SEI Strategic Portfolios May 2022 Monthly Commentary.

Markets stabilise in May 2022; Strategic Portfolio asset class components continue to outperform.

Executive Summary

- Global equities were practically unchanged in aggregate for May as a decline through the first half of the month was masked by a powerful recovery rally toward the end of the period. Emerging-market shares performed in line with developed markets, but a top-down perspective fails to capture the wide range of regional performances.
- UK and Eurozone government-bond yields increased across the yield curve, with longer-term bond rates rising by more than those with shorter terms. Shorter- and longer-term US Treasury rates increased, while rates declined on Treasury's with maturities of 2 to 10 years.
- Local-currency emerging-market debt was the best-performing fixed-interest segment in May as the US dollar's nearly yearlong ascent (measured by the US Dollar Index) appeared to crest in mid-May before retreating through the end of the month. Most other fixed-interest asset classes were also positive besides inflation-indexed securities.
- Alongside the downside protection provided by global managed volatility asset class in recent months, there is evidence starting to take shape that the value positioning in the equities asset classes can provide both downside and upside relative return benefits as the market continues to rotate in favour of stocks with actual fundamentals and not stocks with valuations based on a mirage of ever-growing sales into infinity.
- 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) voted to increase the bank rate by 0.25% for the fourth consecutive time at its May meeting, pushing the benchmark rate to 1.0%, its highest level in 13 years. It also began to reduce its balance sheet by ceasing to reinvest proceeds from its asset-purchase programme and commencing corporate bond sales.

- Consumer prices in the UK jumped by 9.0% in the 12 months to April compared to a 7.0% 12-month climb in March, and the highest level since 1982.[1] UK's claimant count declined in May for the fifteenth consecutive month—by about 57,000, with total claimants representing 4.1% of the population in April compared to 4.2% in March.

- UK manufacturing growth continued to cool slightly in May from a January peak, but remained at healthy levels.[2] Growth in the UK services sector dropped sharply during May from elevated April levels and red-hot growth in March.[3] The UK economy expanded by 0.8% during the first quarter and 8.7% year over year, slowing from rates of 1.3% and 9.5%, respectively, in the fourth quarter of 2021.

- The European Central Bank (ECB) did not hold a monetary policy meeting in May. Following its mid-April meeting, the central bank restated its commitment to winding down its Asset Purchase Programme—set to 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 held at 6.8% in April, the lowest level since Eurostat began tracking the dataset in 1998. Consumer prices in the Eurozone increased during May by 0.8% for the month and 8.1% for the 12-month period, compared to relatively slower respective rates of 0.6% and 7.5% in April.

- Eurozone manufacturing activity remained healthy but eased in May compared to the uptick that held through March and April.[4] Expansion in Eurozone services maintained a solid pace in May, but below April's peak.[5] The Eurozone economy grew by 0.3% during the first quarter and 5.1% year over year, compared to 0.3% and 4.7%, respectively, in the fourth quarter of 2021.

- At its early May meeting, the US Federal Open Market Committee (FOMC) increased the federal-funds rate by 0.50%, the first hike of its size since 2000, to a 0.75%-to-1% range. The FOMC also announced plans to reduce its balance sheet in June, allowing Treasurys and mortgages to run off at maximum respective paces of $60 billion and $35 billion per month.

- The US labour market added 390,000 jobs in May, while average hourly earnings increased by 0.3% for the month and 5.2% over the prior year. The unemployment rate held at 3.6%, just above a 50-

[1] "UK inflation jumps to 40-year high of 9% as food and energy prices spiral." CNBC. 18 May 2022.

[2] IHS Markit / CIPS UK Manufacturing PMI. 1 June 2022.

[3] IHS Markit / CIPS Flash UK Composite PMI. 24 May 2022.

[4] IHS Markit Eurozone Manufacturing PMI. 1 June 2022.

[5] IHS Markit Flash Eurozone Composite PMI. 24 May 2022.

year low. The US consumer-price index increased by 8.3% in the year through April, just below the multi-decade high of 8.5% recorded in March.

- Manufacturing activity in the US was mixed in May, with healthy new-order growth, stagnant employment conditions, and high price pressures.[6] US services growth continued to slow in May after accelerating sharply from the beginning of the year.[7] The overall US economy contracted during the first quarter by an annualised 1.5%, the first decline since the second quarter of 2020.

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 bolstered 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. Allspring Global Investments gained from its value-orientation and defensive positioning within health care, utilities and consumer staple. Allspring's underweight to large-cap technology names was a primary driver of outperformance in May. Acadian Asset Management benefited from its low-volatility preference, which led to an underweight to low-quality stocks.

- **Global Equities Asset Class**: The asset class gained due to an overweight to value during the month. An overweight to financials and underweight to IT and mega-capitalization companies was especially helpful. Poplar Forest Capital, a US value manager, contributed due to the outperformance of value during the month. Stock selection within financials and energy further boosted returns. Towle & Co also registered favourable performance due to its value positioning and security selection within energy. Sompo Japan Nipponkoa Asset Management Co (SNAM) registered favourable performance on a tailwind to value, an overweight to utilities and strong selection within financials and consumer staples. LSV Asset Management registered solid performance during the month due to tailwinds from low volatility investing. Metropole Gestion and Jupiter Asset Management also posted positive performance in May. Metropole's pro-cyclical positioned portfolio strongly participated in the energy and bank rally in Europe. Jupiter's performance was bolstered by style tailwinds with favourable stock selection in consumer services, financials and pharmaceuticals.

Manager Changes

- N/A

[6] IHS Markit US Manufacturing PMI. 1 June 2022.

[7] IHS Markit Flash US Composite PMI. 24 May 2022.

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."

- 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[8].

- 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.

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[8] According to data from The World Bank, Capital Economics, SEI.

- 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.[9]

- 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[10].

- 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.

- 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.

- 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 could 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 can offer sustained long term relative performance potential.

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

[10] U.S. faces 'unacceptable levels of inflation,' Yellen tells senators." Reuters. 7 June 2022.

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 31 May 2022.

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