FAQ:
Russia-Ukraine secondary effects

March 17, 2022

This FAQ is designed to help provide perspective on the current Russia/Ukraine crisis.

Q. How have Russia's escalating attacks within Ukraine reverberated beyond the two countries?

A. With the invasion of Ukraine, Russian stocks sold off sharply before being suspended from trading.

Further afield, stocks with significant links to Russia—be it through stakes in Russian businesses, operations on the ground, or meaningful customer and revenue exposure—have been hit hard.

Russia is a major producer of oil, gas, metals and other commodities. Sanctions, import bans and disruptions to supply have propelled prices to new highs, with punishing knock-on effects for businesses that are energy intensive or rely heavily on commodities in their production cycles, like chemical and steel makers.

Prior to sanctions, Russia was the world's 11th largest economy. Many western consumer brands have closed stores in Russia since the outbreak of war, and with revenues falling commensurately, this has hit the share prices of a wide range of global consumer stocks—from autos to beer, fast food, high-street fashion and luxury goods.

Financial stocks have also tumbled as payment companies (such as Visa and Mastercard) and banks cut ties to Russia, and concerns of loan defaults and reduced profitability have risen.

Q. Outside of Russia, Belarus and Ukraine, where has the fallout been most severe?

A. Although the impact has been spread across the globe, with closer links to Russia and greater reliance on oil and gas imports, European stocks have fallen most sharply[1]. Investors are worried not only about the immediate impact, but also the longer-term effect on the region's economy. The threat of recession looms larger in Europe than elsewhere.

Q. How are active investment managers navigating equity markets during this crisis?

A. With far reaching secondary impacts across so many countries, industries and securities, is has been close to impossible for investors to escape the fallout completely, even when direct Russian exposure in most portfolios has been very limited.

SEI's approach to active equity management is deliberately well diversified and draws on the talents of specialist third-party investment managers targeting multiple sources of enduring investment returns (which we refer to as "alpha sources")—namely value, momentum, quality and security selection (see glossary below for definitions). This has helped to ensure that our portfolios have not been overly exposed to any one geography, sector or investment theme. We hold to this approach regardless of market conditions because, as current events demonstrate, unpredictable geopolitical events can be severely damaging to even the most compelling investment ideas.

Q. What specific changes in the investment environment have you witnessed now that the Ukraine conflict is driving market conditions?

- [1] "They Do Business in Russia, and Now They May Pay a Price." New York Times. February 28, 2022.

A. Over the last two weeks, the extent to which portfolios have been exposed to financial market impacts from the "Russian crisis" has trumped more traditional factors, but it is possible to draw some conclusions from the relative performance of our alpha sources and underlying sub-advisors.

At a general level, the underperformance of Russia-exposed stocks has been felt more acutely by our value allocations, particularly those with the greatest exposure to continental Europe. Value has underperformed within the region in recent weeks, pulled down primarily by the falls in European banks and autos that have been well represented in value portfolios.

That's not to say that value has struggled everywhere; outside of Europe, performance of our value holdings has been much more robust as higher weightings to energy have been beneficial in tandem with rising oil prices, and indirect Russian exposure has been lower.

Again, in general terms, higher-quality, lower-risk stocks have been more resilient, as is often the case in times of crisis. Our quality-oriented sub-advisers have, on balance, performed more strongly. Likewise, our managed volatility strategies have also outperformed. However, payment companies and some of the more profitable consumer brands—which both score highly from a quality perspective—have fared just as poorly as some of the value stocks as a result of their Russia exposure.

The momentum factor has been mixed in recent weeks, and this has been reflected in the performance of our momentum-oriented sub-advisors. In recent times, momentum had largely favored those segments of the market that recovered strongly following the reopening of economies from COVID-19 lockdowns; hence it had rotated into the financials, energy and cyclicals (sectors, industries or stocks are those whose performance is closely tied to the economic environment and business cycle) represented in value portfolios. Therefore, in Europe, momentum returns have been similar to that of value over the short term. Outside of Europe the picture has remained positive, with companies enjoying positive momentum and earnings upgrades.

Q. How are SEI's strategies adapting in this environment?

A. Periods of crisis and instability are worrying for all investors, particularly as the turn of events in the short term can be difficult to predict. These are the types of environments in which active management can come to the fore—to better understand risks and exposures and to weed out the likely losers from the winners.

We and our sub-advisors are reviewing all positions and reassessing the risks and potential rewards as much as possible. As of today, we have seen little portfolio turnover as the market has been quick to adjust prices. Changes now, with no greater clarity about the immediate outlook, would likely be short-sighted. One of the greatest mistakes an investor can commit is to panic and indiscriminately make changes out of fear of losing money.

In times of stress, a clear philosophy and process—like our alpha source framework—can guide calm, rational, long-term decision making. Here's how we're thinking about the investment landscape today.

Momentum: If the fallout from the Ukraine conflict marks a shift in the economic regime (perhaps from a reflationary environment to a period of economic stagflation) or the evolution of new market trends (due to energy shortages or other evolving issues), our momentum sub-advisers will systematically and unemotionally adapt to the new environment more quickly than other investors anchored to past beliefs.

Value: If the macroeconomic backdrop or operating environment has materially changed the medium-term earnings power or risk profile of individual companies, our value managers will realign portfolios into those stocks offering the best expected risk-return payoff.

Quality: We expect the least change within our quality allocations—but even here, if the long-term competitive advantages of any given firm has been eroded as a result of the disruption caused by this crisis then we will see individual stock turnover.

Glossary

Alpha source: Alpha source is a term used by SEI as part of our internal classification system to categorize and evaluate investment managers in order to build diversified fund portfolios. An alpha source is the investment approach taken by an active investment manager in an effort to generate excess returns. Another way to define an alpha source is that it is the inefficiency that an active investment manager seeks to exploit in order to add value.

Momentum: A trend-following investment strategy that is based on acquiring assets with recent improvement in their price, earnings, or other relevant fundamentals

Quality: A long-term buy and hold strategy that is based on acquiring assets with superior and stable profitability with high barriers of entry

Reflation: Reflation refers to a fiscal or monetary policy designed to expand output, stimulate spending, and curb the effects of deflation, which occurs after a period of economic uncertainty or a recession.

Security selection: An investment strategy that employs research and judgement to uncover individual opportunities that have been mispriced by other financial market participants.

Stagflation: Stagflation refers to slow economic growth and high unemployment, or economic stagnation, which is also accompanied by rising prices and inflation.

Value: A mean-reverting investment strategy that is based on acquiring assets at a discount to their fair valuation.

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