SEI Canada Strategic Funds

COVID-19 Outbreak Portfolio Update

March 2020

Executive Summary

- SEI's asset allocation approach delivered returns within design expectations over the crisis period to date.
- For the Income 40-60 Fund, SEI constructs the asset allocation with drawdown risk in mind. Fixed income allocations have provided meaningful risk reduction for the portfolio, and Global Managed Volatility Equities have been beneficial, participating less in the downside during the broad equity sell off.
- For the Growth 80-20 and Balanced 60-40 Funds, returns and risk are primarily driven by equity components, and these components have broadly moved in line with markets, again as expected by design; but, allocations to high-grade fixed income have meaningfully mitigated loss.
- The Conservative Monthly Income Fund is an income-oriented mandate and fixed-income strategic allocations stand at 70% of the fund. Despite equity market volatility, the equity portion of the portfolio received risk reduction via an allocation to Global Managed Volatility Equities.
- Global equity diversification has been beneficial; developed markets have sold off more over this period as the virus has spread outside of China.
- Exposures to investment-grade fixed income, developed-market government bonds in particular, have provided a bulwark against market declines, boosted by a dramatic decline in interest rates.
- Global Managed Volatility Equities, a key part of SEI's asset allocation framework for equity allocations across a majority of strategic portfolios, has helped mitigate some of the impact of falling equity markets, as well as providing significant risk reduction.
- It should be noted that equities are long-term investments. Unless we see significant corporate failures, perhaps driven by a lack of proper policy response, global equity markets should have a natural floor that is driven by the value of the future earnings beyond this crisis.
- We acknowledge the extreme current news-flow cycle can have a psychological impact on investors. Since we fully believe that financial markets will recover after the virus crisis, we encourage investors to avoid the pitfalls of market timing. Further, we note that this crisis may provide an opportunity to put any uninvested cash to work.

Growth 80-20 & Balanced 60-40 Funds Strategic Funds:

- As a strategic investors, SEI believes building portfolios to mitigate overall volatility and drawdown requires anchoring the portfolio in high quality, fixed-income exposures.
- Such holdings provided much-needed diversification away from volatile equity markets during this heightened risk-off period, as absolute returns were cushioned by exposures to government bonds. A modest underperformance was generally driven by an overweight to credit within Canadian Fixed Income.
- On the equity side, SEI's Global Managed Volatility Equities fund is intended to deliver a less volatile approach to global stock exposure. Such exposure provided drawdown protection against the declining equity market.
- Valuation-focused managers have lagged and the overweight to value has detracted from relative returns particularly within the U.S. Large Company Equity fund.
- International Equity has added to relative performance year to date and through this recent patch of volatility, driven by strong security selection from our quality-oriented managers.

Income 40-60 Strategic Fund:

- Income 40-60 has navigated this environment well relative to their more growth-oriented counterparts, as expected.
- High-grade fixed income allocations served to dampen the volatility experienced in equity markets, contributing positively to performance. Falling yields also helped Real Return Bonds contribute positively.
- On the equity side, SEI's Global Managed Volatility Equities fund is intended to deliver a less volatile approach to global stock exposure. Such exposure provided reduced drawdown against the declining equity market and, by design, was also able to provide meaningful risk reduction.

Conservative Monthly Income Fund:

- Canadian Fixed Income and Short Term Bonds served to dampen the volatility experienced in equity markets, although the shorter-duration posture moderately detracted.
- The equity allocation had negative absolute performance, but exposure to Global Managed Volatility Equities helped to reduce drawdown.

Outlook

- Before the onset of virus, the global economy was looking up; U.S. growth was looking good, Europe was showing signs of improvement, China growth was stabilizing, and trade deals were making progress. It is clear now that the disruption caused by the virus will continue for a while; how extensive the disruption will be will depend on the tightrope that governments must now run between managing pressures on their healthcare systems and minimizing economic disruption.
- The U.S. has some unique advantages with regard to limiting the impact of virus: population density outside of major urban areas is much less, the healthcare system is among the best in the world and sanitation is much better than places that have been hit the hardest. SEI believes it would be a mistake to assume that an extrapolation of what happened in China will definitely happen to the rest of the world. In addition, the virus appears to be flattening in China, while Japan seems to have gotten a handle on new cases.
- There will undoubtedly be an impact as travel and leisure activity is reduced, sporting events are cancelled or played to empty stadiums. This may result in a technical recession, however the U.S. came in the outbreak with a higher growth rate, so it may just see slower growth. For the rest of the world, matters look more challenging. China will show a sharp decline in February to April economic activity, while many European countries were showing slower growth rates coming into the outbreak and therefore are more likely to post negative economic outcomes.
- With regard to risk assets and stocks, SEI expects to see more volatility in weeks ahead. Analysts do not have a clear outlook on earnings; some revisions have been made but many more are expected. Chinese supply dynamics may start to improve, but ultimately consumer demand is more important, and few policies will affect consumer behavior in the face of the extreme news-flow.
- Our longer term view is that since we are dealing with a virus and not an economically induced downturn, we can bounce back from it once the severity of the disease lessens, but in the near-term, there is an unprecedented level of uncertainty.
- With that in mind, SEI will retain its emphasis on strategic investing over tactical moves, and we recommend that our investors do the same. Trying to look beyond this crisis is critical for the longer term investor; SEI continues to advocate avoiding market timing during periods of volatility like we are seeing as this can lead to significant impairment of value. Shorter term investors, having hopefully invested in more conservative risk profiles, will have seen their investment values only modestly impacted. Difficult as it may be, one has to maintain an optimism that we have the ability to overcome both the virus and the strong emotional responses that it is generating.

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