SEI Strategic Portfolios:

February 2020 Monthly Commentary

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The continuing Coronavirus outbreak, now spreading into Europe and the US, further spooks equity markets in February; investors continue to seek safety in fixed income

Executive Summary

- After staging a fightback during front end of the month, equity markets end February in a strong risk off mode, with global government bonds leading the way and equities falling sharply. Consistent with the progression of the virus, where there were signs of slowing infection rates observed in China, emerging markets managed to post better returns that developed markets, perhaps also recovering some of their relative value. In small-caps both US and European markets lagged their larger counterparts, while economically sensitive high yield fixed income and emerging markets debt struggled.

- Considering the stability-focused Strategic Portfolios, absolute returns were cushioned meaningfully by fixed income allocations, benefitted from the holding of government bonds. As a strategic investors, SEI believes that such holdings provide much-needed diversification away from volatile equity markets. A slight underperformance was generally driven by a short duration position in our Global Fixed Income funds. The Global Managed Volatility Equities fund somewhat unusually underperformed the declining equity market but by design was able to provide meaningful risk reduction.

- For the growth-focused Strategic Portfolios, in a continuation from January, meaningful negative absolute returns were shared with broader equity markets. Valuation-focused managers continued to lag their benchmark and the overweight to value again proved costly to relative returns particularly within the Global Equities fund.

- It should be noted that equities are essentially very long duration investments and unless we see significant corporate failures, perhaps driven by a lack of proper policy response, as a basket the world's equity market should have a natural floor under it that is driven by the value of the future earnings, which will more than likely exist beyond this crisis. However hard it may be with the extreme current news-flow, if one has a degree of optimism that the world population will survive and that the virus will be beaten, for the long-term investor it makes sense to try to look beyond this crisis and avoid the pitfalls of market timing.

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- Both active management and systematic alpha sources have taken a beating over the last few years as investors have chased an increasingly small number of overvalued mega-cap stocks. In SEI's view, these disappointing past results continue to create an outsized relative return opportunity for the future. As the months of this virus outbreak progress, it is likely to deliver an opportunity for absolute returns for the medium to long term investor to deploy additional capital, however volatility is likely to persist for now and nervous investors are likely to be better off to stick to their investment strategy and make no knee-jerk reactions.

- **Despite the market reversal and the challenges around valuation-focused managers, the SEI Strategic Portfolios maintained their highly competitive position against peer groups, with the Stability-Focused portfolios delivering on their mandate of drawdown protection through recent challenging periods, while the Growth-Focused portfolios provided above-average returns against peers, with the Aggressive Fund outperforming the average of its peers by 1.66% p.a. over 5-year periods to end of January 2020. (Wealth A Distributing Share Class, in GBP, net of all fees).**

Market Overview

- Concerns about the international spread of a novel coronavirus (COVID-19) dominated conditions in financial markets throughout February, continuing a trend that began in late January. Developed-market shares, as measured by the MSCI World Index, registered their largest decline since May 2012. The UK fared the worst among developed markets, followed by Europe and Japan performing in line with each other; the US declined by slightly less than the others. Emerging-market equities outperformed developed markets.

- Mainland China, where COVID-19 originated, finished February with a gain after sharply selling off in January; despite hosting far more COVID-19 cases to date than all other countries combined, China's infection rate slowed considerably while recoveries accelerated as the month progressed.

- Developed-market government bond yields tumbled as investors sought safe-haven assets amid a crescendo of equity-market volatility that peaked on the last trading day of the month, when the CBOE Volatility Index (VIX) hit its highest level since August 2015. UK, European and US government bond rates declined across all maturities; long-term US Treasury yields finished the month at historic lows.

- Energy prices fell sharply during February in light of weakening prospects for global economic growth as governments implemented restrictions to counteract the COVID-19 outbreak that also impact productivity (such as shuttering workplaces, closing schools, quarantining exposed individuals, and imposing trade and travel barriers).

- The Bank of England, European Central Bank (ECB), US Federal Open Market Committee (FOMC) and Bank of Japan (BOJ) held no meetings on their respective domestic monetary policies during February. Furthermore, each central bank kept their respective benchmark rates unchanged following their January meetings. However, the FOMC announced an off-meeting cut of .50% (bringing the funds rate down to a range of 1.00% to 1.25%) on 3 March in an effort to counteract the economic drag introduced by the Covid-19 outbreak.

- UK Prime Minister Boris Johnson shuffled his cabinet ministers and senior government officials during February, prompting Chancellor of the Exchequer Sajid Javid to resign. Javid was replaced by Rishi Sunak, a senior Treasury official and former banker. A preliminary report on UK services sector activity depicted a slower but still sturdy expansion in February, while an early report on UK manufacturing showed a rebound that was beginning to show signs of healthier growth. UK retail sales jumped by 0.9% in January after sliding by 0.5% in December. The UK claimant count unemployment rate held at 3.4% in January.

- The contraction of eurozone manufacturing activity slowed in February, nearing a neutral position (that is neither shrinking nor expanding). A preliminary report on eurozone services activity depicted modest improvement with services growth remaining at healthy levels. The eurozone unemployment rate held at 7.4% in January, while the economy grew by 0.1% during the fourth quarter and 0.9% during 2019; both measures of economic growth were lower than during the prior period.

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- The US Department of Commerce announced new rules that would allow the Trump administration to impose tariffs on imports from countries deemed to have artificially decreased the value of their currencies for trade advantages. US manufacturing growth slowed nearly to a standstill during February, and an early report showed services sector activity contracted in February after expanding at healthy levels in January. Personal spending declined to 0.2% in January from 0.4% in December, and overall fourth-quarter economic growth registered a 2.1% annualized rate.

- China cut tariffs in half on $75 billion worth of US products in mid-February, and also announced the suspension of additional tariffs on US industrial goods later in the month. Domestically, the regional government of Hainan, China, planned to take control of China's HNA Group, an aviation-focused conglomerate with an unsustainable debt load that was further crippled by COVID-19 -induced travel stoppages. The governments of Hong Kong, Singapore and Macau each announced direct fiscal stimulus measures during February, in the form of cash payments or shopping vouchers to their respective citizens, intended to counteract the negative economic effects introduced by the COVID-19 outbreak.

Selected Asset Class Commentary

- Global Fixed Income Asset Class: The asset class returned 0.40% in February, underperforming the Bloomberg Barclays Global Treasury Index by 47 basis points. The underperformance was due to the broad risk-on positioning: underweight duration, off-benchmark exposure to US Treasury inflation-protected securities (TIPS) and spread sectors. Brandywine struggled on an underweight to rates in core Europe, and overweights to local-market duration in Mexico and Colombia. Colchester's duration underweights in core Europe, the US and UK detracted. Overweights to local-market rates in Mexico and Colombia further hurt performance, as did an off-benchmark position in US TIPS. Wellington gained on duration overweights in Canada, Australia and New Zealand, and an overweight to the yen.

- Global Managed Volatility Equities Asset Class: The asset class achieved meaningful risk reduction in February, but somewhat unusually failed to provide downside protection in falling markets. The disappointing results were driven by overall weak low-volatility returns for the period, underweight to mega-cap stocks and a tilt to cheaper names. The market decided that large-cap technology stocks were the best place to hide, and not the classic defensive stocks. All three managers achieved meaningful risk reduction, but posted negative total returns. LSV Asset Management struggled on an underweight to volatile mega-cap US tech names, its preference to cheaper areas of the market and poor stock selection in insurance and biotechnology. Wells Fargo Asset Management was more resilient, benefiting from the deepest low-volatility exposure

Manager Changes

- None over the period.

Portfolio Manager Changes:

- SEI's Investment Management Unit has realigned portfolio management responsibilities for a number of SEI's global equity funds. As a result of these changes, John Lau, CFA, will now be assuming responsibility of the Emerging Markets Equity Building Block. These changes came following the departure of Sandra M. Ackermann-Schaufler, CFA, who left SEI to pursue other opportunities.

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Outlook

- At the beginning of 2019, many investors were licking their wounds following a sharp global stock-market correction. At the beginning of 2020, we were confronted with a notably different market backdrop as share prices generally ended 2019 near their highs of the year. The spread of COVID-19, first within China's mainland borders and then to the rest of the world, have introduced a significant headwind to the global economy, which financial markets have acknowledged in the rapid downward repricing of assets through late January and February.

- Before the onset of virus, the global economy was looking up; US growth was looking good, Europe showing signs of improvement, China growth was stabilizing, trade deals were making progress. It is clear now that the disruption caused by the virus will continue for a while; how extensive the disruption will be will depend on the tightrope that governments must now run between managing pressures on their healthcare systems and minimizing economic disruption.

- The US has some unique advantages with regard to limit impact of virus: population density outside of major urban areas is much less, the healthcare system is among the best in the world and sanitation is much better than places that have been hit the hardest. SEI believes it would be a mistake to assume that an extrapolation of what happened in China will definitely happen to the rest of the world. In addition, the virus appears to be flattening in China, while Japan seems to have gotten a handle on new cases.

- There will undoubtedly be an impact as travel and leisure activity is reduced, sporting events are cancelled or played to empty stadiums. This may result in technical recession, however the US came in the outbreak with a higher growth rate, so it may just see slower growth. For the rest of the world, matters look more challenging. China will show a sharp decline in February to April economic activity, while many European countries were showing slower growth rates coming into the outbreak and therefore are more likely to post negative economic outcomes.

- With regard to risk assets and stocks, SEI would expect to see more volatility in weeks ahead; analysts have no idea where earnings are going; some revisions have been made but many more are expected. Chinese supply dynamics may start to improve, but ultimately consumer demand is more important, and few policies will affect consumer behaviour in the face of the extreme news-flow.

- In the short-term, markets may have not priced in enough bad news, as we have not yet seen sort of oversold conditions as we saw in December 2018 or January 2016. However, with yield falling at the short end of the curve and equity dividend yields rising, investors are still facing the fact that risk assets remain the only way to get compensated above the inflation rate. Overall economy is in pretty good shape, but there is an unprecedented level of uncertainty.

- With that in mind, SEI will retain our emphasis on strategic investing over tactical moves, and we recommend that our investors do the same. Trying to look beyond this crisis is critical for the longer term investor; SEI continue to advocate avoiding market timing during periods of volatility like we are seeing as this can lead to significant impairment of value. Shorter term investors, having hopefully invested in more conservative risk profiles, will have seen their investment values only modestly impacted. Difficult as it may be, one has to maintain an optimism that we have the ability to overcome both the virus and the strong emotional responses that it is generating.

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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.
- 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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