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SEI Strategic Portfolios:

May 2020 Monthly Commentary

Global equity markets continued to rally in May, based on expectations that the economic impact of the global pandemic will be limited to a few quarters

Executive Summary

- Global financial markets continued their sharp rallies in May, albeit short of their remarkable April rebounds. The "risk-on" sentiment came amid a push by local governments to slowly reverse lockdowns of non-essential economic activity; the promising news of progress made in the race to develop COVID-19 vaccines; and the sustained extraordinary support of central banks.

- Equities around much of the world experienced a choppy first half of May that ultimately gave way to a strong second half for the month. However, mainland Chinese and Hong Kong shares were outliers; both came under pressure as the month progressed, with the latter finishing the period with a steep loss. European and US shares generated solid monthly performance, while UK shares delivered more subdued gains.

- Government-bond rates followed divergent paths from country to country. They mostly declined for UK gilts, yet increased for those with the longest maturities, while they increased across all maturities for eurozone government-bonds. As for US Treasurys, short- and long-term rates increased as intermediate-term rates declined for the month.

- Considering the stability-focused Strategic Portfolios, relative returns were boosted by overweights to economically sensitive debt, including corporate bonds, selected emerging markets, as well as peripheral Eurozone debt. Consistent with its design, the Global Managed Volatility Equities fund lagged in a rising equity market but was able to provide meaningful risk reduction.

- For the growth-focused Strategic Portfolios, some of the challenges faced by value managers in recent quarters continued to ease somewhat in May, with several periods of stronger returns potentially indicating a bigger rotation. Our core investment case for SEI's overweight to this area remains the same: extreme relative valuations between the most expensive and cheapest parts of the market. SEI further believes that the post-crisis environment may provide further support for this positioning, given the huge stimulus being provided.

Market Overview

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- In the UK, the Chancellor of the Exchequer Rishi Sunak announced his intention to extend the government's mortgage-payment holiday beyond June as its initial three-month timeframe approached. As of mid-May, UK banks had granted these repayment holiday terms to 1.7 million homeowners[1].

- The Bank of England's (BoE) Monetary Policy Committee held course following its 7 May meeting, keeping the Bank Rate at 0.1% and reiterating a commitment to purchase £200 billion in gilts and investment-grade corporate debt. The central bank's May policy statement cited data that pointed to a significant drop in household consumption and plummeting expectations for sales and business investment during the second quarter.

- Sharp contractions in manufacturing and services conditions appeared to slow across the UK, eurozone and US during May, but remained far from returning to growth. The UK economy shrank by 5.8% during March, representing the largest monthly decline in more than 20 years of UK gross domestic product (GDP) measurements[2]. Economic activity contracted by 2% over the first quarter of 2020. The UK claimant count (which measures the number of people claiming unemployment benefits) jumped to 5.8% in April from 3.5% in March. Retail sales in the UK fell in April by 18.1% from the prior month and by 22.6% from a year earlier.

- In mid-May, the European Commission put forward a proposal for nearly €2 trillion across the EU, with €750 million devoted to recovery efforts and another €1.1 trillion to budgets over the next seven years. The European Central Bank (ECB) did not meet to address monetary policy in May. Germany's constitutional court ruled during May that the ECB must produce justification for the legality of its bond-buying programme, in order to determine whether the Bundesbank could continue to participate.

- The eurozone contracted by -3.8% during the first quarter and -3.2% over the one-year period. Construction output dropped -14.2% in March after slipping just -0.5% in February. Loans to non-financial corporations climbed by 6.6% in April, following an increase of 5.4% in March, continuing a corporate-credit bounce from February's ebb.

- Towards the end of May, the House of Representatives passed an additional $3 trillion in COVID-19 relief funds, but the legislation is held up in the Senate with unclear prospects for approval. Legislation passed the US Congress in early June that would extend the period during which companies can spend loan proceeds and remain eligible for loan forgiveness.

- The increasingly tense US-China relationship was further stressed in May by a US push for more transparency in the ownership of US-listed Chinese companies and the US government's barring of certain Chinese holdings from its retirement plans. China, for its part, imposed an 80% tariff on all barley imported from Australia over the next five years in an apparent response to the Australian government's call for an independent inquiry into the origins of COVID-19.

- The US Federal Open Market Committee held no meeting in May. As part of its crisis-period response, the Fed began buying corporate bond exchange-traded funds on 12 May to support secondary-market liquidity. Fed Chair Jerome Powell announced near the end of May that the central bank's Main Street Lending Program would be operational within days.

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[1] "Sunak planning to extend UK mortgage relief scheme." The Guardian. 20 May 2020.

[2] "UK GDP shrinks by record 5.8% in March, harder COVID hit ahead." Reuters. 12 May 2020.

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- US consumer spending fell by 13.6% during April, registering the sharpest one-month decline since the data series began in 1959[3]. New jobless claims for US unemployment benefits declined from more than 3 million per week in early May to about 2 million later in the month. Nearly 15 million US credit card bills went unpaid during April, and more than 8% of US mortgages were in forbearance as of mid-May. US GDP declined by an annualised 5% during the first quarter of 2020, the largest quarterly decline since the final three months of 2008.

Selected Asset Class Commentary

- **Global Fixed Income:** During the month, the building block benefited from an overweight to peripheral Eurozone countries, overweights to Mexican and Colombian local rates, and off-benchmark exposures to corporate credit and US Treasury inflation-protected securities (TIPS). AllianceBernstein's overweight to peripheral Europe contributed. Off-benchmark exposure to credit, mortgage credit risk transfers and US TIPS also helped. Wellington struggled on an underweight to the euro and overweight to the yen. A duration overweight in the US further detracted.

- **Global Managed Volatility Equities:** The building block achieved meaningful risk reduction in May, but struggled on the back of pronounced style headwinds to low-volatility names and unfavourable overweights to consumer staples, utilities and health care. An underweight to mega-cap stocks was beneficial. Wells Fargo Asset Management fared better against style headwinds during the month, benefiting from greater diversity exposure and its momentum bias. LSV Asset Management's value bias suffered most. Its exposure to cheaper low-volatility names was amplified by stock-specific disappointments in US biotechnology and insurance.

- **Global Equities:** Overall market leadership remained unchanged in May; however a strong rotation in the middle of the month was also in evidence, was not quite enough to change the overall monthly results, but sufficient to challenge investors' complacency in expensive growth stocks. With low volatility being the biggest laggard over the month, LSV's results detracted the most at the Fund level. US value manager Poplar struggled with both style headwinds and sector positioning, as well as poor stock specifics in the technology sector. Towle, also a US value manager, was a significant contributor, benefiting from its bias towards smaller and higher risk stocks. Maj Invest, a global value manager, also outperformed due to similar positioning. Momentum managers, both Lazard and Intech, continued benefiting from the established trend favouring profitability and growth and contributed accordingly.

Manager Changes

- Macquarie Investment Management (Macquarie) was removed from the Emerging Markets Equity building block in May. Macquarie's strategy does not align with SEI's alpha-source framework. Alpha refers to returns in excess of a given investment's benchmark. Active investment managers seek to exploit various factors or sources of alpha in order to add value.

Outlook

- The sudden and widespread stop in economic activity has never before been experienced on such a scale. The ultimate impact on GDP is truly anybody's guess. The first quarter of 2020 saw an annualised decline of 5% in the US. The second quarter will likely be one for the record books; as of

[3] "Consumer Spending Fell a Record 13.6% in April." The Wall Street Journal. 29 May 2020.

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late May, Wall Street economists forecasted a quarter-to-quarter annualised decline exceeding 30%.

- National governments have been quick to respond. All central banks are in crisis-fighting mode, having learned valuable lessons during the 2008-to-2009 great financial crisis, re-establishing unconventional bond-buying programmes and creating some new facilities to expand the types of accepted collateral in order to extend cash to companies in need of liquid assets.

- The Fed and other leading central banks have moved with an alacrity and forcefulness that we find commendable. But central banks cannot single-handedly support this economic shutdown. In our view, fiscal policy—in the form of direct income support, tax deferrals, loan guarantees, and outright bailouts of industries badly damaged by the halt of economic activity—must be the prime tool used to address this crisis.

- The fiscal response is occurring with a speed and decisiveness seldom seen in history. The US Congress passed a series of COVID-19 relief bills that easily topped 10% of GDP. Other developed countries have pursued a similar strategy of massive income support and liquidity injections. Italy, the European epicentre of the virus, will be particularly hard-pressed to do all that is necessary to stabilise its economy; its government debt-to-GDP ratio is already well above that of other major European countries[4].

- In our view, a financial crisis can be averted in Europe if the ECB backs up the debt. This is now-or-never time for the EU and eurozone. The stronger countries must come to the aid of the weaker, or else face an intensified popular backlash that could threaten the unity of the economic zone.

- The onslaught of developments presented by the spread of COVID-19 has forced financial markets to recalibrate prices sharply as expectations about different industries and the overall economy shift quickly. Investors should gain some reassurance, however, from the fact that an earnings recession caused by virus-containment measures is generally only expected to last a couple quarters or so. If market prices are based on a long-term, multi-year expectation, then this fallout should represent a relatively small part of the market's forward-looking focus.

- Only time will tell whether markets have sufficiently discounted the pain that lies ahead. Investors should be cognisant of the fact that earnings estimates will likely come down hard over the next two quarters. These waterfall declines in earnings could still drag equities down with them. It all depends on how willing investors are to look beyond the valley. Markets should prove resilient if there is a common belief that fiscal and monetary responses to the crisis thus far will successfully prop up the global economy.

- Right now, as always, we are focused on trying to deliver as diversified a portfolio as possible to all of our investors, regardless of their risk tolerances. We're considering the known risks inherent to the capital markets as well as the uncertainty that comes with any long-term investing plan, such as the black swan we've encountered in 2020.

- At SEI, we build and maintain long-term-oriented portfolios by being attuned to evolving relationships between asset classes. SEI views its strategies as robust and built to handle the kinds of challenges presented in today's environment. At a portfolio level, we encourage investors to stay diversified and avoid short-term trading in these volatile markets.

[4] "Government debt down to 86.1% of GDP in euro area." Eurostat. 21 January 2020.

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