Markets Corrected by Rising Rates

November 2018

- October saw the broad-market STOXX Europe 600 Index fall to its lowest level in nearly two years.
- A key trigger for the jump in market volatility and selloff in risk assets was the US Federal Reserve's move in September to raise interest rates.
- The increased market volatility supports the conviction that investors should maintain a diversified, long-term outlook.

Global equity markets were hit hard in October, with the FTSE 100 Index in correction territory and suffering its worst monthly performance in over three years (in local currency). European shares, as measured by the STOXX Europe 600 Index, fell to their lowest levels in nearly two years during the month (in local currency).

After recovering from a 10% correction early in 2018, most US equity indexes posted significant year-to-date gains by the end of the third quarter. However, October saw the broad-market S&P 500 Index re-enter correction territory—that is, down over 10% from its recent peak (in US dollars)—for the second time in less than 12 months.

Why Now?

Why is this happening now? Brexit-related uncertainty continues to fuel doubts in the UK, creating a headwind for UK equity performance. A falling pound and weak UK economic data over the past year have been driven by anticipated implications of a hard Brexit (the likelihood of which appears high). Political unpredictability is also on the rise. The plan recently put forth by Prime Minister Theresa May was given a frosty reception by the EU and by her pro-Brexit rivals within the UK's Conservative Party. UK inflation has shown signs of acceleration, complicating monetary policy for the Bank of England.

Beyond the Brexit drama, geopolitical fears exacerbating the global selloff have included Italy's debt situation and ongoing trade-war rhetoric, a slowdown in Chinese growth, and a disappointing batch of third-quarter earnings in the US (particularly in the technology sector).

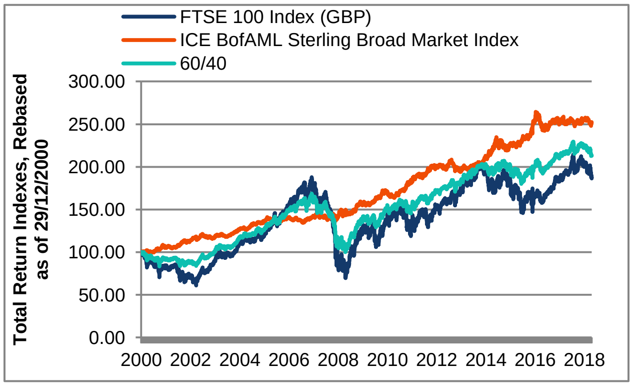
Another key trigger for the jump in market volatility and selloff in risk assets was the US Federal Reserve's move in September to raise interest rates for the fourth time in a year, bringing its key lending rate to 2.25%—with intentions to issue yet another hike in December. Also unsettling the markets was the European Central Bank messaging that it will withdraw quantitative easing (stimulus) from the economy before the end of the year.

Diversification Can Dampen Volatility

The increased market volatility supports the conviction that investing in capital markets involves risk. We believe that, whatever amount of risk an investor chooses to take, that investor should receive as much expected return as possible in exchange for assuming that degree of risk.

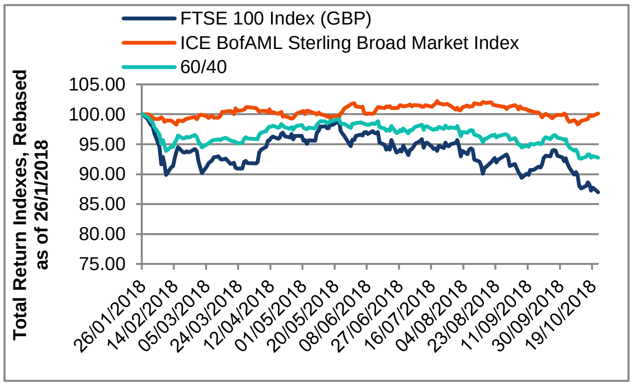
The charts below show returns of both the FTSE 100 Index (GBP) and ICE BofAML Sterling Broad Market Index (GBP) over the last 18 years and the year to date, along with how a portfolio would have performed during these periods if it held 60% in the equity index and 40% in the fixed-income index. While the diversified portfolio performance (GBP) beat the FTSE 100 Index over both time horizons, it also would have subjected the investor to less volatility than the more concentrated equity portfolio during both periods.

Concentrated vs. Diversified Returns: Past 18 Years



Source: Bloomberg

Concentrated vs. Diversified Returns: Year to date



Source: Bloomberg

As illustrated in these two charts, performance patterns tend to shift (often unpredictably) over time. While diversified portfolios can undergo periods in which they lag concentrated portfolios, we do not believe this dilutes the importance of diversification for long-term investors. The key to getting through these less-fruitful cycles is, in our view, being aware of concentrated market leadership and remembering that performance patterns often change.

SEI Strategies

Our stability-focused strategies have benefited from strategic exposures to low-volatility equities that have outperformed the broad-market indexes. Additionally, while investment-grade fixed income has faced headwinds from rising rates for much of the year, it has served as ballast against equity declines during the recent market volatility. As always, we continue to adhere to our philosophy of constructing well-diversified portfolios with an eye on long-term goals.

Our View

Predicting the future is a hazardous venture most of the time. In view of the uncertainties facing investors at the present time, the prediction game is, perhaps, even more challenging. Selling only locks in a potential loss, and trying to find a better entry point is difficult. We know that nothing in the financial markets is certain, and we will not allow short-term performance to fool us into abandoning our philosophy of diversification and investing for the long term.

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Index Definitions:

FTSE 100: The FTSE 100 Index measures the performance of shares from the 100 largest companies listed on the London Stock Exchange.

ICE BofAML Sterling Broad Market Index: The ICE BofAML Sterling Broad Market Index tracks the performance of investment-grade bonds issued in sterling.

S&P 500 Index: The S&P 500 Index is a market-capitalization weighted index that consists of 500 of the largest publicly-traded US companies that are considered representative of the broad US stock market.

STOXX Europe 600: The STOXX Europe 600 index is an unmanaged index of 600 large-, mid- and small-cap companies from 17 European countries. The index covers about 90% of the market capitalization of European stocks.

Important Information

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