Stability-Focused SEI Strategic Portfolios

SEI Strategic Portfolios:

Q3 2017 Quarterly Commentary

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Strengthening global economic data, particularly in leading indicators, deliver a strong 'risk-on' environment in Q3 2017

Executive Summary

- Global fixed income yields delivered mixed results over the quarter, while global equities markets advanced given a general risk-on environment. Emerging markets continued to lead global markets across fixed income and equities, supporting the strategic allocations to these asset classes across the SEI Strategic Portfolios.

- Credit spreads continued to grind tighter, supporting general overweight positions in credit and economically-sensitive debt across the SIS programme. Longer duration bonds generally outperformed in price terms, most specifically in the US, supporting yield curve flattener positions but detracting from a general duration underweight.

- 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 0.10% and 0.47% in Q3 2017, comparing favourably to the -0.22% 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 1.71%, 2.84%, 4.07% 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 competitive risk-adjusted returns.

Market Overview

- A late-quarter speech by Prime Minister Theresa May in Florence helped thaw the contentious postures on both sides of the Brexit negotiating table. German Chancellor Angela Merkel's Christian Union received the largest share of votes in a federal election. Both Kurdistan and Catalonia voted for independence but the referenda were not recognised by their respective governments. In the US, attention has firmly shifted to tax reform. Natural disasters wrought havoc around the globe: including a brutal hurricane season in the Caribbean, earthquakes in Mexico, as well as monsoon floods on the Indian sub-continent.

- Stocks continued to advance around the globe, led by Brazil and other emerging markets. US Treasury yields increased, with shorter-term rates rising by more than longer-term rates. Currency trends held for most of the quarter, as the US dollar weakened further versus the euro and yen before reversing course and strengthening in early September. The US dollar-sterling relationship was fairly steady until mid-September, when the dollar resumed its slide. Oil prices bottomed in early July, climbed to a late-September peak and then finished the quarter above $50 per barrel.

- Global central banks continued to migrate slowly toward tighter policy, most notably with the Fed's announcement in September that it would begin to reduce balance-sheet assets, as well as a projection for a further rate rise before the end of the year. US manufacturing activity accelerated in September, maintaining momentum from August. Overall US economic growth accelerated to an annualised 3.1% during the second quarter, primarily thanks to strong consumer spending.

- In its September statement, the BOE expressed that it may tighten policy by more than markets expect. UK retail activity finished the quarter on a promising note with a significant jump in retail sales volumes. Manufacturing growth was off a bit in September from its August peak, but finished the quarter in better overall circumstances. Economic growth was a firm 0.3% in the final second-quarter reading, but revised downward to 1.5% for the year-over-year period.

- The ECB's September meeting did not yield new information regarding an anticipated reduction of its asset-purchase programme. Eurozone manufacturing and services sector growth both accelerated during September from already-robust levels earlier in the quarter; manufacturing activity pushed to its highest level in more than six-and-a-half years. Improvement in the headline unemployment rate levelled off during the quarter through August, holding at 9.1%.

Selected Asset Class Commentary

- <u>Global Short Duration Fixed Interest Asset Class</u>: Benchmark government yields in the core markets were little changed during the quarter; however there was significant performance variation, with UK gilts posting negative returns, while US Treasuries gained. The asset class benefited from its off-benchmark exposure to corporate bonds and US TIPS. Colchester Global Investors, the top contributing manager, benefited from overweights to the Canadian dollar, Columbian peso, British pound and Swedish krona. Schroder Investment Management Limited detracted due to short positioning in the euro, British pound, and Australian dollar, and an overweight to Australian duration.

- <u>Global Opportunistic Fixed Interest Asset Class</u>: Risk assets performed well as credit spreads continued to grind tighter and emerging market government bonds outperformed developed markets. The asset class performed well during the quarter, benefiting from its marginally overweight credit beta positioning. J.P. Morgan Investment Management, the top contributing manager, benefited from an overweight to high yield bonds, and its higher sensitivity to duration than the benchmark. Schroder Investment Management Limited detracted due to underweights to the euro, pound, and Australian dollar.

- <u>Emerging Markets Debt Asset Class</u>: The third quarter represented a continuation of 2017's strong start with both hard and local currency indices posting solid returns. The asset class continues to benefit from improvement in many emerging market fundamentals, especially regarding current account balances and falling inflation. The appreciation in commodity prices was also supportive. Additionally, fears of higher inflation and a stronger US dollar continued to subside. Neuberger Berman Investment Advisers, the top contributing manager, benefited from security selection within Argentina and Indonesia external debt.

- Global Managed Volatility Equity Asset Class: The asset class underperformed the benchmark during the quarter as expected, but did deliver meaningful risk reduction. LSV Asset Management performed best due to less exposure to low volatility. Value positioning was also beneficial in September. Acadian Asset Management performed worst, as it had the highest exposure to low volatility. A large active weight to consumer staples detracted. The asset class is designed to provide downside protection in stressful market environment, with a cost rising as much when the market rallies.

Manager Changes

- There were no manager changes in Q3 2017.

Outlook

- Neither devastating hurricanes nor all-around political dysfunction have done much to halt the US equity market's rise. Even the game of nuclear chess being played between North Korea's Kim Jong-un and President Trump has failed to elicit much of a response. When considering valuations, the upward momentum of the US economy and earnings, the likely path of US Fed policy and current inflation dynamics, SEI believe that the US equity bull market can continue. Additionally, SEI continues to expect a US business-friendly tax package to be enacted and signed in the US by the Trump administration before the end of the year.

- The overriding question among investors is a simple one: is a recession on the horizon? SEI are confident that the answer is "no." Financial stress, a harbinger of recession, is virtually non-existent. Recent economic data also point to the continuation of steadily strengthening economic growth. Numerous global leading economic indicators are strong and rising; global purchasing manager indices are on the rise, while realised earnings around the world have beaten forecast earnings for the first time since 2011.

- Continuing with the theme of global synchronised economic growth, a large portion of the world appears to be growing at a slightly better-than-trend pace. The breadth of the improvement is particularly impressive; as at July 2017, 72% of the countries that make up the OECD Composite Leading Indicator index have posted improvement over the past year while 75% of the countries in the index came in above 100. This means above-trend growth will likely continue in the months ahead on a global basis.

- One of the big surprises of 2017 is the extensive US dollar weakness. The drop in the greenback coincides with the better global macroeconomic outlook. Economic growth of developed economies around the world is converging with that of the US. Although US monetary policy is further along the path toward tightening, other central banks have already begun to raise policy rates or may do so soon. Even the ECB is expected to announce its first steps away from unconventional monetary stimulus by the end of this year.

- Considering the more defensive SEI Strategic Portfolios, SEI expects yields will slowly move higher as global growth becomes more entrenched and central banks begin to remove extraordinary stimulative measures. The fixed income asset classes are generally short duration versus their benchmarks, favour credit-spread strategies and are positioned for a further narrowing of the yield curve, especially in the US. SEI continues to implement strategies with downside protection potential in the event of adverse market conditions, for example through allocations to Global Short Duration Fixed Interest and Global Managed Volatility Equity, consistent with the potentially shorter time horizon of investors in these Strategic Portfolios.

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 September 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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- 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.

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