

From 10 days of war to 10 years of inflation?

March 2022

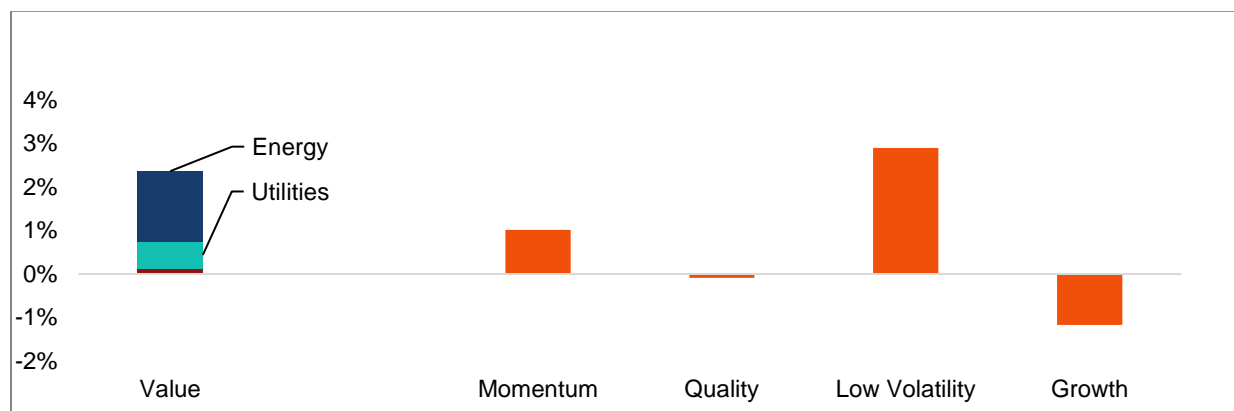
Quantitative Equity Management

- Since Russia invaded Ukraine on 24 February 2022, value positions have been defensive for portfolios in the US and have been helped by exposure to the energy and utilities sectors.
- Value has lagged in Europe during the same time, pulled down by the area’s greater indirect exposure to Russia.
- We believe that the value lag in Europe is likely to be transitory, as the initial impacts of the conflict appear to have been absorbed and should improve as inflationary tailwinds set in.

Over the last 10 days, the extent to which investor portfolios have been exposed to events related to the Russia/Ukraine conflict has trumped more traditional style factors, but it is still possible to draw some conclusions from the relative performance of factor returns.

As shown in Exhibit 1, since Russia invaded Ukraine on 24 February 2022, value (as measured by the SEI Value Factor Family) has been defensive in the US and has been helped by exposure to the energy and utilities sectors, which have risen in tandem with surging oil prices.

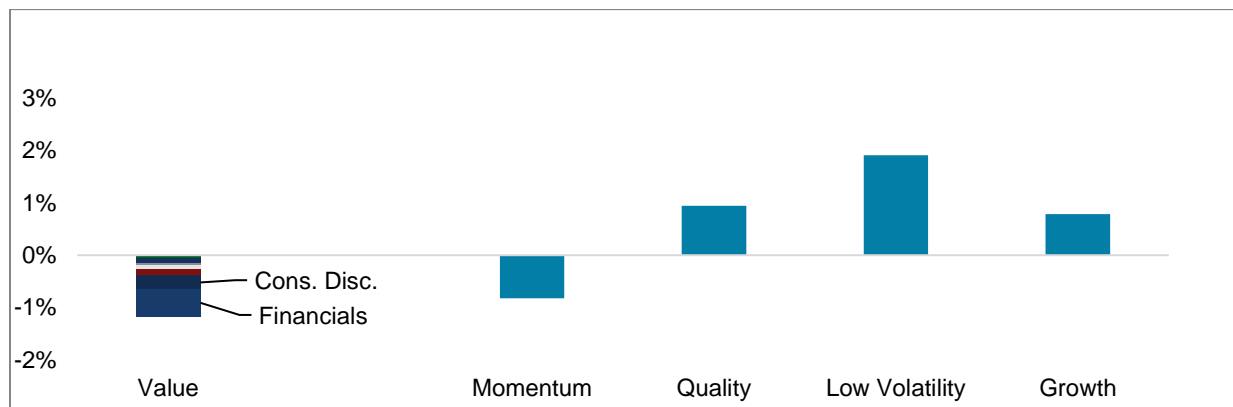
Exhibit 1: US Large-cap Factor Returns



Source: SEI, FactSet. Data spans 2/24/2022-3/8/2022. Past performance is not a reliable indicator of future results. Returns quoted in USD. The metrics are composites of underlying ratios that SEI has determined to be appropriate measures of each refers to past performance of liquidity-weighted top-tercile portfolios vs. the capitalization-weighted benchmark and rebalanced quarterly. Index returns are for illustrative purposes only and do not represent actual fund performance. Index performance returns do not reflect any management fees, transaction costs or expenses. Indexes are unmanaged and one cannot invest directly in an index.

As shown in Exhibit 2, however, the value style in Europe has lagged, and the factor has been pulled down by declines in European banks and autos. Indirect exposure to Russia has been higher in Europe than in the US. 7.7% of European company revenues represented in the value factor portfolio are exposed to countries bordering Russia and Ukraine, while only 2.5% in the US value factor portfolio are similarly exposed.

Exhibit 2: Europe Factor Returns



Source: SEI, FactSet. Data spans 24/2/2022-8/3/2022. Past performance is not a reliable indicator of future results. Returns quoted in USD. The metrics are composites of underlying ratios that SEI has determined to be appropriate measures of each factor. Data refers to past performance of liquidity-weighted top-tercile portfolios vs. the capitalization-weighted benchmark and rebalanced quarterly. Index returns are for illustrative purposes only and do not represent actual fund performance. Index performance returns do not reflect any management fees, transaction costs or expenses. Indexes are unmanaged and one cannot invest directly in an index.

We believe that the value lag in Europe is likely to be transitory, as the initial impacts of the conflict appear to have been absorbed and should ameliorate as inflationary tailwinds set in. Low-volatility has also benefited in both the US and Europe; the factor has helped cushion to the downside, behaving as expected as investor seek to reduce exposure to riskier securities in their portfolio.

Spillover Effects

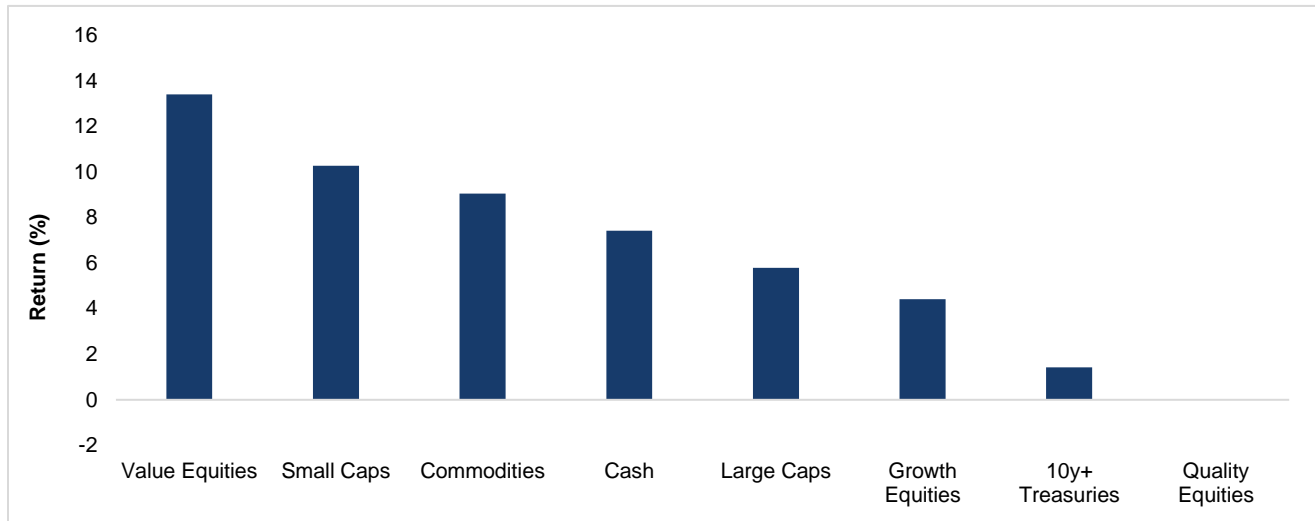
We believe investors should focus on the indirect impacts of the conflict, rather than any direct Russian exposures; these are far more impactful on portfolios:

- Knock-on effects of commodity price spikes feed into inflation.
- Sanctions result in supply-side disruptions and heightened economic uncertainty.
- Central banks have not dealt with elevated and persistent inflation for decades; printing money may now be unpalatable.

The Spectre of Stagflation

The current environment is beginning to compare to the stagflationary 1970s, a decade of significant and protracted inflation, fiscal and monetary instability, price controls, oil price spikes, and the Cold War. The period was a struggle for long-duration assets, including growth equities and long-maturity bonds, as shown in Exhibit 3.

Exhibit 3: US Asset Returns in Inflationary Times



Source: SEI. March 1971 to September 1981 period coincides with the bottom-to-peak move in US 10-year Treasury yields, from 5.5% in March 1971 to 15.8% in September 1981. Value Equities: Top 30% ranked US equities by book-to-market, from Kenneth R. French Data Library. *Commodities*: S&P GSCI, from Standard & Poor's. Small Cap Equities: Bottom 30% ranked US equities by market capitalization, from Kenneth R. French Data Library. Cash: 3-month US Treasury bill returns from Ibbotson and Associates Inc. Large-Cap Equities: S&P 500 Index Total Return. Growth Equities: Top 30% ranked US equities by book-to-market, from Kenneth R. French Data Library. 10y+ Treasuries as measured by the Bloomberg US Treasury: Long Index. Quality Equities: Top 30% ranked US equities by quality as defined in Asness, Frazzini and Pedersen (2014), "Quality Minus Junk"

Industries which lagged during this period include those sensitive to the end-consumer versus "Old Economy" beneficiaries of higher commodity prices¹.

Our outlook

Although the immediate effects of the war are likely to subside, elevated inflation is likely to persist far longer. We believe long-duration assets, including government bonds and growth equities, are likely to suffer the brunt of the performance impact. Value and diversity are natural beneficiaries from rising costs and should perform well in an inflationary environment.

¹ Source: SEI, CRSP industry definitions via Kenneth R. French Data Library.
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Glossary

Growth stocks exhibit earnings growth above that of the broader market.

Long-duration assets are those that are expected to deliver a higher proportion of their future cashflows in the long term.

Low-volatility refers to stocks that are less volatile than the broader market.

Momentum refers to a trend-following investment strategy that is based on acquiring assets with recent improvement in their price, earnings, or other relevant fundamentals.

Quality refers to a long-term buy and hold strategy that is based on acquiring assets with superior and stable profitability with high barriers of entry.

SEI Value Factor Family is a composite index of underlying ratios that SEI has determined to be appropriate measures of the value factor.

Stagflation refers to an economic environment of slow growth, relatively high unemployment, and rising prices.

Value refers to a mean-reverting investment strategy that is based on acquiring assets at a discount to their fair valuation.

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