

# Markets Diverge on Geopolitical Unknowns

## Monthly Snapshot

- › Volatility continued in November, with mixed performance across capital markets. UK and European stocks struggled amid ongoing Brexit uncertainty, while Latin American equities lagged all other regions; US and Asia-Pacific stocks gained on the possibility of a US-China trade-war ceasefire (in US dollar terms).
- › European leaders finally signed a Brexit agreement and the US Federal Reserve released a financial stability report that named the greatest risks to the country's financial system.
- › In such times of market volatility and geopolitical uncertainty, we believe that investors are best served by maintaining a diversified approach and focusing on their long-term investment strategy.

## Economic Backdrop

Volatility continued in November, with mixed performance across capital markets. UK and European stocks registered poor performance amid ongoing Brexit uncertainty, while Latin America reversed course as it posted the worst regional performance in November after outpacing the rest of the world last month. US and Asia-Pacific stocks gained on a possible respite from trade-war concerns ahead of early-December talks between US President Donald Trump and Chinese President Xi Jinping at the Group of 20 (G-20) summit in Argentina; the two leaders ultimately agreed to a temporary trade-war truce calling for the US to postpone tariff increases in exchange for China's commitment to purchase a substantial (but yet-to-be-determined) amount of US agricultural, energy and industrial products in order to reduce the huge US trade deficit with China.

Riskier fixed-income segments such as high-yield and emerging-market debt (foreign-currency-denominated) once again lagged the broader market along with investment-grade bonds. (Local-currency emerging-market debt performed well.) However, in a reversal from the prior month, UK and EU government bond yields increased in November (yields move inversely to prices); the yield on the 10-year US Treasury note moved lower for the month. West Texas Intermediate crude-oil prices tumbled further from their early-October peak, descending by 22% in November.

European leaders finally signed an agreement in November after more than two years of negotiations, officially outlining the terms of the UK's divorce from the EU. If it passes EU and UK parliamentary votes next month, the two sides will enter a 21-month post-Brexit standstill on 29 March during which they will negotiate future trade and security provisions. The treaty also includes a solution to avoid a hard border on Northern Ireland, allowing it to remain in the EU's single market and customs union. An additional non-binding document indicates an agreement to maintain strong economic ties between the UK and EU—yet prohibits UK manufacturers from gaining unrestricted access to the EU's single market; it also calls for close security cooperation.

While reaching a divorce agreement was a significant breakthrough, UK Prime Minister Theresa May must still secure support from sceptical members of Parliament—a particularly difficult task as the treaty includes a range of compromises that have elicited criticism across political affiliations.

## Key Measures: November 2018

EQUITY	
Dow Jones Industrial Average	2.11% ↑
S&P 500 Index	2.04% ↑
NASDAQ Composite Index	0.49% ↑
MSCI ACWI Index (Net)	1.46% ↑
BOND	
Bloomberg Barclays Global Aggregate Index	0.31% ↑
VOLATILITY	
Chicago Board Options Exchange Volatility Index	18.07 ↓
PRIOR MONTH: 21.23	
OIL	
WTI Cushing crude oil prices	\$50.93 ↓
PRIOR MONTH: \$65.31	
CURRENCIES	
Sterling vs. US dollar	\$1.27 ↓
Euro vs. US dollar	\$1.13 =
US dollar vs. yen	¥113.55 ↑

Sources: Bloomberg, FactSet, Lipper

Failure to secure backing from lawmakers before Brexit occurs on 29 March, as scheduled, could result in significant trade and security disruptions between the UK and EU.

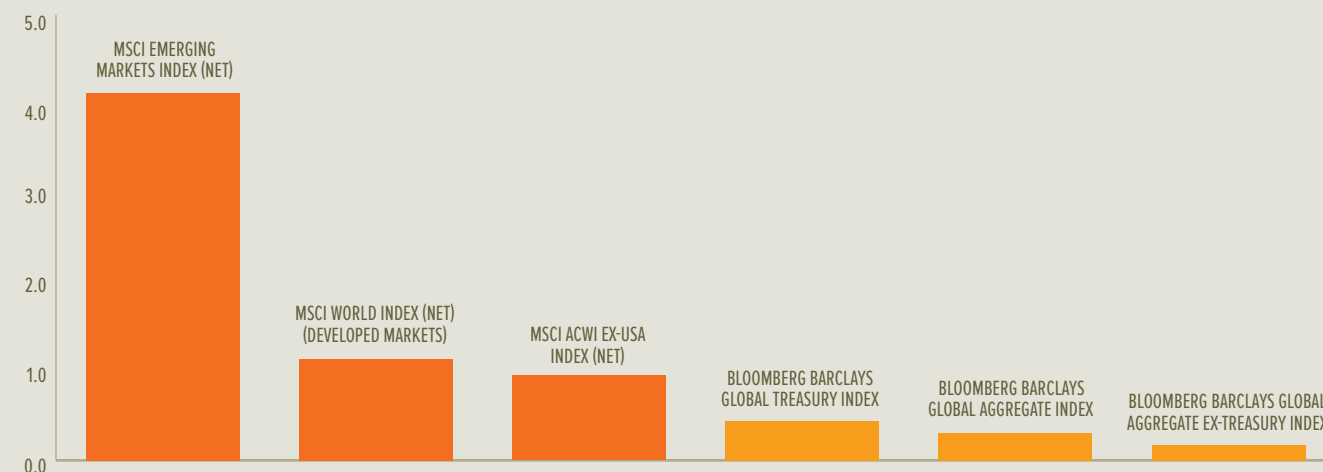
In the US, the Federal Reserve (Fed) released a financial stability report toward the end of the month, citing the biggest risks facing the country's financial system: increased asset prices; historically elevated debt burdens for US businesses; and rising issuance of higher-risk bonds. The report also noted that potential shocks to the US economy—such as indirect effects of Brexit fallout, slowing growth in emerging markets (particularly China), or ongoing trade tensions—could further test the country's financial system. The US-China trade detente in early December came days after the Fed's report was released.

None of the world's major central banks, with the exception of the Fed, held monetary-policy meetings in November; each is scheduled to reconvene in mid-to-late December. The European Central Bank (ECB) released its meeting minutes from the prior month, which stated that recent economic data for the region remained in line with broad-based economic expansion despite weaker-than-anticipated reports; the minutes also reiterated the ECB's intention to end net asset purchases before the end of the year. In the US, the Federal Open Market Committee maintained its federal-funds rate and confirmed that inflation sits near 2% amid strong jobs growth and consumer spending, yet noted moderating business investment. The Fed remains widely expected to hike rates in December.

UK manufacturing beat expectations in November, expanding by two points from the 27-month low recorded in October, yet remained one of the slowest monthly paces recorded in the past two-and-a-half years. Construction growth also fared better than anticipated in November, hitting the highest point since July of this year. Labour-market conditions appeared mixed in the latest report: claimant-count unemployment increased by 0.1% to 2.7% in October; the July-to-September unemployment rate ticked 0.1% higher from the prior reporting period to 4.1%; average year-over-year earnings growth increased by 0.2% to 3.0% over the same three-month period.

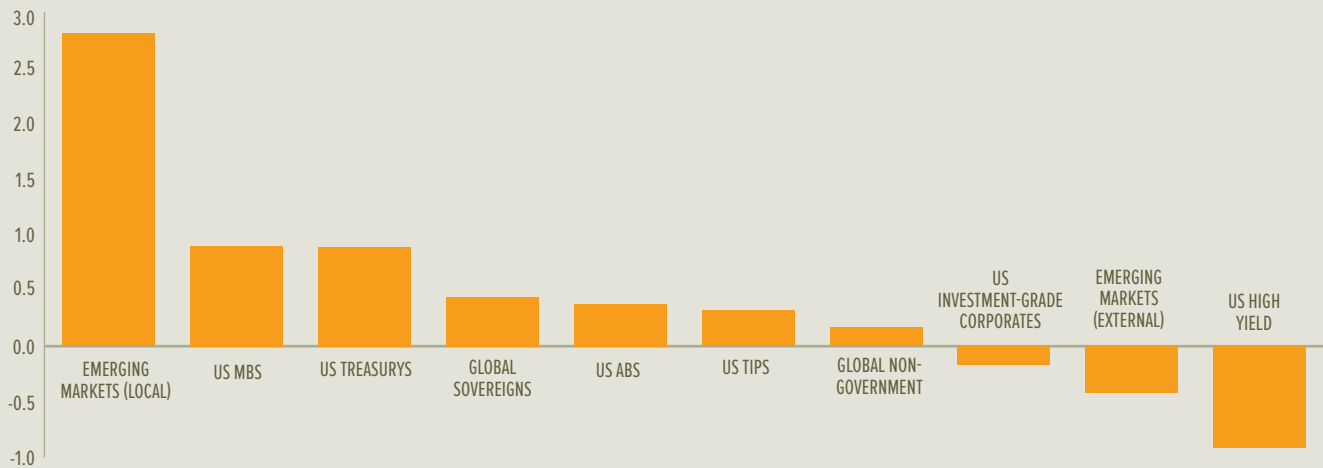
## Major Index Performance in November 2018 (Percent Return)

■ FIXED INCOME ■ EQUITIES



Sources: FactSet, Lipper. See "Corresponding Indexes for Major Index Performance Exhibit" in the Index Descriptions section for more information.

## Fixed-Income Performance in November 2018 (Percent Return)



Sources: FactSet, Lipper. See “Corresponding Indexes for Fixed-Income Performance Exhibit” in the Index Descriptions section for more information.

Eurozone business activity softened further in November, with manufacturing growth picking up by less than expected (with output registering its worst reading in about 65 months) and services growth shrinking to a 25-month low. Unemployment increased so minimally that the rate held steady at 8.1% in October; joblessness in Italy surged, offsetting improvements France, Germany and Spain. The second estimate of overall economic conditions was unchanged, showing eurozone gross domestic product (GDP) expanding by 0.2% in the third quarter and 1.7% year over year—a deceleration over both periods and the slowest quarterly pace since the three-month period ending September 2014.

US manufacturing was depicted in mixed reports as healthy in November, either accelerating to an unusually strong pace or softening slightly to a still-solid rate of expansion. Services-sector growth appeared to moderate in November, according to preliminary reporting. The core personal consumption expenditures price index registered a lower-than-expected 0.1% gain in October, falling below the Fed’s target inflation level with a year-over-year increase of 1.8%. Payrolls increased in November, and average hourly earnings grew by 3.1% year over year, as the unemployment rate remained at a 49-year low. The US economy grew at a slower but still-strong 3.5% annualised rate for the third quarter, according to an unrevised second estimate.

### Our View

The ratcheting-up of trade-war tensions between the US and China has remained the number-one preoccupation of investors. And with good reason: Whatever happens between the two countries has global implications. China and the US together accounted for 42% of world nominal GDP last year. So, when Trump and Xi agreed to a ceasefire, it makes sense that markets around the world breathed a collective (if temporary) sigh of relief—particularly in Asia and other emerging markets, which tend to have trade-dependent economies.

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While China’s currency soared higher immediately after news of the agreement, it remains far lower than the US dollar and versus a broader basket of currencies compared to its level before trade tensions arose. The weaker currency has partially offset the impact from tariffs already imposed by the US, while the competitiveness of Chinese exporters against other countries has improved as a result of this year’s devaluation.

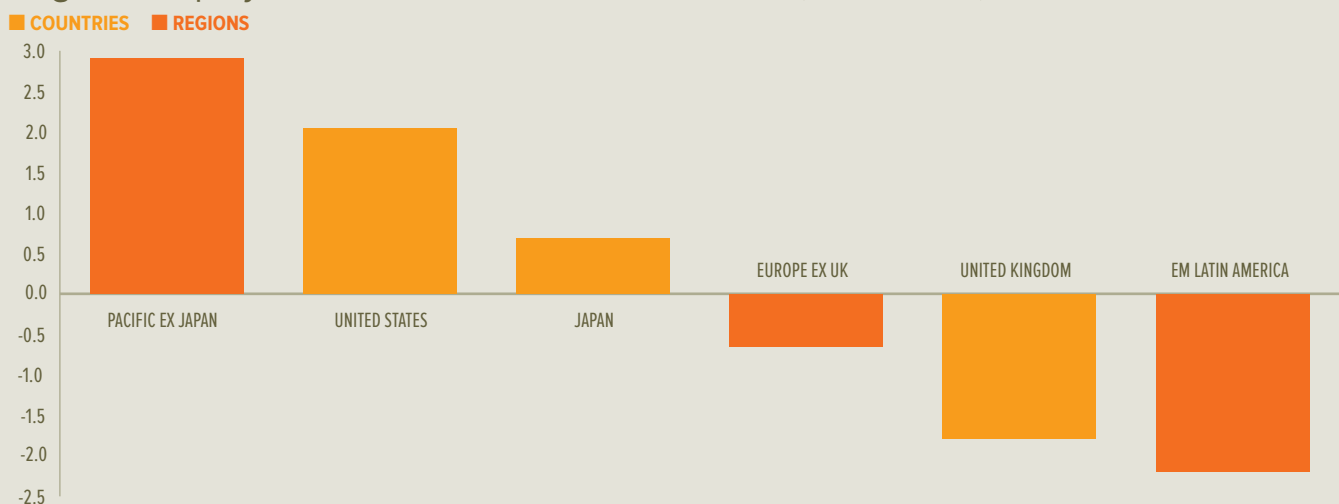
The US is still in strong shape economically—but nobody wins in a trade war. Even White House advisors with a pro-trade bias do not expect the US to come out unscathed if tit-for-tat tariffs between the two countries resume after a 90-day ceasefire.

Despite a near-term view that is fraught with uncertainty, we continue to believe in diversifying portfolios with emerging-market exposure. The alpha opportunities (that is, the ability to achieve returns in excess of benchmarks) also are much greater given the economic and political idiosyncrasies inherent in the asset class. The price-to-earnings ratio for the MSCI Emerging Markets Index is still running at a discount to that of the MSCI USA Index (as at 30 November 2018).

Before the trade war with China appeared set to cool at month end, the Trump administration had already turned more conciliatory toward other countries with which it had picked fights. Broad agreement has been reached with Mexico and Canada on the new trilateral United States-Mexico-Canada Agreement (USMCA), which replaces NAFTA (notwithstanding Mexico’s stipulation of being exempt from steel and aluminium tariffs); the proposed new agreement is now pending approval by the US Senate and House of Representatives. However, the threat of tariffs on European and Japanese autos and auto parts was reignited by the Trump administration ahead of formal negotiations due to start in January; we are hopeful that the White House realises that it’s better to gain allies in its battle against China than fight on multiple fronts.

In Europe, there are business-as-usual problems: sluggish economic growth, still-high unemployment and the never-ending disagreements over how expansive monetary policy should be. Europe also faces trade

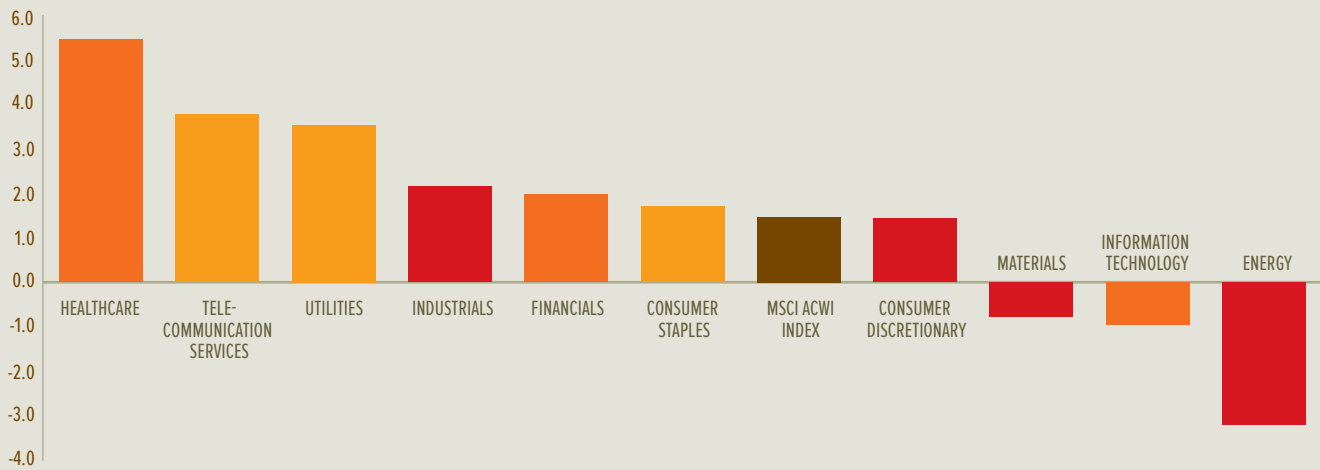
## Regional Equity Performance in November 2018 (Percent Return)



Sources: FactSet, Lipper. See “Corresponding Indexes for Regional Equity Performance Exhibit” in the Index Descriptions section for more information.

## Global Equity Sector Performance in November 2018 (Percent Return)

■ DEFENSIVES ■ BLENDS ■ CYCICALS



Sources: FactSet, Lipper. MSCI ACWI Index Sector Components (Cyclicality determined by SEI).

tensions of its own. The UK is far more dependent on the EU as an export market than the other way around. A “hard” Brexit would therefore severely affect the UK’s export of financial and other services (keep in mind that manufacturing accounts for only 10% of the UK’s GDP nowadays, while services account for 80%).

Although a last-minute agreement or a mighty kicking of the can down the road is possible, widespread fear of a hard Brexit is apparent in the economic data. The Organisation for Economic Co-operation and Development’s (OECD) leading economic indicators show that the UK has deteriorated more dramatically than any of the world’s other major developed economies.

As if the future departure of the EU’s second-largest member isn’t bad enough, Italian government-bond yields have risen sharply higher this year as the Lega/Five-Star coalition pushes to make good on some of its campaign promises. Italy is the third-largest eurozone economy, and has the fourth-largest debt-to-GDP ratio in the world. To say the least, a debt crisis in Italy would not be as easy to handle as the Greek one (which wasn’t all that easy).

A complicating factor for Italy and other highly-indebted countries is the tapering of asset purchases by the ECB. Since the program’s inception, the ECB’s purchases of Italian bonds equate to 53% of the country’s cumulative deficit (as at 30 September 2018), according to German think tank Centre for European Economic Research (ZEW). Italy will be losing a large price- and risk-insensitive buyer of its bonds at an inopportune time. The ECB is set to finish its taper at the end of the year.

Tax cuts, deregulation and strong revenue growth have provided an ideal backdrop for US equities to appreciate, but performance could be constrained if earnings estimates fade in light of increasing tariffs on tradable goods. Valuations also could fall if interest rates climb at a faster-than-expected pace. That said, we still think it’s premature to turn negative on the near-term US outlook given today’s mosaic of economic fundamentals. In our view, the risks to the US stock market are evenly balanced.

The multi-year persistence of high US corporate profit margins is unusual. Margins have spiked in the past two quarters, reflecting the impact of the US tax cut and the acceleration of sales growth. In the latter stages of an economic expansion, margins normally contract on a sustained basis as higher costs for labour, interest-expense and depreciation take a larger slice of the pie.

Besides uncertainty about trade tensions with China, we see the Fed as another, more traditional, major potential threat to the US equity bull market. The question is how high the federal-funds rate will ultimately go, and whether that level proves to be sufficient to keep inflation near the central bank's 2% target or turns out to be overkill. We agree with the Fed's view that the federal-funds rate is still below the so-called neutral rate of interest. Additional rate increases appear appropriate, as long as the Fed doesn't keep hiking after reaching the neutral rate—a level that has historically seen the stock market run into real trouble.

One can argue about whether the valuations embedded in the US equity market are high, especially when measured against other global stock markets, although earnings growth in the latter has been less robust. The extreme appreciation in some large technology companies also suggests that the US stock market could be subject to a sharp rotation from previous winners to the laggards somewhere down the road. SEI equity strategies certainly tilt in the direction of more value-oriented companies and industries.

Predicting the future is a hazardous venture most of the time. In view of the uncertainties presently facing investors, the prediction game is, perhaps, even more challenging. Accordingly, we believe in a diversified approach to investing. Although maintaining exposure to risk assets may feel uncomfortable, we believe that investors with long time horizons should know that mistiming entries and exits into and out of equities can be costly. Today, mistiming an exit is the greater concern.

## Standardised Performance

		1 year to 30-Nov-18	1 year to 30-Nov-17	1 year to 30-Nov-16	1 year to 30-Nov-15	1 year to 30-Nov-14
<b>KEY MEASURES</b>						
Dow Jones Industrial Average		7.62%	30.02%	10.91%	1.87%	13.42%
S&P 500 Index		6.27%	22.87%	8.06%	2.75%	16.86%
NASDAQ Composite Index		7.75%	30.55%	5.53%	7.86%	19.43%
MSCI ACWI Index (Net)		-0.98%	24.64%	3.68%	-2.49%	8.04%
Bloomberg Barclays Global Aggregate Index		-2.82%	6.53%	3.10%	-4.33%	0.68%
<b>MAJOR INDEX PERFORMANCE</b>						
Bloomberg Barclays Global Aggregate ex-Treasury Index		-2.86%	6.92%	2.57%	-3.79%	2.81%
Bloomberg Barclays Global Aggregate Index		-2.82%	6.53%	3.10%	-4.33%	0.68%
Bloomberg Barclays Global Treasury Index		-2.79%	6.20%	3.55%	-4.79%	-1.12%
MSCI ACWI ex-USA (Net)		-8.12%	27.59%	-0.03%	-7.32%	0.61%
MSCI Emerging Markets Index (Net)		-9.09%	32.82%	8.47%	-16.99%	1.06%
MSCI World Index (Net)		0.14%	23.66%	3.15%	-0.72%	8.91%
<b>FIXED-INCOME PERFORMANCE</b>						
US Treasury Inflation-Protected Securities (TIPS)	Bloomberg Barclays 1-10 Year U.S. TIPS Index	-0.18%	1.52%	3.28%	-1.46%	1.21%
Global Non-Government	Bloomberg Barclays Global Aggregate ex-Treasury Index	-2.86%	6.92%	2.57%	-3.79%	2.81%
Global Sovereigns	Bloomberg Barclays Global Treasury Index	-2.79%	6.20%	3.55%	-4.79%	-1.12%
US Investment-Grade Corporates	Bloomberg Barclays U.S. Corporate Investment Grade Index	-3.04%	6.16%	4.58%	0.16%	7.22%
US Asset-Backed Securities (ABS)	Bloomberg Barclays U.S. Asset-Backed Securities Index	1.00%	1.38%	1.98%	1.22%	1.88%
US Mortgage-Backed Securities (MBS)	Bloomberg Barclays U.S. Mortgage-Backed Securities Index	-0.49%	2.14%	1.64%	1.70%	5.42%
US Treasuries	Bloomberg Barclays U.S. Treasury Index	-0.96%	1.89%	0.98%	1.15%	3.95%
US High Yield	ICE BofAML US High Yield Constrained Index	0.22%	9.28%	12.25%	-3.53%	4.61%
Emerging Markets (External)	JPMorgan EMBI Global Diversified Index	-4.84%	10.91%	7.19%	0.24%	10.53%
Emerging Markets (Local)	JPMorgan GBI-EM Global Diversified Index	-5.55%	15.04%	5.52%	-18.14%	-0.33%
<b>REGIONAL EQUITY PERFORMANCE</b>						
United Kingdom	FTSE All-Share Index	-7.12%	22.81%	-8.89%	-3.26%	0.11%
EM Latin America	MSCI Emerging Markets Latin America Index (Net)	-1.62%	19.51%	24.35%	-34.54%	-5.83%
Europe ex UK	MSCI Europe ex UK Index (Net)	-10.54%	33.75%	-7.78%	-3.75%	0.38%
Pacific ex Japan	MSCI Pacific ex Japan Index (Net)	-5.09%	20.67%	10.82%	-12.67%	0.77%
United States	S&P 500 Index	6.27%	22.87%	8.06%	2.75%	16.86%
Japan	TOPIX, also known as the Tokyo Stock Price Index	-6.33%	26.79%	2.87%	9.92%	-1.40%
<b>GLOBAL EQUITY SECTOR PERFORMANCE</b>						
MSCI ACWI Index		-0.98%	24.64%	3.68%	-2.55%	8.04%
MSCI ACWI Consumer Discretionary Index		0.72%	23.91%	-0.72%	5.71%	6.11%
MSCI ACWI Consumer Staples Index		-2.43%	18.20%	-0.58%	1.67%	9.42%
MSCI ACWI Energy Index		-0.24%	5.89%	11.80%	-16.60%	-9.52%
MSCI ACWI Financials Index		-6.16%	25.41%	6.64%	-5.48%	5.95%
MSCI ACWI Healthcare Index		10.79%	21.72%	-6.80%	2.03%	22.43%
MSCI ACWI Industrials Index		-5.41%	24.08%	8.15%	-1.79%	4.46%
MSCI ACWI Information Technology Index		2.01%	43.05%	8.69%	3.77%	21.54%
MSCI ACWI Materials Index		-9.43%	26.24%	17.42%	-15.64%	-2.86%
MSCI ACWI Telecommunication Services Index		-3.61%	11.24%	-0.82%	-6.97%	5.89%
MSCI ACWI Utilities Index		-0.87%	23.52%	3.10%	-10.15%	15.00%

All references to performance are in US dollar terms unless otherwise noted. See Standardised Performance for more information.

## Glossary of Financial Terms

**Bull market:** A bull market refers to a market environment in which prices are generally rising (or are expected to do so) and investor confidence is high.

**Federal-funds rate:** The federal-funds rate is the interest rate at which a depository institution lends immediately available funds (balances at the US Federal Reserve) to another depository institution overnight in the US.

**Fundamentals:** Fundamentals refers to data that can be used to assess a country or company's financial health such as amount of debt, level of profitability, cash flow or inventory size.

## Index Descriptions

**MSCI World ex USA Index:** The MSCI World ex-USA Index is a free float-adjusted market-capitalisation-weighted index that is designed to measure the equity market performance of developed markets, excluding the US.

## Corresponding Indexes for Key Measures Exhibit

Dow Jones Industrial Average	The Dow Jones Industrial Average is a widely followed market indicator based on a price-weighted average of 30 blue-chip New York Stock Exchange stocks that are selected by editors of The Wall Street Journal.
NASDAQ Composite Index	The NASDAQ Composite Index is a market-value-weighted index of all common stocks listed on the National Association of Securities Dealers Automated Quotations (NASDAQ) system, representing a subset of the US equity market.
MSCI ACWI Index	The MSCI ACWI Index is a market-capitalisation-weighted index composed of over 2,000 companies, and is representative of the market structure of 46 developed- and emerging-market countries in North and South America, Europe, Africa and the Pacific Rim. The Index is calculated with net dividends reinvested in US dollars.
Bloomberg Barclays Global Aggregate Index	The Bloomberg Barclays Global Aggregate Index is an unmanaged market-capitalisation-weighted benchmark that tracks the performance of investment-grade fixed-income securities denominated in 13 currencies. The Index reflects reinvestment of all distributions and changes in market prices.
Chicago Board Options Exchange Volatility Index (VIX)	The Chicago Board Options Exchange Volatility Index (VIX) tracks the expected volatility in the S&P 500 Index over the next 30 days. A higher number indicates greater volatility.



## Corresponding Indexes for Major Index Performance Exhibit

MSCI ACWI ex-USA Index	The MSCI ACWI ex-USA Index includes both developed- and emerging-market countries, excluding the US.
MSCI Emerging Markets Index	The MSCI Emerging Markets Index is a free float-adjusted market-capitalisation-weighted index designed to measure the performance of global emerging-market equities.
MSCI World Index	The MSCI World Index is a free float-adjusted market-capitalisation-weighted index that is designed to measure the equity market performance of developed markets.
Bloomberg Barclays Global Aggregate Index	The Bloomberg Barclays Global Aggregate Index is an unmanaged market-capitalisation-weighted benchmark that tracks the performance of investment-grade fixed-income securities denominated in 13 currencies. The Index reflects reinvestment of all distributions and changes in market prices.
Bloomberg Barclays Global Aggregate ex-Treasury Index	The Bloomberg Barclays Global Aggregate ex-Treasury Index is an unmanaged market index representative of the total return performance of ex-Treasury major world bond markets.
Bloomberg Barclays Global Treasury Index	The Bloomberg Barclays Global Treasury Index is composed of those securities included in the Bloomberg Barclays Global Aggregate Index that are Treasury securities.

## Corresponding Indexes for Fixed-Income Performance Exhibit

US High Yield	BofA Merrill Lynch U.S. High Yield Master II Constrained Index
Global Sovereigns	Bloomberg Barclays Global Treasury Index
Global Non-Government	Bloomberg Barclays Global Aggregate ex-Treasury Index
Emerging Markets (Local)	JPMorgan GBI-EM Global Diversified Index
Emerging Markets (External)	JPMorgan EMBI Global Diversified Index
US Mortgage-Backed Securities (MBS)	Bloomberg Barclays U.S. Mortgage Backed Securities Index
US Asset-Backed Securities (ABS)	Bloomberg Barclays U.S. Asset-Backed Securities Index
US Treasuries	Bloomberg Barclays U.S. Treasury Index
US Treasury Inflation-Protected Securities (TIPS)	Bloomberg Barclays 1-10 Year U.S. TIPS Index
US Investment-Grade Corporates	Bloomberg Barclays U.S. Corporate Investment Grade Index

## Corresponding Indexes for Regional Equity Performance Exhibit

United States	S&P 500 Index
United Kingdom	FTSE All-Share Index
Pacific ex Japan	MSCI Pacific ex Japan Index (Net)
Japan	TOPIX, also known as the Tokyo Stock Price Index
Europe ex UK	MSCI Europe ex UK Index (Net)
EM Latin America	MSCI Emerging Markets Latin America Index (Net)

## Important Information

**Data refers to past performance. Past performance is not a reliable indicator of future results.**

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