Selloff Scare Hits Markets Everywhere

Monthly Snapshot

- Capital markets almost universally posted dismal performance in October (in U.S. dollar terms). Recent top performers such as U.S. growth shares suffered the steepest declines, while global fixed-income securities were also hurt by the selloff.
- U.S. mid-term elections occupied the public's attention as healthcare and immigration became defining issues. Overseas, Brexit negotiations continued past the October deadline.
- While investors may feel uncomfortable maintaining exposure to risk assets amid such market declines and geopolitical uncertainty, mistiming entries and exits into and out of equities can be costly. We therefore believe, as always, that investors are best served by remaining focused on the long term.

Economic Backdrop

Capital markets almost universally posted dismal performance in October. The straightforward countercyclical environment meant that recent top performers such as U.S. growth shares suffered the steepest declines. The most cyclically-oriented sectors (consumer discretionary, energy and industrials) were hit the hardest, while classic defensive sectors (consumer staples and utilities) were positive. Asia Pacific was pummelled, particularly China. Latin America shares gained—presumably on ballot-box expectations for Jair Bolsonaro, Brazil's conservative pro-business president-elect.

Fixed income was not spared in October's selloff; higher-risk segments—like high yield and emerging-market debt—fared worst, but investment-grade bonds also declined. Government bond yields declined in the U.K. and EU, but increased in the U.S. West Texas Intermediate crude-oil prices peaked at the beginning of October before descending more than 14% by the end of the month; the trend was largely similar in other commodities.

U.S. mid-term elections occupied the public's attention as healthcare and immigration became defining issues while the economic landscape remained broadly appealing. The country's trade policy was marked by worrying ultimatums (as President Donald Trump's administration continued to threaten tariffs on essentially all China imports) and, in contrast, a hopeful outlook for interpersonal progress (with an end-of-month phone call between the leaders of these two major trading partners). Mexico committed to abstaining from signing the U.S.-Mexico-Canada Agreement (or USMCA, a revised trade deal intended to replace the North American Free Trade Agreement known as NAFTA) until the U.S. exempts Canada and Mexico from steel and aluminium tariffs.

Brexit negotiations continued past the October 17 deadline, days after U.K. Prime Minister Theresa May suggested at an EU summit to extend the post-divorce transition period. The proposal reportedly earned a warm reception, yet EU leaders have since continued to develop no-deal contingency plans. Negotiations appear to hinge on the EU's insistence that the withdrawal agreement allow Northern Ireland to remain in its

Key Measures: October 2018

EQUITY		
Dow Jones Industrial Average	-4.98%	↓
S&P 500 Index	-6.84%	↓
NASDAQ Composite Index	-9.16%	↓
MSCI ACWI Index (Net)	-7.49%	↓
BOND		
Bloomberg Barclays Global Aggregate Index	-1.12%	↓
VOLATILITY		
Chicago Board Options Exchange Volatility Index PRIOR MONTH: 12.12	21.23	↑
OIL		
WTI Cushing crude oil prices PRIOR MONTH: $73.25	$65.31	↓
CURRENCIES		
Sterling vs. U.S. dollar	$1.28	↓
Euro vs. U.S. dollar	$1.13	↓
U.S. dollar vs. yen	¥112.86	↓

Sources: Bloomberg, FactSet, Lipper

single market and customs union; the U.K. prefers a temporary customs arrangement during the transition period, while negotiating a more permanent customs union between the EU and the entire U.K.

A late-October report revealed that May had negotiated the right of U.K.-based financial services companies to continue operating in EU markets after Brexit (although the prime minister's office characterized the report as speculative). The deal would establish a relationship based on the principle of equivalence (that is, the premise that the financial regulatory frameworks of the two areas are in broad alignment)—which is what currently governs the EU-U.S. relationship, for example. German Chancellor Angela Merkel announced she would not stand for re-election as leader of the Christian Democratic Union later this year or as chancellor in 2021 amid poor regional election results for her governing coalition.

The Federal Open Market Committee had no official meeting during October—but minutes released from its September meeting explained that the word "accommodative" was removed from its statement about monetary policy to avoid giving a "false sense of precision" regarding interest-rate expectations. The Federal Reserve (Fed) proposed rolling back banking regulations in late October, spurred by Congress' passage of the Economic Growth, Regulatory Relief, and Consumer Protection Act earlier this year. The proposal sought more flexible capital requirements and less frequent stress tests for smaller and lower-risk firms; reduced standardized requirements for medium-sized firms; and no relief for the largest and highest-risk firms. The Bank of England's Monetary Policy Committee announced no new actions following its meeting on November 1 and lowered economic growth expectations for 2018 and 2019. The European Central Bank (ECB) and Bank of Japan made no changes at their respective late-October meetings.

U.S. manufacturing was depicted in mixed reports as still healthy but modestly softer in October; services-sector growth appeared to accelerate in preliminary reporting. The core personal consumption expenditures price index held at 2.0% in September, remaining at the Fed's target inflation level. Payrolls expanded convincingly in October, and average hourly earnings grew by 3.1% year over year, contributing to the latest evidence of a trend toward higher wage growth. The U.S. economy grew at a slower but still-strong 3.5% annualized rate for the third quarter, according to preliminary reports.

U.K. manufacturing growth dropped in October from the prior month's downward-revised report, registering the slowest expansion in 27 months. Construction growth remained below its long-term average in October, but accelerated to its second-best growth rate since mid-2017. Labor-market conditions were nearly frozen in the latest report, with the claimant-count unemployment rate holding at 2.6% in September. June-to-August unemployment was also unchanged from the prior reporting period, registering a rate of 4.0%, while average year-over-year earnings growth edged upward to 2.7% over the same three months.

The eurozone's manufacturing expansion cooled in October for the ninth time in the past 10 months, falling firmly into slow-growth territory. Services growth also moderated, but remained at healthier levels. The unemployment rate held at 8.1% in September, with almost no net change across the eurozone; although Italy saw a sharp uptick in joblessness that was partially offset by gains in Spain. A preliminary report of overall economic conditions showed eurozone gross domestic product (GDP) expanding by 0.2% in the third quarter and 1.7% year over year, representing a deceleration over both periods and the slowest quarterly pace since the three-month period ending September 2014.

Portfolio Review

U.S. equities fell steeply in October, with the most significant losses in small-cap stocks. Our large-cap strategy was challenged slightly by lower exposure to high-dividend-yielding "bond-substitute" sectors like utilities and real estate, while a tilt toward mid-cap stocks also detracted. A preference for value-oriented strategies was helpful, however, and served as a partial offset. Our small-cap strategy performed favorably compared to the benchmark despite a deeply inhospitable environment. Stability- and value-oriented strategies generally contributed, while momentum strategies detracted. In terms of holdings, stock selection in the healthcare, energy and materials sectors added the most to relative performance. Further afield, international developed- and emerging-market equity markets were also down sharply during October. Our international developed-market strategy struggled due to poor selection in the energy, healthcare and technology sectors. Within healthcare, selection in pharmaceuticals and biotechnology was weak, while ex-benchmark exposure to emerging-market technology and selection in the technology hardware sector detracted. Our emerging-market equity strategy slightly

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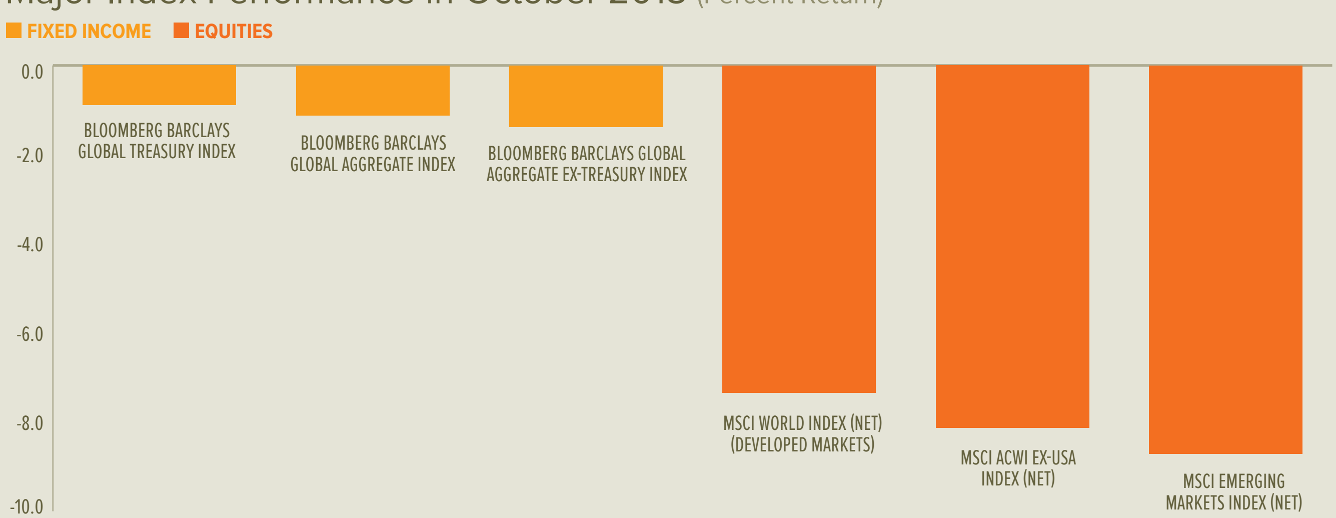
Major Index Performance in October 2018 (Percent Return)

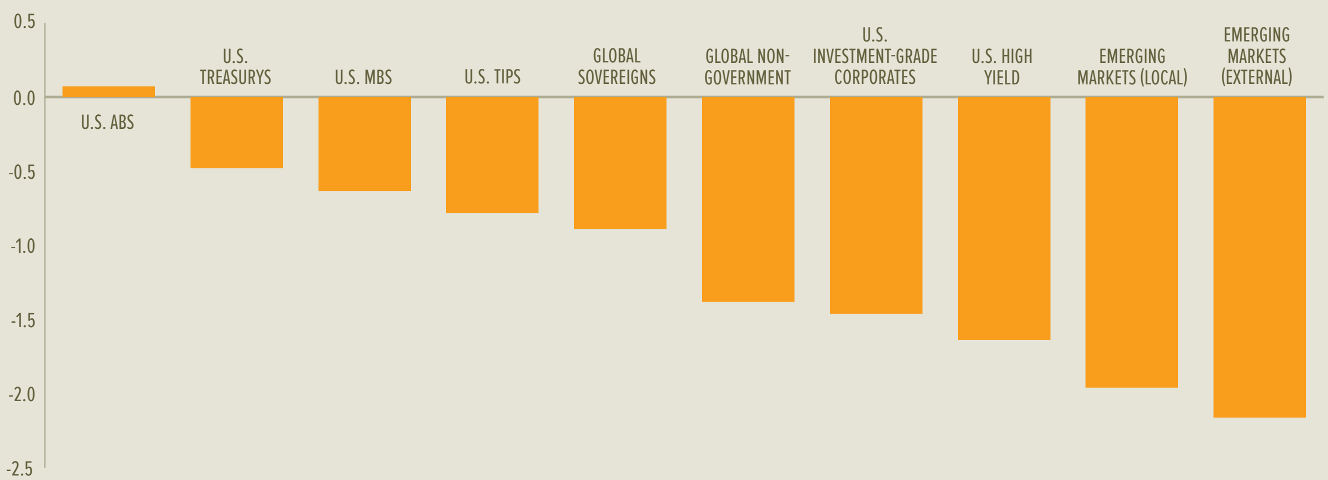


Sources: FactSet, Lipper

outperformed the benchmark in October due to strong selection in consumer discretionary, especially in retailing and media. Selection was also positive in the healthcare and information technology sectors, while positioning in financials and energy detracted.

U.S. investment-grade non-government fixed-income sectors underperformed comparable Treasurys in a challenging month, but our core fixed-income strategy performed in line with the benchmark. Duration and yield-curve positioning detracted, as did an overweight to corporates—yet a preference for financials helped outpace the broader corporate market, which was held back by industrials. An overweight to agency mortgage-backed securities (MBS) detracted, but an allocation to non-agency MBS contributed as housing-market fundamentals remained supportive. An overweight to asset-backed securities (ABS) detracted given their modestly negative performance; a preference for higher-quality commercial MBS (CMBS) cushioned exposure to the segment's poorer-performing lower-quality tranches. An underweight to taxable municipals added as they declined in tandem with the broad selloff. Our U.S. high-yield strategy fared better than the benchmark amid poor conditions for below-investment-grade fixed income in October. An allocation to bank loans was the single-greatest contributor, while selection in retail, energy and media detracted. Emerging-market debt had the weakest performance within the fixed-income universe; our strategy struggled with currency positioning. Overweights to higher-risk assets came under pressure as spreads widened in October. The Brazilian real was an exception to the risk-off sentiment given the country's pro-market election results; our currency underweight therefore detracted, but exposure to foreign-denominated bonds and duration contributed. An overweight to the Mexican peso detracted after the country's incoming president decided to scrap a major infrastructure project following a national referendum.

Fixed-Income Performance in October 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 October 2018 (Percent Return)

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

Manager Positioning and Opportunities

U.S. economic activity and corporate earnings have continued to increase, but there are indications that the current market cycle has already seen its greatest gains. Volatility may remain due to increasing inflation, rising interest rates and trade tensions. Our large-cap strategy continued to underweight some of the largest-cap stocks, as there were a higher number of attractively valued opportunities further down the capitalization spectrum. We were also underweight utilities due to their interest-rate sensitivity, high-debt balance sheets and low profitability. Within small caps, we maintained positive exposure to value and momentum; we've also generally been trimming momentum at the margin in an effort to bolster value. Overseas, our international developed- and emerging-market equity strategies retained exposure to themes with long-term structural tailwinds—resulting in overweights to technology and industrials in both strategies, and underweights to defensive sectors (particularly utilities). From a regional perspective, our developed-market strategy was underweight Australia and Japan (even as we added to Japanese positions) and overweight ex-benchmark opportunities in Asia, Canada and Latin America. We reduced exposures to Germany and Italy, while trimming ex-benchmark names in Korea and Mexico. In our emerging-market strategy, we increased our weight to India while decreasing exposure to Mexico and Taiwan. An ex-benchmark weight in Hong Kong was slightly trimmed. We maintained exposure to Turkey and an ex-benchmark Argentina allocation, as we view both countries as having attractive upsides.

Our core fixed-income strategy's duration posture has drifted lower in recent months, but remained slightly long versus the benchmark. Yield-curve positioning consisted of an overweight to 25- to 30-year bonds, an underweight to 15- to 20-year bonds, and neutral positioning in the short- and intermediate-term segments. We remained modestly overweight corporates with a preference for financials, and have been selectively adding as spreads widened during the heavy September-to-October issuance period. Overweights to ABS and CMBS were maintained, with an emphasis on limiting exposure to higher-risk segments (specifically student loans within ABS and retail property within CMBS). An allocation to non-agency MBS and an overweight to agency MBS remained. Within high yield, we retained an allocation to bank loans and sizeable overweights to the leisure, media and retail sectors. We were significantly underweight energy, financial services, banking and basic industry. Our emerging-market debt strategy re-allocated responsibilities at the end of October with the addition of two investment managers and a refined focus for two existing managers. We believe this realignment will better capitalize on the managers' respective skillsets.

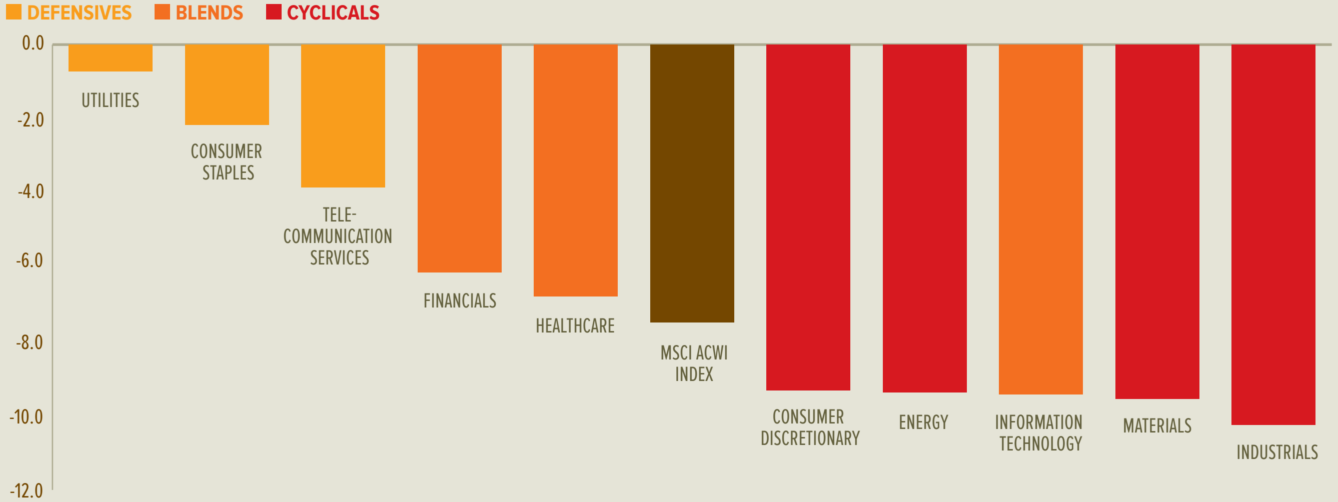
Our View

The ratcheting-up of trade-war tensions between the U.S. and China has become the main preoccupation among investors. And with good reason: Whatever happens between the two countries has global implications. China and the U.S. together accounted for 42% of world nominal GDP last year.

China's currency has fallen sharply not only against the dollar but also against a broader basket of currencies. The weaker currency partially offsets the impact from tariffs imposed by the U.S., while the competitiveness of Chinese exporters against other countries has improved as a result of this year's devaluation.

On the downside, the weak Chinese currency makes it almost certain that the Trump administration will increase the tariff rate to 25% at the beginning of January. It also could fuel the ire of other big importers of Chinese goods, perhaps making it easier for the U.S. to enlist the support

Global Equity Sector Performance in October 2018 (Percent Return)



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

of other World Trade Organization members in its attempt to sanction China over unfair trading practices.

The U.S. is in strong shape economically. Although nobody wins in a trade war, even White House advisors with a pro-trade bias believe that the U.S. will be the least hurt of the two countries.

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Despite a near-term view that is fraught with uncertainty, we continue to believe in diversifying portfolios with emerging-market exposure. We believe the alpha opportunities (that is, the ability to achieve returns in excess of benchmarks) also are much greater, given the economic and political idiosyncrasies inherent in the asset class. The price-to-earnings ratio for the MSCI Emerging Markets Index is running at about a 30% discount to that of the MSCI USA Index (as of September 30, 2018), near attractive relative-valuation levels last seen in early 2016.

As the trade war with China heats up, the Trump administration has turned more conciliatory toward other countries with which it has picked fights. Broad agreement has been reached with Mexico and Canada on the new trilateral USMCA, which replaces NAFTA (notwithstanding Mexico's stipulation of being exempt from steel and aluminum tariffs). The threat of tariffs on European and Japanese autos and auto parts has also been taken off the table. This may be a temporary truce, but we are hopeful that it represents a realization by the White House that it's better to gain allies in its battle against China than fight on multiple fronts.

In Europe, there are business-as-usual problems: sluggish economic growth, still-high unemployment and the never-ending disagreements over how expansive monetary policy should be. Europe also faces trade tensions of its own. The U.K. is far more dependent on the EU as an export market than the other way around. A so-called hard Brexit would therefore severely affect the U.K.'s export of financial and other services (keep in mind that manufacturing accounts for only 10% of the U.K.'s GDP nowadays, while services account for 80%).

Although a last-minute agreement or a mighty kicking of the can down the road is possible, widespread fear of a hard Brexit is apparent in the economic data. The Organisation for Economic Co-operation and Development's leading economic indicators show that the U.K. has deteriorated more dramatically than any of the world's other major developed economies.

As if the future departure of the EU's second-largest member isn't bad enough, Italian government bond yields have risen sharply higher this year as the Lega/Five-Star coalition pushes to make good on some of its campaign promises. Italy is the third-largest eurozone economy and has the fourth-largest debt-to-GDP ratio in the world. To say the least, a debt crisis in Italy would not be as easy to handle as the Greek one (which wasn't all that easy).

A complicating factor for Italy and other highly-indebted countries is the tapering of asset purchases by the ECB. Since the program's inception, the central bank's purchases of Italian bonds equate to 53% of the country's cumulative deficit (as of September 30, 2018), according to Germany-based think tank Centre for European Economic Research. Italy will be losing a large price- and risk-insensitive buyer of its bonds at an inopportune time. The ECB is set to finish its taper at the end of the year.

Tax cuts, deregulation and strong revenue growth have provided an ideal backdrop for U.S. equities to appreciate, but performance could be constrained if earnings estimates fade in light of increasing tariffs on tradable goods. Valuations also could fall if interest rates climb at a faster-than-expected pace. That said, we still think it's premature to turn negative on the near-term U.S. outlook given today's mosaic of economic fundamentals. In our view, risks to the U.S. stock market are evenly balanced.

The multi-year persistence of high U.S. corporate profit margins is unusual. Margins have spiked higher in the past two quarters, reflecting the impact of the U.S. tax cut and the acceleration of sales growth. In the latter stages of an economic expansion, margins normally contract on a sustained basis as higher costs for labor, interest expense, and depreciation take a larger slice of the pie.

Besides rising trade tensions with China, we see the Fed as another, more traditional, major potential threat to the U.S. equity bull market. The question is how high the federal-funds rate will ultimately go, and whether that level proves to be sufficient to keep inflation near the central bank's 2% target or turns out to be overkill. We agree with the Fed's view that the federal-funds rate is still below the so-called neutral rate of interest. Additional rate increases appear appropriate, as long as the Fed doesn't keep hiking after reaching the neutral rate—a level that has historically seen the stock market run into real trouble.

One can argue about whether the valuations embedded in the U.S. equity market are high, especially when measured against other global stock markets; although earnings growth in the latter has been less robust. The extreme appreciation in some large technology companies also suggests that the U.S. stock market could be subject to a sharp rotation from previous winners to the laggards somewhere down the road. SEI equity strategies certainly tilt in the direction of more value-oriented companies and industries.

Predicting the future is a hazardous venture most of the time. In view of the uncertainties presently facing investors, the prediction game is, perhaps, even more challenging. Accordingly, we believe in a diversified approach to investing. While maintaining exposure to risk assets may feel uncomfortable, we believe that investors with long time horizons should know that mistiming entries and exits into and out of equities can be costly. Today, mistiming an exit is the greater concern.

Glossary of Financial Terms

Bull market: A bull market refers to a market environment in which prices are generally rising (or are expected to do so) and investor confidence is high.

Federal-funds rate: The federal-funds rate is the interest rate at which a depository institution lends immediately available funds (balances at the Federal Reserve) to another depository institution overnight in the U.S.

Fundamentals: Fundamentals refers to data that can be used to assess a country or company's financial health such as amount of debt, level of profitability, cash flow or inventory size.

Price-to-Earnings Ratio: Equal to market capitalization divided by after-tax earnings. The higher the price-to-earnings ratio, the more the market is willing to pay for each dollar of annual earnings.

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.

MSCI World ex USA Index is a free float-adjusted market-capitalization-weighted index that is designed to measure the equity-market performance of developed markets, excluding the U.S.

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.

Shenzhen Stock Exchange Composite Index tracks performance of A share stocks (which are denominated in renminbi, the local currency) and B share stocks (which are denominated in Hong Kong dollars, an offshore currency) on China's Shenzhen Stock Exchange.

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)

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