Equities Advance to Start the Second Half

Monthly Snapshot

- A thaw in U.S.-EU trade tensions appeared possible following late-month negotiations, while the EU and Japan finalized a major deal eliminating most tariffs. The imposition of tariffs still threatens to envelop U.S.-China commerce.
- Shares generally advanced in developed and emerging markets alike as volatility receded. Government bond yields climbed in an environment defined by the slow removal of accommodative central-bank policies.
- The economic fundamentals that drive equity markets still appear solid, even in places like Europe and developing economies. Interest rates, while higher, are still at levels that support global economic growth.

Economic Backdrop

The second half of 2018 began with mixed progress on the global thematic landscape. Trade barriers, which escalated through the beginning of July and still threaten to envelop U.S.-China commerce, appeared set for substantial relief between the U.S. and EU following a successful late-month negotiation by President Donald Trump and European Commission President Jean-Claude Juncker. The EU and Japan also finalized a major trade deal in mid-July that eliminated most tariffs between the two trading partners.

The Western alliance suffered a setback as President Trump declared the EU a “foe” on trade and called into question the pact’s core mutual-defense principle following a North Atlantic Treaty Organization summit in Brussels, Belgium. A one-on-one meeting between the U.S. president and Russian President Vladimir Putin raised concerns across the political spectrum—particularly after a subsequent press conference in which Trump second-guessed U.S. intelligence agencies’ unanimous assessment of Russia’s interference in the 2016 U.S. elections.

U.K. Prime Minister Theresa May ruled out the possibility of allowing Northern Ireland to remain in the EU’s customs union or single market in a bid to please pro-Brexit conservatives—but held out the prospect of harmonizing the entire U.K. trade regime with remaining member states. The EU’s chief Brexit negotiator, Michel Barnier, rejected a key component of May’s plan that sought to have each region collect trade duties on the other’s behalf. May’s foreign and Brexit secretaries resigned early in the month after they deemed her final negotiating proposal too soft.

The Federal Open Market Committee refrained from taking additional action on the first of August after increasing the federal funds rate in June. The Bank of England’s Monetary Policy Committee increased its benchmark rate at the beginning of August in an effort to dampen inflation pressures; in a late-July meeting, the European Central Bank (ECB) reaffirmed its policy-path commitment to taper asset purchases over the remainder of 2018. The Bank of Japan maintained its near-zero target rate, but set its band at -0.2% to 0.2% (an increase of 0.1%) at the end of July.

Key Measures: July 2018

EQUITY		
Dow Jones Industrial Average	4.83%	↑
S&P 500 Index	3.72%	↑
NASDAQ Composite Index	2.19%	↑
MSCI ACWI Index (Net)	3.02%	↑
BOND		
Bloomberg Barclays Global Aggregate Index	-0.17%	↓
VOLATILITY		
Chicago Board Options Exchange Volatility Index PRIOR: **16.09**	12.83	↓
OIL		
WTI Cushing crude oil prices PRIOR: **$74.15**	$68.76	↓
CURRENCIES		
Sterling vs. U.S. dollar	$1.35	↑
Euro vs. U.S. dollar	$1.19	↑
U.S. dollar vs. yen	¥111.91	↑

Sources: Bloomberg, FactSet, Lipper

U.S. equities advanced for most of the month before retreating in the last week, while British and European shares climbed slowly throughout July. Japanese shares increased early in the month, holding onto gains thereafter. Equities in Hong Kong, mainland China, Brazil and Mexico also generally advanced during July. Stock-market volatility was fairly subdued the world over, settling from an early-month peak. Shorter-term U.K. gilt yields increased and longer-term yields were mixed, while yields on euro-area and U.S. government bonds increased similarly across all maturities.

Preliminary surveys pointed to accelerating U.S. manufacturing growth and a strong continued expansion in services activity during July. Home sales declined in June, marking the third-straight month of lower existing home sales and the lowest rate of new-home sales since February. The initial estimate of second-quarter gross domestic product (GDP) showed that U.S. economic growth accelerated to an annualized 4.1% rate due to strong consumer spending and exports.

U.K. sales volumes pointed to firm retail demand in July, according to a distributor survey, but were down from elevated June findings. Industrial trends were similar, with generally favorable survey results for July that were nevertheless just shy of the prior month. Consumer prices were unchanged in aggregate during June, causing the year-over-year increase to hold at 2.4%; producer prices increased by 10.2% (for inputs) and 3.1% (for outputs) from a year earlier.

Eurozone manufacturing activity appeared set for solid continued expansion in July according to an early survey, while services growth slid to still-respectable levels. Unemployment dropped to 9.1%, the lowest level in the eurozone since February 2009. GDP slipped to 0.3% for the second quarter and 2.1% for the year-over-year period. Despite somewhat disappointing GDP growth, the eurozone economy remains relatively healthy.

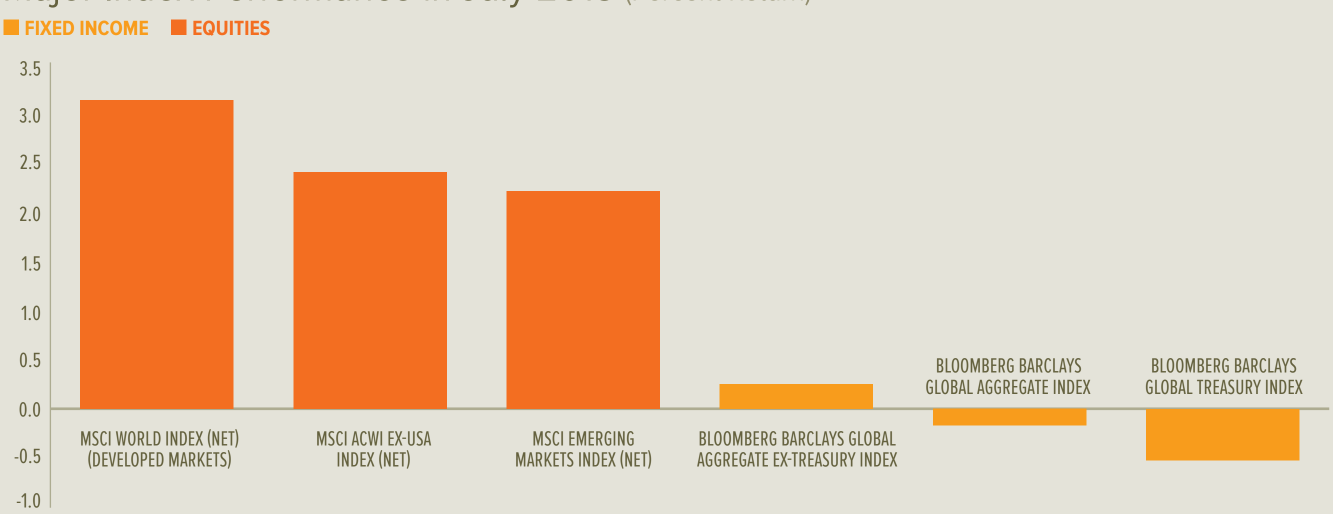
Portfolio Review

The U.S. equity market climbed in July, led by a sharp advance in large-cap stocks, and our strategies performed in line with their respective benchmarks. Our large-cap strategy benefitted from a value orientation, but was held back by momentum exposure. An underweight to the information technology sector helped, while stock selection within consumer discretionary detracted. Our small-cap strategy was held back by poor selection in financials and consumer staples, but selection elsewhere contributed. Overseas, developed and emerging markets rallied to a lesser degree than U.S. large-cap stocks. Our international developed-market equity strategy underperformed as French and Italian auto holdings lagged. Dutch holdings and ex-benchmark positions in Latin America helped, however, as political sentiment improved in Brazil and Mexico. Our emerging-market equity strategy was also challenged as growth and cyclical positioning lagged.

U.S. investment-grade non-government fixed-income sectors were modestly positive in July; our core fixed-income strategy performed in line with its benchmark during the period. A slightly long-duration posture detracted as interest rates increased, although a yield-curve-flattening bias was beneficial. An overweight to financial corporates contributed, as did an allocation to non-agency mortgage-backed securities (MBS), while an underweight to agency MBS weighed on performance. Commercial MBS outperformance was restrained by a higher-quality preference in a month that favored lower quality. An overweight to asset-backed securities (ABS) was beneficial, while an underweight to taxable municipals detracted. Our high-yield strategy matched the benchmark amid its strongest one-month performance since July 2017. Selection in energy, basic industry and an allocation to bank loans were key contributors, while selection in automotive, transportation and leisure detracted. Emerging-market debt rebounded from a terrible second quarter with the best performance among fixed-income market segments in July. Our strategy outperformed despite an overweight to local debt in an environment that favored foreign-currency-denominated debt. An overweight to Mexican assets and the peso contributed to fund outperformance in the wake of the country's presidential election, while an overweight to Turkey detracted as presidential reforms appeared to compromise government financial institutions and inflation remained unchecked.

Emerging-market debt rebounded from a terrible second quarter with the best performance among fixed-income market segments in July.

Major Index Performance in July 2018 (Percent Return)



Sources: FactSet, Lipper

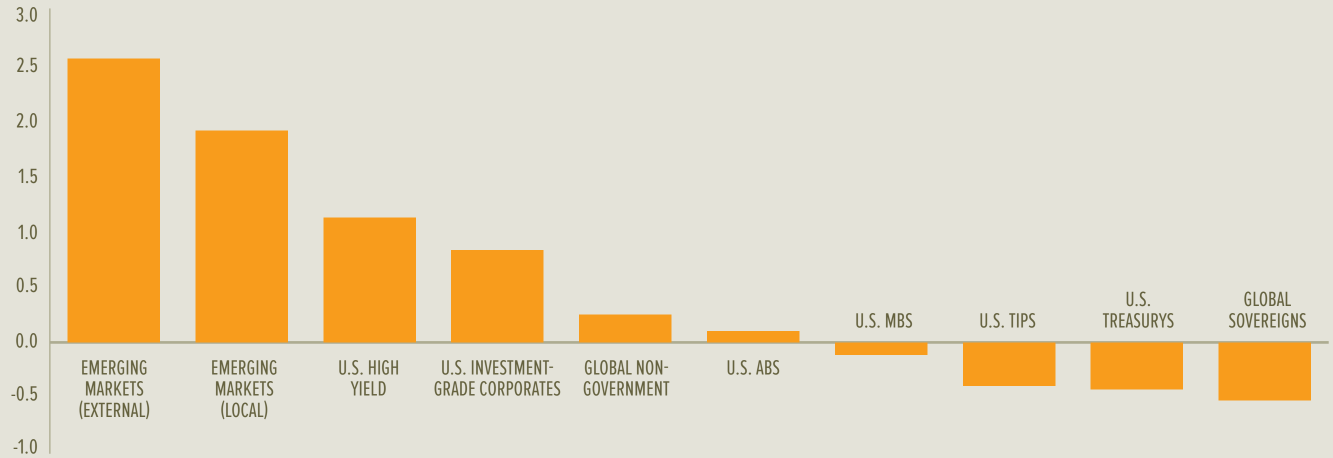
Our large-cap strategy was underweight the largest stocks in its benchmark, and remained tilted toward value in an effort to capture its long-term premium and potential mean reversion.

Manager Positioning and Opportunities

U.S. equities are almost 10 years into a bull market, but still have the benefit of an accommodative economic environment and favorable earnings trends. Markets may continue to exhibit volatility due to high stock valuations, increasing inflation, rising interest rates and trade tensions. Our large-cap strategy was underweight the largest stocks in its benchmark, and remained tilted toward value in an effort to capture its long-term premium and potential mean reversion. Our small-cap strategy was still overweight to value and momentum, but trimmed momentum at the margin and added to value. Our international developed-market equity strategy retained exposure to market themes with structural tailwinds—including an overweight to technology (driven by growth of the internet and digital services around the globe) and overweights to commercial, professional services, and transportation stocks (which benefitted from global growth). Traditional defensive sectors remained underweight since they offer less opportunity for growth. The rising-technology usage theme was also present in our emerging-market equity strategy, leading to an overweight in technology hardware, while industrials also remain overweight.

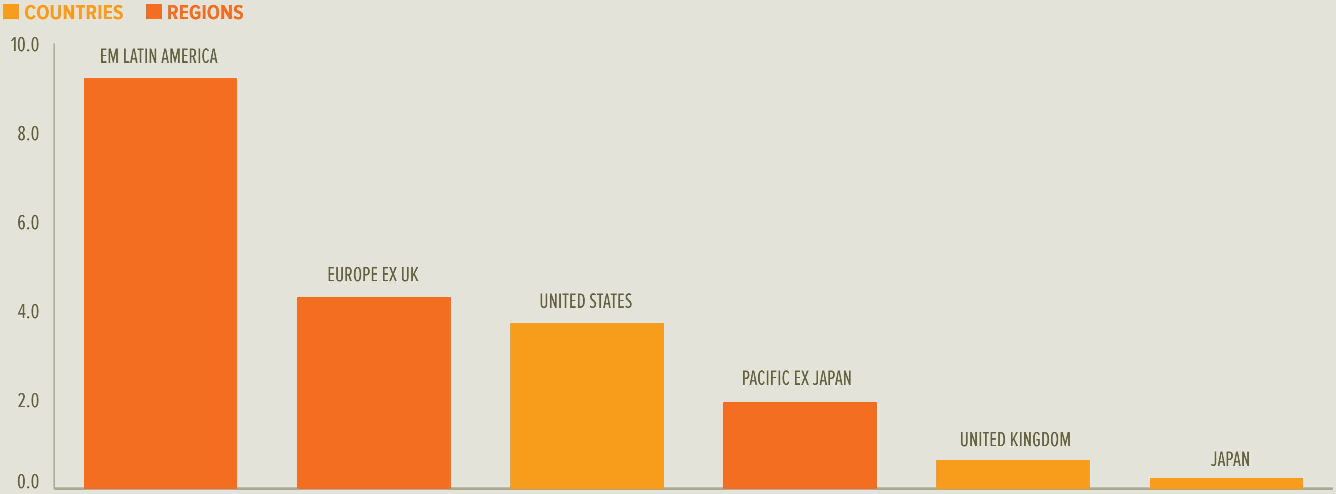
Our core fixed-income strategy had a modestly long duration posture and curve-flattening bias, and remained overweight the banking sector. Select overweights to asset-backed securities and commercial mortgage-backed securities were also maintained given their competitive risk-adjusted yields; we kept an allocation to non-agency mortgage-backed securities (MBS), and continued to slightly underweight agency MBS while increasing exposure. The strategy generally remained in gradual risk-reduction mode, but started to add risk as spreads widened in the second quarter. Within high yield, our strategy maintained a bank-loan allocation and significant overweights to media, retail, leisure and insurance. The strategy's largest underweights were to energy, financial services, services, banking and

Fixed-Income Performance in July 2018 (Percent Return)



Sources: FactSet, Lipper. See "Corresponding Indexes for Fixed-Income Performance Exhibit" in the Index Descriptions section for more information.

Regional Equity Performance in July 2018 (Percent Return)



Sources: FactSet, Lipper. See "Corresponding Indexes for Regional Equity Performance Exhibit" in the Index Descriptions section for more information.

basic industry. Our emerging-market debt strategy remained overweight to local-currency debt, albeit to a lesser degree than in recent months. Top country overweights were to Argentina, Mexico and Egypt, and top underweights were to Hungary, Philippines and Taiwan.

Our View

Investors were raging bulls at the beginning of 2018 as equity prices vaulted higher. But that optimism faded dramatically as the news flow turned less favorable. As far as we're concerned, that's okay—because the potential for a meaningful advance in equities is greater when investors are pessimistic and bad news is already largely discounted in the price of riskier assets.

If one believes, as we do, that the global economy is sound and that the political uncertainties currently roiling markets will be contained, then the proper course (in our view) should be to remain exposed to equities and other risk assets and ride out the short-term ups and downs.

The economic data coming out of Europe has been hugely disappointing this year. Instead of building upon the improved business activity of 2016 and 2017, there has been a widespread deceleration. At SEI, we have been reluctant to get too bearish on Europe's fundamentals, but there's no denying that financial-market participants are disbelievers. Analysts' 2018 and 2019 earnings-growth estimates for the companies within the MSCI EMU (European Economic and Monetary Union) Index are quite low compared to those of other major regions and countries.

ECB President Mario Draghi and other bank governors decided to conclude net asset purchases by the end of this year because they view deflation risks as having moderated significantly. Since the ECB will no longer be a price-insensitive buyer of eurozone debt, we could see yield spreads rise as investors demand a risk premium for those countries with a heavy

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debt burden relative to the size of their economy. Italy's new government wants to institute several expensive propositions that would blow a hole in the government's budget, likely causing the country's bonds to be further discounted by investors—with other periphery countries' bond yields rising in sympathy (yields move inversely to prices).

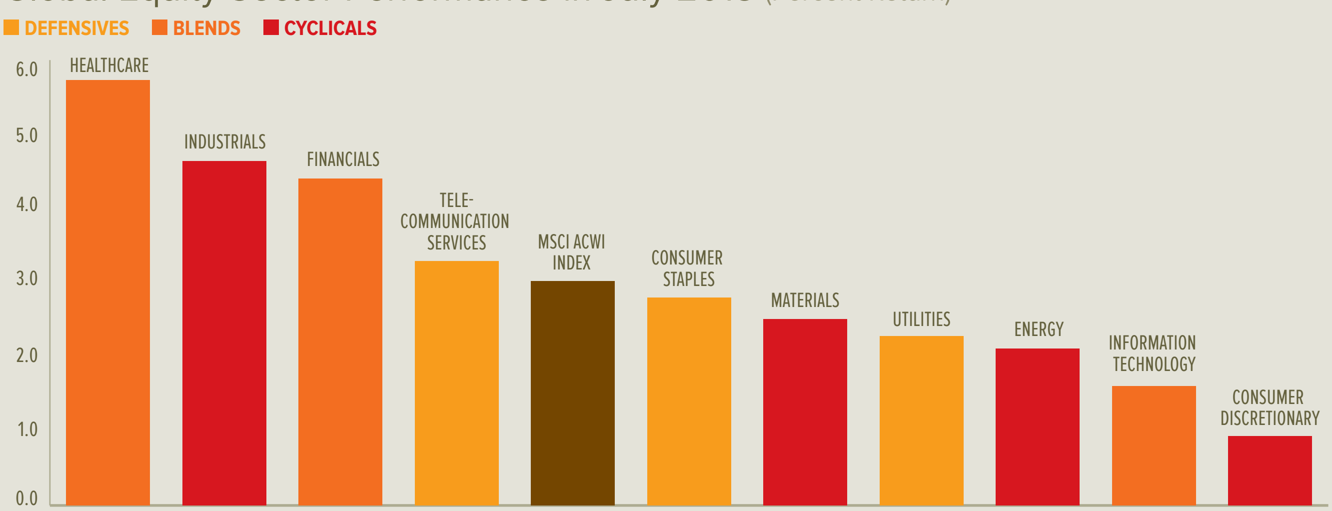
Recent U.K. economic data reports, like those of other countries in Europe, suggest that Great Britain is wending its way through a soft patch. Underlying growth nevertheless appears solid, indicating the U.K. economy is in stable condition; although the trade sector looks to be a problem spot.

The biggest source of uncertainty facing the U.K. is its looming withdrawal from the EU. The Conservative Party's internal fight over the country's future relationship with the EU has stalled progress toward a clear post-Brexit status. Maybe it's sheer coincidence, but sterling versus the U.S. dollar is almost where it was the day after the Brexit vote on 23 June 2016. The recent trend has been to the downside, as currency-market participants worry about the rising odds of a hard Brexit and more-thorough disruption of U.K. trade with the EU. We would not be surprised to see further downside volatility in sterling as we draw closer to the EU exit date.

Fears of a trade war pitting the U.S. against foes and allies alike notwithstanding, American investors, businesses and consumers have much to applaud. U.S. corporate tax reform, tax cuts for households, and reduced or modified regulation of various industries have led to record-high consumer and business confidence.

But saber-rattling between the U.S. and China has deteriorated into actual skirmishing, and the latest back-and-forth suggests this spat will get worse before it gets better. To be blunt, the Trump administration's strategy of waging a trade war with China could prove to be the equivalent of cutting off one's nose to spite one's face.

Global Equity Sector Performance in July 2018 (Percent Return)



Sources: FactSet, Lipper. MSCI ACWI Index Components (as defined by SEI).

A trade war will likely lead to higher prices for consumers and hurt the bottom lines of companies that sell imported goods and those that depend on global supply chains in their production process—resulting in a net loss for society. A small group of producers will probably benefit substantially from the trade impediments, while most consuming industries and households suffer declines in purchasing power—declines that may be small at the level of the individual, but would add up to an enormous loss across the affected economies.

SEI will be watching closely how this drama plays out in the months ahead. With any luck, the Trump administration will shy away from further ratcheting tensions. But we must admit that doesn't seem to be in the cards in the near-term.

A confluence of events has conspired to hurt the performance of emerging-market assets. An extensive trade war that disrupts multinationals' supply chains would disrupt the flow of raw commodities and semi-finished materials from developing economies, which depend on these exports for economic growth. Rising U.S. interest rates, resulting in another period of sustained U.S. dollar strength, are a second threat. The soft patch in Europe and recent signs of deceleration in China's economic growth is a third.

But while emerging-market stocks and bonds have come under pressure this year, we've yet to see any widespread deterioration in economic performance or financial conditions. On balance, we think most emerging markets have the ability to weather the storm—again, assuming the disruption to global trade does not devolve into something more encompassing.

Make no mistake about it: the headwinds blowing in the face of risk assets have picked up. Growth in business activity has slowed a bit, especially in Europe. Monetary policy in the U.S. is getting tighter, and is set to become less expansionary in Europe as well. Inflation has ticked higher, driven by synchronized global growth and a tightening of labor markets and industrial capacity in the U.S., Germany, the U.K., China, and elsewhere in Asia. A jump in oil prices is also pushing headline consumer-price index readings to their highest levels in several years; the Organization of the Petroleum Exporting Countries and Russia have shown a fair degree of discipline in constraining the supply of crude oil at a time when demand is strong and inventory levels have fallen. Some developing countries have been forced to raise their policy rates dramatically to defend their currencies.

Most important, the stoking of trade-war tensions by the U.S. threatens to undermine the very foundation of the system that has supported the global economy since the end of the World War II. Although the actual trade actions to date have been modest, the impact on global supply chains bears close watching.

But the economic fundamentals that drive the stock market still appear solid, even in places like Europe and developing economies. Plus, interest rates remain at levels that are accommodative to global economic growth. The key risks—escalating trade tensions and the polarization of electorates

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over issues like immigration and fiscal sovereignty—appear more political in nature. The positives include a still-solid global economy; strong momentum in corporate-profits growth; and equity valuations that still appear reasonable against the backdrop of still-low, albeit rising, interest rates.

Signs of financial stress remain isolated to the weaker economies; although Italy is an important case, owing to its size and position as a major eurozone country.

A broadening of the trade war with China or a U.S. departure from the North American Free Trade Agreement would likely have a severely negative impact on the profitability of U.S. manufacturers, prompting us to reassess our still-positive view. Impediments to trade also could lead to a higher inflation rate as U.S. companies use the tariffs umbrella to raise their selling prices. The Federal Reserve may feel compelled to lean against this threat to price stability, thereby aggravating any economic shock arising from the disruption of global supply chains—which is how a bear market could develop.

This is not our base-case scenario. We still think this old bull has some life left in it, but the risks to the equity market now seem more balanced than skewed to the bullish side.

Index Descriptions

All indexes are quoted in gross performance unless otherwise indicated.

The Bloomberg Barclays 1-10 Year U.S. TIPS Index measures the performance of inflation-protected public obligations of the U.S. Treasury that have a remaining maturity of 1 to 10 years.

The Bloomberg Barclays U.S. Asset Backed Securities (ABS) Index measures the performance of ABS with the following collateral types: credit and charge card, auto and utility loans. All securities have an average life of at least one year.

The Bloomberg Barclays Global Aggregate Bond Index (formerly Lehman Brothers Global Aggregate Index), an unmanaged market-capitalization-weighted benchmark, tracks the performance of investment-grade fixed-income securities denominated in 13 currencies. The Index reflects reinvestment of all distributions and changes in market prices.

The Bloomberg Barclays Global Aggregate ex-Treasury Index is an unmanaged market index representative of the total-return performance of ex-Treasury major world bond markets.

The Bloomberg Barclays Global Treasury Bond Index is composed of those securities included in the Bloomberg Barclays Global Aggregate Bond Index that are Treasury securities.

The Bloomberg Barclays U.S. Corporate Investment Grade Index is a broad-based benchmark that measures the investment-grade, fixed-rate, taxable corporate bond market.

The Bloomberg Barclays U.S. Mortgage Backed Securities (MBS) Index measures the performance of investment-grade, fixed-rate, mortgage-backed, pass-through securities of Government National Mortgage Association (GNMA), Federal National Mortgage Association (FNMA) and Freddie Mac (FHLMC).

The Bloomberg Barclays U.S. Treasury Index is an unmanaged index composed of U.S. Treasurys.

The BofA Merrill Lynch U.S. High Yield Constrained Index contains all securities in The BofA Merrill Lynch U.S. High Yield Index but caps exposure to individual issuers at 2%.

The BofA Merrill Lynch U.S. High Yield Index tracks the performance of below-investment-grade, U.S. dollar-denominated corporate bonds publicly issued in the U.S. domestic market.

The Chicago Board Options Exchange Volatility Index (VIX) tracks the expected volatility in the S&P 500 Index over the next 30 days. A higher number indicates greater volatility.

The Dow Jones Industrial Average is a widely followed market indicator based on a price-weighted average of 30 blue-chip New York Stock Exchange stocks that are selected by editors of *The Wall Street Journal*.

The FTSE All-Share Index represents 98% to 99% of U.K. equity market capitalization. The Index aggregates the FTSE 100, FTSE 250 and FTSE Small Cap Indexes.

The JPMorgan EMBI Global Diversified Index tracks the performance of external debt instruments (including U.S. dollar-denominated and other external-currency-denominated Brady bonds, loans, eurobonds and local-market instruments) in the emerging markets.

JPMorgan GBI-EM Global Diversified Index tracks the performance of debt instruments issued in domestic currencies by emerging-market governments.

The MSCI ACWI Index is a market-capitalization-weighted index composed of over 2,000 companies, representing the market structure of 48 developed- and emerging-market countries in North and South America, Europe, Africa and the Pacific Rim. The Index is calculated with net dividends reinvested in U.S. dollars.

The MSCI ACWI ex-USA Index includes both developed- and emerging-market countries, excluding the U.S.

The MSCI Emerging Markets Index is a free float-adjusted market-capitalization-weighted index designed to measure the performance of global emerging-market equities.

The MSCI Emerging Markets Latin America Index captures large- and mid-cap representation across five emerging-market countries in Latin America.

The MSCI EMU (European Economic and Monetary Union) Index: is a free float-adjusted market-capitalization-weighted index that is designed to measure the equity market performance of countries within EMU. The Index consists of the following 10 developed-market country indexes: Austria, Belgium, Finland, France, Germany, Ireland, Italy, Netherlands, Portugal and Spain.

The MSCI Europe ex-UK Index is a free float-adjusted market-capitalization-weighted index that captures large- and mid-cap representation across 14 developed markets countries in Europe (Austria, Belgium, Denmark, Finland, France, Germany, Ireland, Italy, the Netherlands, Norway, Portugal, Spain, Sweden and Switzerland). The Index covers approximately 85% of the free float-adjusted market capitalization across European developed markets, excluding the U.K.

The MSCI Pacific ex Japan Index captures large- and mid-cap representation across four of five developed-market countries in the Pacific region (excluding Japan).

The MSCI Japan Index is designed to measure the performance of the large- and mid-capitalization stocks in Japan.

The MSCI World Index is a free float-adjusted market-capitalization-weighted index designed to measure the equity market performance of developed markets. The Index consists of the following 23 developed-market country indexes: Australia, Austria, Belgium, Canada, Denmark, Finland, France, Germany, Hong Kong, Ireland, Israel, Italy, Japan, Netherlands, New Zealand, Norway, Portugal, Singapore, Spain, Sweden, Switzerland, the U.K. and the U.S.

The NASDAQ Composite Index is a market-value-weighted index of all common stocks listed on the National Association of Securities Dealers Automated Quotations (NASDAQ) system.

The S&P 500 Index is a capitalization-weighted index made up of 500 widely held U.S. large-cap companies.

The TOPIX, also known as the Tokyo Stock Price Index, is a capitalization-weighted index of all companies listed on the First Section of the Tokyo Stock Exchange. The Index is supplemented by the subindexes of the 33 industry sectors. The Index calculation excludes temporary issues and preferred stocks, and has a base value of 100 as of January 4, 1968.

Corresponding Indexes for Fixed-Income Performance Exhibit

U.S. High Yield	BofA Merrill Lynch U.S. High Yield Master II Constrained Index
Global Sovereigns	Bloomberg Barclays Global Treasury Bond Index
Global Non-Government	Bloomberg Barclays Global Aggregate ex-Treasury Index
Emerging Markets (Local)	JPMorgan GBI-EM Global Diversified Index
Emerging Markets (External)	JPMorgan EMBI Global Diversified Index
U.S. Mortgage-Backed Securities (MBS)	Bloomberg Barclays U.S. Mortgage Backed Securities Index
U.S. Asset-Backed Securities (ABS)	Bloomberg Barclays U.S. Asset-Backed Securities Index
U.S. Treasurys	Bloomberg Barclays U.S. Treasury Index
U.S. Treasury Inflation-Protected Securities (TIPS)	Bloomberg Barclays 1-10 Year U.S. TIPS Index
U.S. Investment-Grade Corporates	Bloomberg Barclays U.S. Corporate Investment Grade Index

Corresponding Indexes for Regional Equity Performance Exhibit

United States	S&P 500 Index
United Kingdom	FTSE All-Share Index
Pacific ex Japan	MSCI Pacific ex Japan Index (Net)
Japan	TOPIX, also known as the Tokyo Stock Price Index
Europe ex UK	MSCI Europe ex UK Index (Net)
EM Latin America	MSCI Emerging Markets Latin America Index (Net)

Disclosures

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