SEI Strategic Portfolios:

October 2019 Monthly Commentary

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Quietening trade war dynamics provide support to equities and improve yield-curve optics

Executive Summary

- October 2019 saw equities gain, with emerging markets rising faster than developed markets; European smaller companies generally outperformed larger company counterparts, while in the US the opposite was true. Fixed income markets also mostly gained, with the exception of global government bonds. Emerging markets debt had a meaningful rally.

- Considering the more stability-focused UK Strategic Portfolios, a duration underweight added to performance, as did allocations to higher yielding fixed income and emerging market debt. Consistent with its objective, the Global Managed Volatility Equities building block provided meaningful risk reduction albeit as would be expected underperforming the equity market as it rallied.

- At the more Growth-Focused UK Strategic Portfolios, allocations to valuation-focused managers delivered mixed results; however stock selection with two specific managers was challenged and their results overpowered the positives. Signs continue to grow that the negative environment for value investing is starting to shift. It is too early to call this the turning point, but the magnitude of the shift in a short space of time underpins SEI's belief that there is a significant opportunity to be had on a forward-looking basis.

- Both on a strategic (long-term) and tactical (short-term entry point) basis, SEI firmly stands by the belief that the valuation-focused investment approach works; SEI believe that investors will ultimately see markets revert to the mean and therefore benefit from this positioning. Patience and discipline are required for this; SEI intends to exercise both of these virtues. The SEI Euro Strategic Portfolios have experienced periods like this before and exercising discipline served clients well in those times, and SEI continues to believe it will do so now as well.

- **Despite the market reversal and the challenges around valuation-focused managers, the SEI Strategic Portfolios maintained their highly competitive position against peer groups, with the Stability-Focused portfolios delivering on their mandate of drawdown protection through the challenging last quarter of 2018 and in periods of market reversal in 2019, while the Growth-Focused portfolios provided above-average returns against peers, with the Aggressive Fund outperforming the average of its peers by 1.72% in the first ten months of 2019, as well as remaining ahead between 1.1% and 2.8% per annum over the 3- and 5-year periods to end of October 2019. (Wealth A Distributing Share Class, in GBP, net of all fees).**

Market Overview

- Global equity markets climbed at an accelerating pace in October; with a particular boost observed in emerging markets. While U.S. and Japanese stocks followed a relatively steady upward path, U.K. and European stocks advanced sharply after a mediocre start to the month. Mainland Chinese equity markets ended higher for the full month despite multiple rallies and selloffs; Hong Kong stocks fared well after a soft start.

- During the month, short-term treasury rates declined and long-term rates increased marginally. The opposing changes in US rates, driven largely by the US Federal Reserve's (Fed's) most recent 0.25% cut to the federal-funds rate, resulted in the yield curve partially reverting to its "normal" upward slope, as longer-term treasuries began to yield more than their shorter-term counterparts. Government bond rates increased fairly evenly across all maturities in the UK and Europe, with long-term yields rising slightly more than short-term yields.

- The UK's unclear path out of the EU came into focus during October. Prime Minister Boris Johnson's re-negotiated Brexit deal was deemed acceptable in principle by a majority of the House of Commons on October 22, marking the furthest progress toward resolution up until that point, but was ultimately defeated in Parliament on concerns about executing the solution within its proposed three-day timetable. Parliament finally consented to Johnson's call for a snap election on December 12, increasing the likelihood that a solid road to Brexit will be paved before the next departure date.

- The BoE had no meeting in October. The contraction in UK manufacturing activity mostly levelled off during October, although new orders continued to slide as falling domestic demand overtook rising exports. Inventory stocking ahead of the October 31 Brexit deadline also contributed to the relative improvement in activity. The UK claimant count unemployment rate held firm at 3.3% during September, while the blended June-to-August UK unemployment rate edged up to 3.9%; average year-over-year earnings growth fell from 4.0% to 3.8%.

- The European Central Bank (ECB) made no changes following October's final monetary-policy meeting with Mario Draghi at its helm. The outgoing ECB president offered a defense of the central bank's recent policy shift toward further accommodation, as Christine Lagarde, former managing director of the International Monetary Fund (IMF), prepared to take the reins in November.

- Eurozone manufacturing continued to contract sharply in October, while already modest services-sector growth eased slightly. Labour conditions in the eurozone were fair during September, with the eurozone unemployment rate remaining unchanged at 7.5%, the lowest level since July 2008. The eurozone economy continued to grow by 0.2% during the third quarter, while year-over-year growth slowed to 1.1% (from 1.2% in the second quarter).

- Trade relations appeared to thaw between the US and China in October. The US cancelled the planned October 15th increase in tariffs on Chinese products; later in the month, China announced $20 billion in purchases of US agricultural goods, declaring a willingness to soften policies on forced technology transfers and barriers to foreign investment.

- The US Federal Open Market Committee (FOMC) announced an expected 0.25% decrease in the federal-funds rate toward the end of October, representing its third cut in as many meetings. In mid-October, the US central bank made its first monthly purchase of $60 billion in Treasury bills as part of a program to increase liquidity in the financial system.

- Turning to US domestic politics, an already-divisive atmosphere turned sharply contentious as Democrats in the House of Representatives continued their impeachment enquiry into President Donald Trump—punctuating the month with a full House vote to formalise the investigation.

- US manufacturing activity improved in October, contracting at a less significant pace, as export orders returned to growth territory. Services sector conditions continued to expand slowly. The US unemployment rate increased to 3.6% during the month despite a higher-than-expected gain in payrolls, an improved labor-force participation rate, and greater average hourly earnings.

Selected Asset Class Commentary

- Global Managed Volatility Equities Asset Class: Concurrent with its design, the asset class underperformed its benchmark during the month on the back of style tailwinds. Overweight positions to defensive sectors, including utilities and consumer staples, and an underweight to information technology (IT) detracted; however, a value tilt contributed. Wells Fargo Asset Management's deep low-volatility exposure hindered performance. LSV Asset Management benefited from a less-pronounced low beta exposure and improved stock selection.

- Europe Ex-UK Equities Asset Class: The asset class outperformed its benchmark in October, primarily due to the underperformance of mega caps. Value posted gains during the month. However, Metropole Gestion underperformed despite the value tailwind. Outperformance from stability manager, Wellington, took place due to its quality bias via underweighting mega caps. Wellington also achieved positive returns through its quality industrial holdings. Finally, Acadian outperformed due to an underweight to mega caps and a value tilt.

Manager Changes

- None over the period.

Portfolio Manager Changes:

- SEI's Investment Management Unit has realigned portfolio management responsibilities for a number of SEI's global equity funds. As a result of these changes, John Lau, CFA, will now be assuming responsibility of the Emerging Markets Equity Building Block. These changes came following the departure of Sandra M. Ackermann-Schaufler, CFA, who left SEI to pursue other opportunities.

Outlook

- SEI has, on the whole, held an optimistic view on equities and other risk-oriented assets for the past 10 years. When markets corrected sharply in price, as several US equity indexes did in 2011, 2015 and late last year, pullbacks were seen as buying opportunities. SEI believes that staying invested has been a sound overall strategy. Today, whilst it is still doubtful that a true bear market is on the immediate horizon, SEI is surprised by the resilience of the stock-market averages during the third quarter in the face of numerous economic and political uncertainties, both in the US and globally.

- The US economy remains in reasonably good shape and appears to be in little danger of contracting any time soon. Granted, the manufacturing and agricultural sectors are being stressed by the trade - war with China, SEI believes there is a limit to how far this deterioration in economic activity will go. However, few economists would dispute that the US consumer sector is in great shape.

- Traders in the federal-funds futures market expect more rate cuts on the heels of the FOMC's July and September cuts. The central bank is also no longer letting its securities portfolio contract now that it halted quantitative easing. If the economy were to weaken in a serious way, it could ramp up its purchases of treasuries again.

- Looking at the US stock market, the forward-earnings trend has flattened in recent quarters. Periods of flat-to-down earnings over several quarters occurred in the 2014-to-2015 period, and in 2011, 2007 and 1998, each coinciding with flat-to-declining stock prices, increased volatility and moderate-to-severe market corrections.

- Momentum and 'growth' styles continued to outperform quality and value for much of the third quarter. However, September saw a sharp reversal in this trend for the first time since the beginning of 2018 as value outperformed. It's hard to say whether this reversal will be sustained, although SEI's equity managers continue to be positioned for this.

- A trade truce between China and the US would be a relief, but it would be only one piece of a larger mosaic that must first come together. Getting the world back on a faster growth track will depend on an economic rebound in the domestic economies of China and Europe. SEI's expectation of an economic revival in China depends on the assumption that all the fiscal and monetary policy measures put in place over the past year will overcome the major challenge posed by the trade war.

- Slowing growth in China, the US and the Eurozone does not bode well for other economies. On a positive note, many developing countries have been able to cut interest rates in recent months. Meanwhile, capital-market conditions in emerging countries still appear benign. Spreads on US dollar-denominated debt remain in the middle of their range for the past eight years.

- Despite all its economic and political problems, European-wide equity markets have done rather well this year in local-currency terms. The MSCI Europe ex UK Index climbed 21.1% year to date, actually matching that of the MSCI USA Index. The United Kingdom Index was the laggard, gaining only 13.8% (source: SEI), still something of an achievement considering the messy political situation in the UK.

- How does one explain the rather robust performance of European equities? It can largely be attributed to the lack of an alternative option. Now that Germany's sovereign yield curve is negative all the way up to 30 years, European investors have scarce opportunity to build wealth in less risky fixed income assets and are therefore forced into equities and other risk-oriented investments. Investors globally face similar challenges, even if not quite to the same extent.

- In view of the uncertainties facing investors presently, the prediction game is arguably even more challenging than usual. Accordingly, as always, SEI believes in a diversified approach to investing. Although maintaining exposure to equities and other risk-oriented assets can at times feel uncomfortable, it is SEI's view that investors with long time horizons should avoid timing the market or making outsized sector or regional bets. It is best not to assume, for example, that the S&P 500 Index and growth stocks will always be the only games in town. The recent volatility and sharp style rotations in the past quarter should serve as reminders that trends do not last forever.

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Past Performance is not a reliable indicator of future results. Standardised performance is available upon request. All data is as at 31 October 2019.

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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- 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.
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