SEI Strategic Portfolios

SEI Strategic Portfolios January 2023 Monthly Commentary.

Equity and fixed income markets rally in January, while the bias towards value in equities continued to contribute to performance

Executive Summary

- Most global stock markets began 2023 with a strong rally, bolstered mainly by investor optimism amid generally positive economic data and signs that the U.S. Federal Reserve (Fed) will continue to slow the pace of interest-rate hikes. It appears that the so-called "January effect", which theorizes that the financial markets (particularly small-cap stocks) tend to gain more in January than in any other month,has once again prevailed. Emerging-market equities performed particularly well, with Latin America and Emerging Asia generating the greatest returns.[1]

- U.S. fixed-income assets generally garnered strong returns in January as bond yields declined. High-yield and investment-grade corporate bonds performed in line with each other, outpacing mortgage-backed securities (MBS) and U.S. Treasuries. All Treasury yields with maturities of one year or greater declined during the month, with the intermediate- and long-term segments of the yield curve falling further than short-term yields. Consequently, the yield curve remained inverted, with short-term yields exceeding long-term yields.

- The Global Equity asset class delivered another robust month of positive relative performance in January, further building on the 1-, 2-and 3-year outperformance delivered by the bias towards the Value factor and valuation focused managers.

- At the margin, SEI has started to adapt the allocations in the Global Equity Asset Class with the overweight to value being reduced in favour of the Momentum factor, with Momentum managers are now (in SEI's opinion) in fairer value sectors and no longer chasing the trend in expensive names. The Quality factor is still underweight due to the fact it's still very expensive.

- Nevertheless, the value bias in the equities part of the SEI Strategic Portfolios remains in place. SEI would reiterate 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 approach.

- 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 nowhere near over; 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.

[1] According to the MSCI Emerging Markets Latin America and MSCI Emerging Markets Asia indexes.

Market Overview

- The Bank of England (BOE) raised its benchmark interest rate by 0.5% to 4.0% in early February as inflation remained elevated. However, the central bank noted that overall inflation has slowed and likely will decline significantly during the coming year. The BOE also said that, although the labor market remains tight, there have been signs of slower wage growth.

- The pace of rising consumer prices in the U.K. slowed in December to a rate of 0.4% from 0.5% in the month over month and to 10.5% from 10.7% in the 12-month period. Restaurants and hotels along with food and non-alcoholic beverages recorded the largest price increases over the calendar year.[2] According to the Office for National Statistics, U.K. GDP expanded by 0.1% in November 2022, but fell by 0.3% for the three-month period ending in November. Downturns in production and services more than offset a 0.3% gain in construction.

- Manufacturing activity in the U.K. remained in contraction territory for the sixth consecutive month in January but moved closer to expansion than it had in four months.[3] Activity in the U.K. services sector dipped to its lowest level in two years in January, with the Flash UK Services PMI Business Activity Index falling by 1.9 to 48.0.[4] However, business expectations for 2023 significantly improved on greater optimism with regard to the global economic backdrop and decreasing inflationary pressures in the coming year.

- The European Central Bank (ECB) boosted its benchmark interest rate by 0.5% to 2.5% in early February in its ongoing effort to combat inflation. The ECB commented that it expects to implement another 0.5% increase during its next meeting in March, and then evaluate the direction of its monetary policy. Inflation in the eurozone slowed in the 12-month period ending December by 0.9% to 9.2%. Food and energy prices saw the largest increases for the month.[5]

- Eurozone manufacturing activity remained in contraction territory in January, although the S&P Global Flash Eurozone Manufacturing Purchasing Managers Index (PMI) reached a five-month high of 48.8.[6] Services activity in the eurozone expanded for the first time in six months in January, with the S&P Global Flash Eurozone Services PMI rising 1.6 points to 50.7.[7] The eurozone's economy grew by 0.1% in the fourth quarter of 2022, down from a 0.3% gain in the prior quarter. GDP rose by 1.9% year over year and increased by 3.5% for the 2022 calendar year.[8]

- As widely expected, the U.S. Fed raised the federal-funds rate by 0.25% to a range of 4.50% to 4.75%—the smallest increase since its rate-hiking policy began in March 2022. The central bank's policymakers reiterated their commitment to reducing inflation to the 2% target rate, and said

[2] According to the UK Office of National Statistics. January 2023.

[3] S&P Global/CIPS U.K. Manufacturing Output Index. January 2023.

[4] S&P Global/CIPS Flash U.K. Composite PMI. January 2023.

[5] According to Eurostat. January 2023.

[6] S&P Global Flash Eurozone Manufacturing PMI. January 2023.

[7] S&P Global Flash Eurozone Services PMI. January 2023.

[8] According to Eurostat. January 2023.

they would continue to monitor the labor market, inflation pressures and expectations, and financial and international developments to inform its economic outlook.

- US core inflation, as measured by the Consumer Price Index for all items less food and energy, rose 0.3% in December and 5.7% year over year, compared to the respective 0.2% and 6.0% monthly and annual increases in November. The slowing inflation spurred investor optimism that the central bank may not need to raise the federal-funds rate as high as previously estimated. Overall inflation (including food and energy costs) dipped 0.1% in December after increasing by 0.1% in November, and registered a year-over-year gain of 6.5%.

- The Department of Labor reported that U.S. payrolls expanded by a greater-than-expected total of 517,000 in January—up sharply from the 260,000 jobs added in December. The unemployment rate dipped 0.1 percentage point to 3.4%, with the leisure and hospitality, and professional and business services sectors seeing the greatest improvement. Average hourly earnings rose by 0.3% in January and 4.4% year over year, compared to the respective monthly and annual increases of 0.3% and 4.6% in December.

- According to the Department of Commerce, U.S. GDP growth moderated in the fourth quarter of 2022 to an annualized rate of 2.9% from 3.2% in the prior quarter; the largest increases were in private inventory investment (which measures changes in inventory values), consumer spending, and federal government spending. These gains offset reductions in exports and residential fixed investment (purchases of private residential structures and residential equipment that property owners use for rentals).

- The Bureau of Economic Analysis reported that consumer spending dipped 0.2% month over month in December; despite the holiday shopping season, 1.6% decline in purchases of durable and non-durable goods more than offset a 0.5% increase in spending on services.

Selected Asset Class Commentary

- **Global Managed Volatility Equities Asset Class:** The asset class posted a positive return for the month, though it notably lagged the broader market. Low volatility and defensive sector allocations were key detractors over the period. Lack of participation in the market's rally was further driven by a tilt toward value and poor selection within large megacaps, where the strategy generally holds zero exposure to speculative growth stocks. The managers each fell short of expectations for the period. LSV's performance was modestly ahead of its counterparts; its less defensive sector allocation did not detract as much as that of Acadian or Analytic.

- **Global Equities Asset Class:** The asset class outperformed in January, with positive contributions from value managers offset by underperformance in momentum and quality. Positive security selection at the asset class level helped to mute additional headwinds. Most of the Value managers outperformed in a positive month for value. Towle stood out from the group, delivering strong outperformance. Metropole was helped by their positioning towards riskier, cheaper areas of the market. Lazard detracted most due to poor momentum factor performance following a reversal in market trends. StonePine was another detractor as higher quality, higher profitability, and more stable names gave way to higher risk, speculative growth stocks.

Manager Changes

- N/A

Outlook

- We anticipate further volatility 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.

- "Stagnation" is the best way to describe the state of the global economy, but several regions will likely enter recession in the coming months. The Philadelphia Fed's most recent survey pegged the probability of a U.S. recession occurring in the first quarter in 2023 at 47%.[9] However, it is not at all clear to us whether that will be the case.

- Wages are down in inflation-adjusted terms, the housing market is suffering a severe contraction, and some industries (notably within technology) are 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 U.S. and other countries challenged by exceptionally tight labour markets and already-high wage inflation.

- Further Fed monetary-policy tightening is expected to continue in 2023 beyond the recent 0.25% interest-rate hike—with its target range projected to reach 5%-to-5.25% by June and 5.1% by year end. The obvious question is whether the Fed's forceful approach this past year and, presumably, in the year ahead, will be sufficient to bring inflation down. Or will it still prove insufficient, thereby forcing the central bank to keep raising its policy rate beyond its current expectations?

- While markets are likely to be volatile in 2023, for the long-term investor there would seem to be opportunity across the asset class spectrum in the SEI Strategic Portfolios. There is potential for solid returns from fixed income now that yields are higher and interest rates hikes are mostly behind us. In equities SEI continues to believe there are positive relative returns available from the value factor and managers that seek to exploit mispricing in the market.

Important Information on Performance

This is a Marketing Communication. Past Performance does not predict future returns. Standardised performance is available upon request. All data is as at 31 January 2023.

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

[9] According to the Federal Reserve Bank of Philadelphia, November 2022.

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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