Stability-Focused SEI Strategic Portfolios

SEI Strategic Portfolios:

Q2 2017 Quarterly Commentary

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Global equities markets continued to push higher in Q2 as political risks receded, global economic data stayed robust and inflation remained benign

Executive Summary

- Despite a softening outlook for the UK and US economies as well as ongoing delays with the Trump administration's policy agenda, global economic data continued to strengthen in the second quarter, supporting an outlook for a continuation of globally-synchronised growth across most developed and emerging economies.

- With the exception of the UK, global bond yields again largely finished the quarter modestly lower, with US high-yield fixed income and emerging markets debt posting strong returns; a bias towards economically sensitive fixed income was again supportive of returns, as were yield curve flattening positions. Global diversification within fixed income also added to relative returns, as was a shorter duration bias at the strategy level as well as within the UK Core Fixed Interest asset class.

- The Stability-Focused Strategic Portfolios (the Defensive, Conservative, and Moderate Funds, collectively "the Funds", Sterling Wealth A share class, in GBP, net of all fees) returns ranged between -0.23% and -0.32% in Q2 2017, comparing favourably to the -0.82% BofA Merrill Lynch Sterling Broad Market index over the same time period, which can be seen as a representation of the UK fixed income market.

- SEI manages the Stability-Focused Strategic Portfolios to specific maximum drawdown targets which tend to result in an asset allocation structure that seeks to deliver a smoother investment journey for investors. Evidence of the success of this approach can be found in the 5-year volatility data of the Stability Focused Strategic Portfolios, with respective values of 1.81%, 3.88%, 5.96% for the Defensive, Conservative, and Moderate Funds, again comparing favourably against the fixed-income only BofA Merrill Lynch Sterling Broad Market index volatility number of 5.11%. On this basis, the Stability-Focused Strategic Portfolios continue to deliver highly robust risk-adjusted returns.

Market Overview

- Political developments abounded during the second quarter: UK Conservatives lost their parliamentary majority; Emmanuel Macron was elected to the French presidency; US President Donald Trump scolded NATO and sidestepped a mutual-defence endorsement, and faced the appointment of a special prosecutor to investigate whether his campaign colluded with Russia during last year's election.

- Despite this turbulent backdrop, stocks climbed globally, but the results were uneven. US stocks advanced after strong first-quarter earnings reports. Equity markets were roughly flat in Europe and the UK after early quarter weakness, followed by a rally, before sliding into quarter end. In fixed income markets, the US treasury yield curve flattened at an accelerating pace, with short-term interest rates increasing and intermediate- and long-term interest rates declining. Oil prices tumbled to a late-June low of $42.53 per barrel, before bouncing slightly higher by quarter end.

- In the UK, the BoE made no changes during the quarter; but more hawkish votes were cast for a rate hike, as the latest quarterly data showed the rate of inflation above the central bank's 2% target. The UK services sector ended below its March level, while UK manufacturing finished the second quarter roughly flat. Construction activity peaked in May, yet still improved overall for the period. Labour-market conditions softened, with an uptick in claimant-count unemployment.

- The ECB also held firm, continuing asset purchases as anticipated, yet betrayed optimism by changing statement language to suggest that members don't expect benchmark rates to move lower, in an acknowledgement of firming economic conditions. Eurozone manufacturing activity crept higher for the tenth straight month through June. Services growth moderated during the quarter, but held at robust levels amid increasing new orders and backlogs. The unemployment rate continued to edge lower.

- The US dollar continued a slide that began in the New Year; US dollar weakness is particularly notable in the context of the US Fed's monetary policy tightening endeavours, including a second benchmark hike, which would normally be expected to support US dollar strength. US manufacturers expanded only modestly through May, while the services sector ended the quarter where it began. The unemployment rate fell through April and May to 4.3%.

Selected Asset Class Commentary

- Global Short Duration Fixed Interest Asset Class: The building block performed well during the quarter, against a backdrop of the further tightening of credit spreads, and unwinding of the reflation trade in the US. The main contributors to building block performance were the underweight to core eurozone duration, US curve flattener positioning and off-benchmark exposure to spread sectors. AllianceBernstein, the top contributing manager, benefited from an overweight to corporate bonds, Australia, and the Czech koruna, and an underweight to the core eurozone.

- Global Fixed Interest Asset Class: Implied inflation fell (particularly in the US) and the US dollar lost more ground against most of the other major currencies. The main contributors to building block performance included an underweight to core eurozone duration, US yield curve flattener positioning and off-benchmark exposure to spread sectors. Inflation exposure detracted, while active currency decisions yielded mixed results. AllianceBernstein, the top contributing manager, benefited from overweights to Australia and the Czech koruna, and an underweight to the core eurozone.

- Global Opportunistic Fixed Interest Asset Class: There was some evidence of decoupling between the major bond markets, with the US yield curve flattening, but core eurozone rates selling off as political risk receded and reflationary dynamics looked to slowly take hold. The main contributors to building block performance included a down-in-quality bias, overweight to emerging market rates, underweight to core eurozone duration, and exposure to the Czech koruna. AllianceBernstein, the top contributing manager, benefited from an overweight to corporate bonds and underweight to European duration.

- Global Managed Volatility Equities Asset Class**:** The building block marginally underperformed the benchmark during the quarter, as expected, as markets continued to rally, but it did deliver meaningful risk reduction. Acadian Asset Management, the top contributing manager, benefited from the recovery in momentum. Analytic Investors benefited from non US exposure, and the weakening US dollar. LSV Asset Management detracted as value struggled during the quarter. The building block is designed to provide downside protection in stressful market environment, with an expected cost of not rising as much when the market rallies.

Manager Changes

- There were no manager changes in Q2 2017.

Outlook

- At the start of this year, SEI held an optimistic view regarding the path of the US economy, corporate profits and, by extension, the stock market. There seemed to be great opportunity for the passage of business-friendly tax and regulatory reforms; but hopes on legislative policy now appear too optimistic. Trump's unpopularity has emboldened the opposition to put up a unified resistance. Although the optimism is being tested, SEI is sticking to its expectation that a major tax bill will be pushed through Congress. Original hopes of a big cut in US corporate tax rates will most likely be replaced by a smaller cut. This fiscal stimulus should still boost economic growth prospects, but could eventually add to inflationary pressures since the country's economy is edging closer to full employment.

- Fed Chair Janet Yellen and a majority of her colleagues might be coming to the same conclusion, as evidenced by the second federal funds rate hike this year and apparent intentions to reduce the size of Fed's balance sheet. The pace of quantitative tightening should not be exceptionally disruptive to the bond market, at least during its ramp-up phase. But the Fed's selling could aggravate upward pressure on bond yields if investors become more concerned about the inflation outlook. With the 10-year treasury bond currently yielding just 2.25%, however, it is obvious that inflation concerns are not yet paramount.

- In Europe, Economic sentiment in the region has risen to the highest level since 2007, suggesting that economic growth may soon accelerate. Perhaps more important for investors, eurozone earnings were beginning to pick up in a recovery that appears to have momentum. The ECB's expansion efforts seem to have finally had a positive impact. Loan growth accelerated to its best pace in six years, an encouraging-yet-slow expansion that argues strongly in favour of ECB President Mario Draghi's long-standing preference to maintain the current pace of quantitative easing at least through 2017.

- The recent UK election result means the country is now far more likely to move toward a "soft" Brexit. In SEI's view, UK services industries and the City of London have more to gain from a hybrid relationship with the European Union than from a complete sundering of the relationship. This latest political surprise comes at a time when the UK economy was showing mixed economic results. Inflation has been accelerating over the past year, which can be traced to sterling's 20% decline since August 2015.

- Overall, this economic backdrop warrants little change in SEI's recent positioning; in fixed income, modest short-duration bias remains, while SEI is actively looking to de-risk the fixed income building blocks, especially those with a greater bias towards credit markets. However, a general pro-cyclical bias remains in place.

- Markets have made significant progress already this year and while it would be unreasonable to expect a similar trajectory for the second half of the year, overall SEI believes markets can continue to move forward on the basis of continuing economic growth, accommodative central banks, benign inflation and increasing levels of fiscal stimulus.

Important Information on Performance

Past Performance is not an indicator of future performance. Standardised performance is available upon request. All data is as at 30 June 2017.

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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- 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.

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