SEI UK Strategic Portfolios

SEI UK Strategic Portfolios: November 2020 Monthly Commentary

Vaccine news provides a boost for markets in November; specifically benefiting cyclical, undervalued segments

Executive Summary

- Despite a US presidential election that featured the highest turnout rate in 120 years, and 11th-hour negotiations between Europe and the UK as the real-and-final Brexit Day ticked ever closer, the most pivotal developments in November were the promising results of clinical trials for a short list of COVID-19 vaccines.

- The series of vaccine-related announcements injected great enthusiasm into equity markets around the world. European and UK shares led the way, with the MSCI Europe Index and MSCI United Kingdom Index posting their best one-month returns since 1975 and 1981, respectively.[1]

- Japanese equities had a record-breaking month as well, nearly doubling their *annualised* return over the last decade [According to the net performance of the MSCI Japan Index]. US shares also performed exceptionally well, but lagged most of the developed world. Emerging-market equities trailed developed markets, as China's relatively subdued returns masked a huge rally by Latin America, reversing their roles from October.

- UK and Eurozone government-bond rates increased across all maturities, led by intermediate-term rates. US Treasury rates fell slightly across most maturities, with the longest-term rates declining furthest. The West-Texas Intermediate crude-oil spot price rose by 27% during November[2], hitting the highest level since February after declining in late October as lockdowns were reintroduced.[3]

- Considering the Stability-Focused Strategic Portfolios, returns were boosted by stronger returns from economically sensitive debt, including corporate bonds, US high yield and emerging markets bonds. The Global managed volatility equities building block, consistent with its investment mandate, lagged in a rising market. However, it was able to deliver risk reduction over the period.

- For the Growth-Focused Strategic Portfolios, SEI continues 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 positive relative return. Despite strong returns from this segment of the market in November, SEI's indicators, such as valuation dispersion, exhibit the highest readings ever. In SEI's view, a once-in-a-generation opportunity is turning out to

[1] Source, Source: SEI Data Portal

[2] Source, SEI

[3] Source: The Wall Street Journal Market Data.

be an once-in-a-lifetime opportunity, and 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, the potential for inflationary impacts, and the increasing likelihood for a vaccine sooner rather than later. Crucially, where there have been sell-offs in recent times, it looks to be in evidence that this positioning has potential for meaningful downside protection, should markets enter into a more protracted downward leg.

Market Overview

- UK manufacturing growth strengthened in November, accelerating after cooling off in September and October. An early report of UK services activity showed October's modest growth giving way to a contraction in November. UK mortgage lending declined in October; but at £4.29 billion, it represented the second highest figure since March. Meanwhile, UK consumer credit contracted by £590 million in October, the second straight monthly decline. The overall UK economy grew by 15.5% during the third quarter, but contracted by 9.6% year over year[4].

- The Bank of England's Monetary Policy Committee expanded its quantitative-easing programme at its early-November meeting, committing a fresh £150 billion toward bond purchases for a total of £895 billion. The Committee's latest quarterly report projected that the UK economy could contract by 11% in 2020, a deterioration from the 5.4% contraction estimated a quarter ago[5].

- Negotiations between the UK and EU over a post-Brexit trade agreement were being conducted face-to-face in London at the end of November. At this point, even if both sides agreed to a deal, there would no longer be adequate time for it to be approved by each government's respective parliament and then implemented by 1 January without creating disruptions. The sticking points remained on fishing rights, state aid to businesses, and cross-border dispute resolution.

- Eurozone manufacturing growth remained healthy in November, despite easing from October's pace. The Eurozone services sector contracted further in November, according to a preliminary report. Growth in loans to non-financial corporations dipped below 7% in October for the first time since April. The overall Eurozone economy grew by 12.6% during the third quarter, but contracted by 4.4% year over year.

- The US general election produced a rebuke of Donald Trump's administration. Former Vice President Joe Biden was declared the winner of the presidential race in early November by the Associated Press, which serves as the traditional, if not formal, arbiter of US presidential election outcomes. A legal effort to alter the election's outcome remained unsuccessful through the end of November.

- US manufacturing growth continued at a robust pace in November, and an early report of services activity showed an acceleration of already-strong growth for the month. New US claims for unemployment benefits bottomed in early November to just above 700,000 applications per week, and then rose for two consecutive weeks. The overall US economy grew at a 33.1% annualised rate during the third quarter of 2020.

- The US Federal Open Market Committee (FOMC) made no changes at its early-November meeting. In the middle of the month, the US Department of the Treasury requested that the US Federal Reserve (Fed) extend four emergency lending facilities that had been established in March, yet also asked the central back to return $455 billion of unused funding for five other lending facilities. President-elect Biden named former Fed Chair Janet Yellen as his nominee for US Secretary of the Treasury.

---

[4] Source: Bloomberg Economic Calendar

[5] Sources: "Bank Rate held at 0.1% and asset purchases increased by £150bn - November 2020." Bank of England; and "Monetary Policy Report - November 2020." Bank of England.

Selected Asset Class Commentary

- **Global Opportunistic Fixed Income Asset Class:** The asset class benefited from its down-in-quality bias within corporate credit, which included off-benchmark exposure to high-yield bonds. AllianceBernstein gained on favourable exposure to off-benchmark corporate credit and CRTs. Schroder Investment Management's overweight to BBB rated securities helped, as did selection within communications, consumer non-cyclicals and energy. JP Morgan benefited from overweight's to credit beta and BBBs. Selection within banks, consumer non-cyclicals, transportation and energy further contributed. Wellington's global government-related mandate struggled on overweight's to UK and core European rates and a US steepened position.

- **Global Equities Asset Class:** The asset class' pro-cyclical positioning added to returns in November. Fundamental value managers performed well during the month. Momentum and stability managers partially mitigated outperformance. Value managers were attracted to cyclical stocks, which experienced the largest rebound. Metropole Gestion was the strongest contributor. Metropole's portfolio was already full of inexpensive, albeit controversial names, and earlier in the year, they further rotated into the beaten down segments of the market. Metropole particularly benefited from allocations to financials and energy. Financials and energy also drove Poplar Forest Capital's outperformance in US equities. Towle & Co, a US small cap value manager enjoyed additional tailwinds from their size positioning. Although Jupiter Asset Management and Maj Invest also outperformed, their results were muted due to quality and profitability inputs. Momentum managers suffered the most in November during a momentum crash. All momentum and stability managers lagged. Lazard Asset Management was a notable detractor. The manager's positions detracted across all sectors, with the exception of financials. The asset class' maximum underweight position on momentum managers was detrimental over the last year, but was beneficial over the month.

- **Emerging Markets Equities Asset Class:** During the month, the asset class benefited from an underweight to recent high-flying stocks and its preference for cyclicals. RWC Asset Advisors gained on solid selection in China, where exposure to online retailing and auto companies contributed. Neuberger Berman outperformed expectations as stability lagged during the month as value rotated into the lead. Selection within India and an underweight to Chinese online retailing stocks helped. KBI Investors benefited from tailwinds to value and dividend yield as markets rotated out of growth, momentum and stability. Qtron was the lone detractor during the month. The manager struggled on poor selection across a range of sectors, especially financials.

Manager Changes

- Acadian Asset Management (Acadian) was added to the US Large Companies building block in November 2020. Acadian's strategy takes a momentum-oriented approach that incorporates top-down and bottom-up elements. The team's investment process is quantitative in nature and focuses on drivers of outperformance for the momentum alpha source. We believe the team is well resourced and has deep experience. We expect Acadian's strategy to complement the manager line-ups within the building block.

- AJO, L.P. (AJO) was removed from the US Large Companies building block in November 2020. AJO announced that it would be closing after year-end. According to a memo from firm founder Ted Aronson, trading will cease 30 November 2020 and the firm will wind down by 31 December 2020.[6]

[6] Source, SEI

Outlook

- It has already been an eventful and exhausting year, but in SEI's view, the next few months could prove critical to the future course of the global economy and financial markets. Most countries were in V-shaped recovery mode during the third quarter, moving sharply off their low points in May and June.

- The latest round of lockdowns to contain COVID-19 outbreaks appear more limited in scope than those instituted earlier this year. For developed countries, virus treatments have improved, vulnerable populations appear to be better protected, and younger, generally healthier people have started to account for a much larger share of confirmed new cases.

- Despite these positive developments, SEI doubts there will be a full return to normal economic behaviour until safe and effective vaccines are approved and distributed globally. The news on this score has also been favourable, and probably is a key reason for the continued buoyancy of equities and other risk assets.

- There is no disputing that US economic activity remains far below normal. Although incomes have been recovering as more people returned to work, the lack of additional income support may be a drag on consumer spending in the final months of the year. Business sentiment appears to have bottomed, but the outlook remains sufficiently uncertain to keep us in a watch-and-wait mode.

- In August, Fed Chairman Jerome Powell officially unveiled a new framework for conducting the central bank's monetary policy. The Fed has decided to see how low the US unemployment rate can get before it causes the inflation rate to exceed the 2% mark by a meaningful extent. It may be a long time before the federal-funds rate rises, as the FOMC's own projection does not envision a return to 2% inflation until the end of its forecast window in 2023.

- In SEI's view, all that is really left in the Fed's monetary toolbox is quantitative easing, along with the provision of lifeline support to corporations as well as state and local governments through its various credit facilities. Monetisation of debt will likely continue until the pandemic crisis is in the distant past and the US unemployment rate approaches its previous lows.

- The ongoing UK-EU trade negotiations have created a unique political melodrama; a hard Brexit would certainly not help matters. But the worst possible impact of a no-deal divorce, and subsequent reversion to the World Trade Organization's (WTO) most-favoured-nation trading rules, would likely be sustained by financial companies and other service-producing entities as WTO rules deal mostly with tradable goods. The increase in tariffs, for the most part, will be bearable once border-related issues are worked out. In the meantime, the UK and the rest of Europe are facing a second wave of COVID-19 that could turn what has been a V-shaped recovery into something looking more like a W.

- This year's pandemic and postponement of the summer Olympics proved to be a bitter ending to Japanese Prime Minister Shinzo Abe's record-breaking term in office. His push to lift Japan out of its deflationary spiral was somewhat successful. Prices mostly stopped declining in the aggregate, but there were few occasions when overall consumer-price inflation rose above 1%. Pandemic pressures have caused a return to outright deflation in recent months.

- In our view, it is unlikely that radical changes will be made to the direction of policy under Japan's new Prime Minister Yoshihide Suga. In the near-term, the priority will be on the response to the coronavirus; fiscal policy will remain quite expansionary. The BOJ will continue to buy most of the government-issued bonds along with other types of corporate debt and equity as part of its Quantitative and Qualitative Easing programme over the past four years.

- Emerging markets are already showing some good news. The price of raw industrials has moved sharply higher since bottoming in early May. It's a good bet that emerging-market corporate profits will also rise sharply if industrial commodity prices advance in a sustained, multi-year fashion as they have in previous cycles.

- From a positioning point of view, the positive results reported by vaccine makers are encouraging for the outlook of the global economy, and investors have been looking across the valley of troubling rises in COVID-19 cases and hospitalizations in their repricing of cyclical stocks.

- Clients should continue to keep in mind that short-term performance can be noisy, we would much prefer to study and reflect on longer periods of time than days and weeks, but as the financial media frames high-level narratives around it, there are important nuances often overlooked which can and do have varying impacts on our funds.

- These developments forming in the equity markets are certainly encouraging for how a majority of our equity building blocks are constructed and positioned, but a full manifestation of the so-called “Great Rotation” is still somewhat speculative at this stage. To be sure, we are seeing a nascent relative recovery in many of the stocks that were left behind at the start of the pandemic, which may in hindsight mark the beginning of a true style rotation.

- There are still risks related to the virus and its impact on the global economy, but the positive news on the vaccine front should foster fuller economic reopening’s and eventually a return to pre-pandemic levels of activity.

- As virus-related risks ease, we could see a gradual build in favourable sentiment towards cyclical and value stocks and a refocus by investors on fundamentals and valuations. This would give us more confidence that a secular style change could be underway. Keeping an eye on the medium term, however, gives SEI strong conviction that these positions will ultimately pay off for our clients, and we would encourage our clients to continue to invest with a time horizons that correspond with their investment goals.

<u>Important Information on Performance</u>

Past Performance is not a reliable indicator of future results. Standardised performance is available upon request. All data is as at 30 November 2020.

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.

<u>Important Information</u>

This material is not directed to any persons where (by reason of that person's nationality, residence or otherwise) the publication or availability of this material is prohibited. Persons in respect of whom such prohibitions apply must not rely on this information in any respect whatsoever. Investment in the funds or products described herein are available only to intended recipients and this communication must not be relied or acted upon by anyone who is not an intended recipient.

Whilst considerable care has been taken to ensure the information contained within this document is accurate and up-to-date, no warranty is given as to the accuracy or completeness of any information and no liability is accepted for any errors or omissions in such information or any action taken on the basis of this information.

The SEI Strategic Portfolios are a series of the SEI Funds and may invest in a combination of other SEI and Third-Party Funds as well as in additional manager pools based on asset classes. These manager pools are pools of assets from the respective Strategic Portfolio separately managed by Portfolio Managers which are monitored by SEI. One cannot directly invest in these manager pools.

SEI Investments (Europe) Limited acts as distributor of collective investment schemes which are authorised in Ireland pursuant to the UCITS regulations and which are collectively referred to as the "SEI Funds" in these materials. These umbrella funds are incorporated in Ireland as limited liability investment companies and are managed by SEI Investments Global, Limited, an affiliate of the distributor. SEI Investments (Europe) Limited utilises the SEI Funds in its asset management programme to create asset allocation strategies for its clients.

Reference in this document to any SEI Funds should not be construed as a recommendation to buy or sell these securities or to engage in any related investment management services. Recipients of this information who intend to apply for shares in any SEI Fund are reminded that any such application must be made solely on the basis of the information contained in the Prospectus (which includes a schedule of fees and charges and maximum commission available). Commissions and incentives may be paid and if so, would be included in the overall costs.

A copy of the Prospectus can be obtained by contacting your Financial Advisor, SEI Relationship Manager or using the contact details below.

Investments in SEI Funds are generally medium to long term investments. The value of an investment and any income from it can go down as well as up. Fluctuations or movements in exchange rates may cause the value of underlying internal investments to go up or down. Investors may not get back the original amount invested. SEI Funds may use derivative instruments which may be used for hedging purposes and/or investment purposes. **This material represents an assessment of the market environment at a specific point in time and is not intended to be a forecast of future events.**

The risks described below may apply to the underlying assets of the products into which the Strategic Portfolios invest:
Investment in equity securities in general are subject to market risks that may cause their prices to fluctuate over time.

- Fixed income securities are subject to credit risk and may also be subject to price volatility and may be sensitive to interest rate fluctuations.

- 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.

The Funds are denominated in one currency but may hold assets priced in other currencies. The performance of the Fund may therefore rise and fall as a result of exchange rate fluctuations.

This information is issued by SEI Investments (Europe) Limited ("SIEL"), 1st Floor, Alphabeta, 14-18 Finsbury Square, London EC2A 1BR. This document and its contents are directed only at persons who have been classified by SIEL as a Professional Client for the purposes of the FCA Conduct of Business Sourcebook. SIEL is authorised and regulated by the Financial Conduct Authority.

SEI sources data directly from FactSet, Lipper, and BlackRock, unless otherwise stated.