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Capital Market Assumptions Update: Revised to Reflect Rates Outlook

NOVEMBER 2021

Snapshot

- Fixed-income return assumptions were reworked to reflect possible future rate paths, leading to mixed results.
- Equity assumptions edged slightly higher given the prospect of increased short-term risk-free rates.
- The value of these assumptions is not in accurately predicting performance, but in having a better understanding of the relationships between assets classes—which enables us to help investors make well-informed decisions.

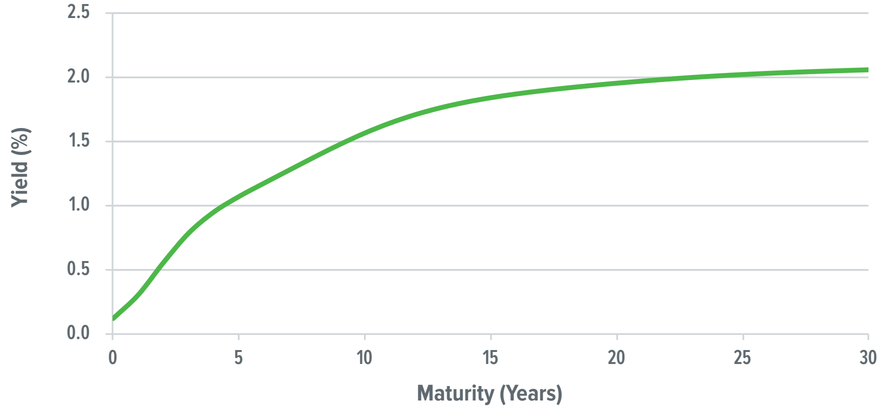
At SEI, we recently updated our capital market assumptions (CMAs) as part of our review and monitoring process. This brought our estimates for risk premiums over cash in line with our current expectations for capital markets (cash is used as a proxy for the theoretical return on a risk-free asset).

Fixed-income returns will depend on maturity and credit exposure

Central banks around the world reacted swiftly and significantly in their efforts to prop up the global economy in light of the COVID-19 pandemic. Several have indicated their willingness to keep rates low and allow inflation to run above target for some time. With that said, major central banks have started to signal expectations that they may begin to reduce asset purchases and/or raise rates over the next year or two.

The anticipated future path of rates reflects the belief that central banks will begin to alter the course of their respective policies and be able to hold inflation under control. This is evident in the somewhat flattening shape of the yield curve, along with the slightly higher rates across maturities and the return of breakeven inflation to normal levels.

Exhibit 1: Canada Nominal Government Yield Curve

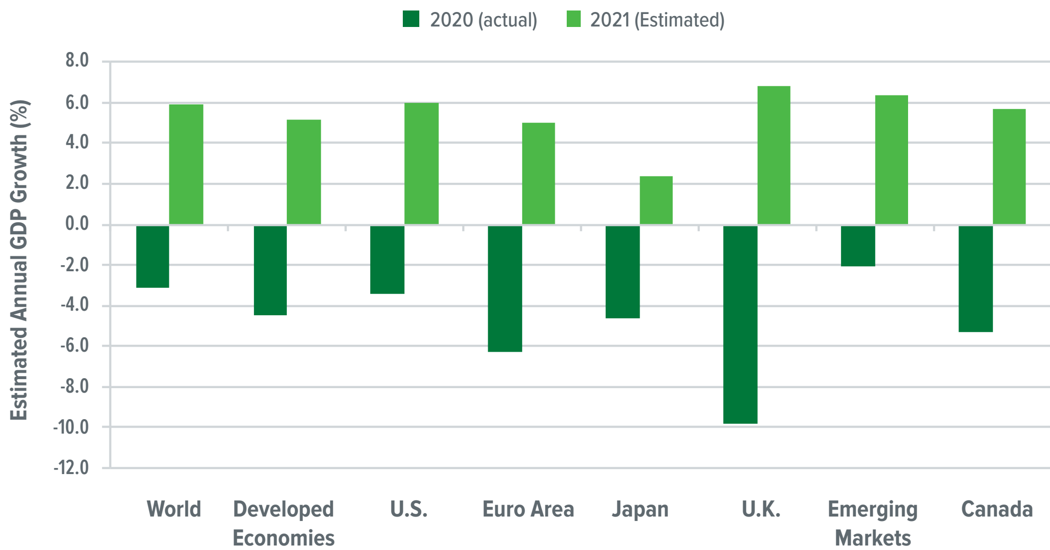


Source: SEI, Bank of Canada. Data as of 10/26/2021.

Global equity return expectations slightly higher

Based on current global central-bank policies implemented in light of the COVID-19 pandemic and their projections of low overnight lending rates, our base-case view is a slow return of interest rates to more typical levels. Equity asset classes are still expected to deliver similar risk-premium levels as they have historically; we anticipate lower absolute returns given the lower interest-rate environment. However, with short-term interest rates expected to increase, returns on risky asset classes like equities should improve.

Exhibit 2: Estimated Global Gross Domestic Product (GDP) Growth



Source: International Monetary Fund. Data as of 10/31/2021.

About SEI's capital market assumptions

At SEI, we develop forward-looking, long-term capital market assumptions about risk, returns and correlations for a variety of global asset classes, interest rates and inflation. Our assumptions are based on quantitative analyses of historical data and current market environments along with qualitative reasoning. We believe this approach allows for greater impartiality than methods that rely on historical data alone, which are often skewed by a single time period or event.

We aggregate our asset-class assumptions into a diversified portfolio, and then run Monte-Carlo simulations to develop scenarios across a wide variety of market environments that can provide insight into the potential impact of future market variability over time.

In our view, the value of these assumptions is ultimately not in their accuracy as point estimates, but in their ability to capture relevant relationships and changes in those relationships as a function of economic and market influences—and in our ability to help investors make well-informed decisions.

Please refer to our recent publication, *Developing Capital Market Assumptions for Asset Allocation Modeling,* for more detail about how we develop CMAs at SEI. Information regarding the actual assumptions that we use in a specific portfolio can be requested from your SEI representative.

CMAs are not predictions of how asset classes will perform or reliable indicators of future performance; instead, they are expected long-term characteristics of asset classes. The below figures are SEI's mean estimates for select asset classes. They do not represent all asset classes SEI analyses nor should they be considered projections for any SEI investment products. Different tools and models can simulate various market conditions using these assumptions as inputs. CMAs are used in the strategic asset allocation process, for asset/liability studies, and in proposal-generation systems. All assumptions are pre-tax and gross of any fees or expenses related to investing.

Exhibit 3: Capital Market Assumptions (Returns in Canadian dollars)

Asset Class	Arithmetic Return	Previous Arithmetic Return	Difference
Equities			
Canada Equity	5.86%	5.38%	0.48%
Canada Large Cap	5.74%	5.35%	0.39%
Canada Small Cap	6.62%	6.23%	0.40%
Emerging-Market Equity	8.87%	8.48%	0.39%
Fixed Income			
Canada Core Fixed Income	2.40%	1.70%	0.70%
Global Fixed Income Hedged	2.01%	1.72%	0.29%
U.S. High-Yield Fixed Income	5.04%	4.64%	0.40%
Liquidity			
Canada Cash	0.75%	0.36%	0.39%

Important Information

This material represents an assessment of the market environment at a specific point in time and is not intended to be a forecast of future events, or a guarantee of future results. This information is for educational purposes and should not be relied upon by the reader as research or investment advice regarding the funds or any stock in particular nor should it be construed as a recommendation to purchase or sell a security, including futures contracts. There is no assurance as of the date of this material that the securities mentioned remain in or out of the SEI Funds. There are risks involved with investing, including loss of principal. Diversification may not protect against market risk. There are other holdings which are not discussed that may have additional specific risks. In addition to the normal risks associated with investing, 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. Emerging markets involve heightened risks related to the same factors, in addition to those associated with their relatively small size and lesser liquidity. Bonds and bond funds will decrease in value as interest rates rise.

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