SEI UK Strategic Portfolios: August 2021 Monthly Commentary

Economically sensitive fixed income and equities outperform in August; markets continue to fret over the potential for negative impacts from the Pandemic

Executive Summary

- Investor risk appetite increased in most corners of the world during August. Equities delivered strong performance in developed and emerging markets alike, led by Japan and the US within the major economies. European and UK shares also posted healthy returns, while China and Hong Kong were slightly down for the month. Globally, the financial sector was the top performer, while materials lagged with a modest decline.

- Bonds were mostly a bit lower, aside from higher-risk segments like high-yield and emerging-market debt, as rates increased around the world. Short- to medium-term rates trailed the advance across the gilt yield curve, while they led the climb in Eurozone government bonds. Intermediate-term US Treasury rates rose by more than short- and long-term rates.

- The US dollar strengthened (according to the DXY Index), peaking in mid-August before giving back a majority of the month's advance. Prices were down across West-Texas Intermediate and Brent crude oil in August as OPEC+ (the Organization of the Petroleum Exporting Countries led by Saudi Arabia, plus Russia) continued to ramp up production.

- Inflation-sensitive assets were subdued during the month. The Bloomberg Commodity Index registered a small loss in US dollar terms, and the decline in US Treasury Inflation Protected Securities (TIPS) essentially matched the slide in US Treasurys of comparable maturities.

- Considering the more Stability-Focused Strategic Portfolios, allocations to US High Yield Fixed Income and Emerging Market Debt provided a meaningful positive contribution, while investment grade fixed income was challenged. The Global Managed Volatility Equities asset class provided a positive absolute return but detracted modestly on a relative return basis.

- For the Growth-Focused Strategic Portfolios, SEI is sticking to the ongoing narrative, continuing to favour exposure to value and small size, in the firm belief that the valuation-focused approach is one of the best long-term sources of strong relative return. As the great investor Benjamin Graham once suggested, sun-hats are best bought in the winter, when the price is low. Given the current market valuation dynamics, as well as the highly likely event that the pandemic will eventually pass, SEI will continue to take this approach.

- While the mid-June through August retreat from this area had a negative impact on short-term relative return, on a year-to-date and one-year basis this position is still adding meaningful value. SEI's view is that there is a significant relative return opportunity associated with the value-biased positioning, however as we keep reiterating, it will not be delivered in a straight line.

- SEI's indicators, such as valuation dispersion, even after the beginnings of this 'Great Rotation', continue to exhibit some of the highest readings ever. In SEI's view, what is normally seen as a once-in-a-generation opportunity continues to represent a once-in-a-lifetime opportunity, and for the medium to long term investor, there should be plenty left in the tank in terms of positive relative return from this positioning.

- SEI further believes that the post-crisis environment may provide further support for this positioning, given the huge stimulus either being provided or under discussion and the potential for inflationary impacts. Flare-ups in concerns around the pandemic are likely to be counterproductive but from an investment point of view, SEI would urge investors to stay invested and try to look past this.

Market Overview

- The Bank of England's (BOE) Monetary Policy Committee (MPC) voted in early August to maintain its policy path: the bank rate remained 0.1% and the maximum allowance for asset purchases was unchanged at £895 billion.

- UK manufacturing activity continued to rapidly expand at a pace in August that was in line with July's levels, although supply-chain issues worsened (with average supplier lead times at their longest-recorded levels aside from April 2020's early COVID-19-induced bottlenecks) even as output improved[1]. Services growth also remained strong in the UK during August, but was well below the torrid pace that defined most of the first half of 2021[2]. The UK claimant count (which calculates the number of people claiming Jobseeker's Allowance) held at 5.7% of the population in July as the total number of claimants decreased from 2.30 million to 2.29 million.

- The broad UK economy grew by 4.8% during the second quarter and 22.2% year over year, up from -1.6% and -6.1%, respectively, during the prior quarter.

- The European Central Bank (ECB) did not convene a meeting on monetary policy during August. During July, however, the central bank unveiled the results of a strategy review in which it adopted a symmetric inflation target of 2% over the medium-term (meaning that it views deviations above or below its target as undesirable) and an acknowledgement that it anticipates fluctuations over shorter time frames.

- Manufacturing growth in the Eurozone continued to ease in August from its June record high, but still registered extraordinary strength[3]. Relative country-level prospects narrowed as fast-growing countries (Netherlands, Ireland, Germany and Austria) moderated to multi-month lows, while slower growers (Italy, Spain and Greece) improved to multi-month highs, although France remained mired in slower growth.

- Eurozone services activity in August held just below July's record pace of expansion (dating back to June 2006)[4]. The Eurozone unemployment rate declined to 7.6% in July from 7.8% in June. The overall Eurozone economy grew by 2.0% during the second quarter and 13.6% year over year, representing a marked improvement over the first quarter's respective rates of -0.3% and -1.3%.

- The Infrastructure Investment and Jobs Act slipped off the front pages as August progressed. Scheduled US congressional summer recesses and a near-universal occupation with the strained US withdrawal from

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[1] IHS Markit / CIPS UK Manufacturing PMI. 1 September 2021.

[2] IHS Markit / CIPS Flash UK Composite PMI. 23 August 2021.

[3] IHS Markit Eurozone Manufacturing PMI – final data. 1 September 2021.

[4] IHS Markit Flash Eurozone PMI. 23 August 2021.

Afghanistan dominated priorities in Washington, DC. The final end-of-August departure of US military troops concluded 20 years of military operations in Afghanistan.

- The US Federal Open Market Committee (FOMC) also held no formal monetary policy meeting during August. Federal Reserve (Fed) Chairman Jerome Powell spoke at the Federal Reserve Bank of Kansas City's annual economic symposium in Jackson Hole to reinforce that the FOMC could begin to taper, or reduce, asset purchases this year. The FOMC currently purchases $80 billion in US Treasurys and $40 billion in agency mortgage-backed securities per month.

- US manufacturing activity softened in August, but remained in red-hot growth territory. New orders and production jumped, backlogs lengthened, and price pressures intensified, while employment contracted modestly[5]. Services growth was strong in the US during August, but continued to mirror the UK's softening trajectory following a remarkable period of expansion[6]. New claims for US jobless benefits trended toward 350,000 per week during August, spending an entire month below 400,000 for the first time since March 2020. Overall US economic growth measured an annualised 6.6% during the second quarter, just above the first-quarter pace of 6.3%.

Selected Asset Class Commentary

- **US High Yield Fixed Income Asset Class:** Ares Management gained on selection within energy and telecommunications. Brigade Capital Management contributed due to positive security selection within basic industry and media. JP Morgan Investment Management registered favourable performance due to selection within healthcare and utilities. T. Rowe Price detracted due to poor selection within basic industry and energy. Benefit Street Partners struggled on poor selection within services and capital goods.

- **Global Managed Volatility Equities Asset Class:** During the month, the asset class' underweight to large-cap technology hurt performance. An overweight to defensive areas of the market, such as consumer staples and utilities, further detracted. LSV Asset Management's value orientation and underweight to large-cap technology stocks hindered returns. Acadian Asset Management gained on a more-balanced exposures to profitable, higher quality growth stocks within low volatility. Acadian's selection within biotechnology companies enhanced returns.

- **Global Equities Asset Class:** The asset class underperformed the benchmark, predominantly due to its overweight to Value. Among the negative contributors, no single manager stood out, with Poplar, Maj Invest, SNAM, and Towle, all suffering from their underlying value alpha source. SEI's view remains steadfast; value investing presents a significant opportunity for those that believe the world will move past the Coronavirus crisis. Lazard benefited from favorable Momentum themes, as longer term trends supporting growth stocks regained traction. The manager participated in the alpha source accordingly, with excess returns coming mainly from selection within the US market, with both the long and short sides capturing alpha.

Manager Changes

- N/A

[5] IHS Markit U.S. Manufacturing PMI. 1 September 2021.

[6] IHS Markit Flash U.S. Composite PMI. 23 August 2021.

Outlook

- Equity markets have long anticipated the economic improvement we now are watching unfold. There is increasing concern, however, that equity prices have risen so much that there is little appreciation potential left, even if the global economy continues to forge ahead into 2022.
- The last couple of months have witnessed a partial unwinding of the rotation trade that began last autumn. So far, this appears to us as a temporary pause in a longer-term upswing. The global recovery and expansion have a long way to go, especially since many countries are still imposing lockdown measures to varying degrees.
- In today's environment, with economies opening up and interest rates still at extraordinarily low levels, the dominant trend favours further price gains over the next year or two. Still, investors must take into account that the US economy appears to have reached "peak growth."
- In the meantime, companies are expected to enjoy a great deal of pricing power and will almost certainly pass along at least a portion of their increased costs to customers. Unfortunately, one person's pricing power is another person's inflation. The big question is whether the price pressures seen this year are transitory, as central bankers around the world say they are.
- Investors in the bond market seem to agree with the central bankers. Although US bond yields rose sharply in the first quarter, they have fallen over the past three months. There's no telling how long bond investors will maintain such a calm perspective if prices keep rising at a pace that has not been seen in almost 30 years.
- The recent stumble in the rotation theme was exacerbated by the shift in Fed expectations. It is clear, however, that the US central bank will be cautiously moving away from its current policy stance. The first move will likely be the tapering of its bond-buying programme, which may be announced in late August at the annual Jackson Hole conference, with actual tapering beginning in the first quarter of 2022 at the earliest.
- The path of US fiscal policy is harder to decipher given strained bipartisanship and the narrowness of the Democratic majority in the Congress. A traditional infrastructure bill is a good bet, but the push for non-traditional forms of infrastructure will depend on whether the Democrats in the Senate can come to terms with each other.
- The combination of (1) above-average economic growth, (2) significantly higher inflation than seen in the past decade (3) a fiscal policy that expands the size of federal government spending and (4) extreme monetary ease aimed at suppressing interest rates is the perfect backdrop for risk assets—and for the creation of speculative bubbles.
- We remain optimistic that the more cyclical and value-oriented areas within emerging markets will bounce back from their modest stumble in June. But there are near-term challenges besides the shift in perceptions about Fed policy and the future course of the US dollar and commodity prices. Credit growth has decelerated significantly in China, similar to the slowdowns recorded in 2013 and 2018, years when the performance of emerging markets was less than stellar.
- As vaccination rates slow in the developed world, more shots will be available for the rest of the world. We expect a rolling reopening of the global economy that will extend well into 2022. This wave of recovery could resemble a prolonged up-cycle that keeps the pressure on supply chains, leading to continued shortages of goods and labour. Investor faith in the "transitory inflation" narrative probably will be tested as we head into year end and enter 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 at 31 August 2021

Asset class performance discussed is based on the majority SEI fund underlying the asset class. This does not include analysis of the manager pools, hedged share class investments within SEI Funds, additional SEI funds or any third-party funds within the Strategic Portfolios. As a result, performance for the total asset class allocation may vary. Not all asset classes discussed are included in all Strategic Portfolios. All asset class comparative performance is relative to the benchmark of the specific SEI fund representing the majority of the asset class investment.

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