired the reference to "transitory" from the Fed's lexicon when describing inflation, the central bank's own (and investors') forecasts still held onto the assumption that inflation pressures would ease substantially in 2022.

- Consequently, the Fed's projections of the federal-funds rate issued in December 2021 were well below the actual rate increases that the central bank implemented in the past year. Further Fed monetary policy tightening is expected in 2023, with a year-end median prediction of 5.1% and a central-tendency forecast (incorporating the majority of FOMC decision-makers) of 5.1% to 5.4%. The obvious question is whether this unexpectedly forceful approach taken by the Fed this past year and, presumably, in the year ahead, will be sufficient to bring inflation down.

**Important Information on Performance**

**Past Performance does not predict future returns.** Standardised performance is available upon request. All data is as at 31 December 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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Investment in equity securities in general are subject to market risks that may cause their prices to fluctuate over time.

- Fixed income securities are subject to credit risk and may also be subject to price volatility and may be sensitive to interest rate fluctuations.
- 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.

- International investments may involve risk of capital loss from unfavourable fluctuation in currency values, from differences in generally accepted accounting principles or from economic or political instability in other nations.

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