Unrelenting Recoveries Despite Unresolved Diplomacy

Economic Backdrop

Equity markets around the globe continued their recoveries unabated in February. U.S., U.K. and eurozone government-bond yield curves steepened as long-term rates increased by more than short-term rates, and oil prices ended the month slightly higher.

U.S. trade negotiators expressed optimism about progress with their Chinese counterparts during February, although concrete developments remained limited to assurances from China to boost U.S. agricultural imports; President Donald Trump announced that the March 1 deadline to reach a trade deal would be extended. The U.S. president and North Korea's Supreme Leader Kim Jong Un held a second summit in Vietnam near the end of the month. Trump concluded that North Korea was not making adequate concessions about denuclearization to warrant the removal of sanctions, and ended the meeting earlier than planned.

U.K. Prime Minister Theresa May delayed a parliamentary confrontation on the path forward for Brexit, setting up a series of votes to occur from March 12 to 14—first on whether to approve her deal, then (if the first vote fails) on whether to offer explicit support for a no-deal Brexit, and finally (if the second vote also fails) on whether to delay Brexit. If all three proposals are rejected and no action is taken by March 29, members of parliament can push for votes on a second referendum or a revocation of Article 50 (which is the U.K.'s notice of departure to the EU). The prime minister ruled out the passive outcome of a no-deal Brexit.

May informed European Council President Donald Tusk in late February that she may need to delay Brexit even if her deal earns parliamentary approval; there's evidence that EU leaders would prefer one large postponement—likely by converting the transition period through 2020 into a delayed divorce—rather than an open-ended number of multi-month extensions. An increasingly active bi-partisan alliance in U.K. parliament has also been agitating for a delayed Brexit, which is why May is including this as an option in the mid-March series of parliamentary votes.

Monthly Snapshot

- Equity markets around the globe continued their recoveries unabated in February. U.S., U.K. and eurozone government-bond yield curves steepened as long-term rates increased by more than short-term rates.
- President Trump announced that the March 1 deadline to reach a trade deal with China would be extended as U.S. negotiators expressed optimism about progress.
- Even if an extraordinarily unfavorable economic scenario comes to pass, with tariff wars deepening and the Federal Reserve hiking rates too far and too fast, we doubt the U.S. economy will experience anything worse than a garden-variety recession by 2021.

Key Measures: February 2019

Equity		
Dow Jones Industrial Average	4.03%	↑
S&P 500 Index	3.21%	↑
NASDAQ Composite Index	3.60%	↑
MSCI ACWI Index (Net)	2.67%	↑
Bond		
Bloomberg Barclays Global Aggregate Index	-0.58%	↓
Volatility		
Chicago Board Options Exchange Volatility Index PRIOR MONTH: **16.57**	14.78	↓
Oil		
WTI Cushing crude oil prices PRIOR MONTH: **$53.79**	$57.22	↑
Currencies		
Sterling vs. U.S. dollar	$1.33	↑
Euro vs. U.S. dollar	$1.14	↓
U.S. dollar vs. yen	¥111.32	↑

Sources: Bloomberg, FactSet, Lipper

The Federal Reserve (Fed) did not conduct a monetary policy meeting in February, but several key members of its policy-setting committee gave speeches confirming its patient, data-dependent approach to future tightening decisions. The Bank of England's early-February Monetary Policy Committee meeting produced no new actions. Its post-meeting statement expressed continued bias toward a gradually tighter policy; however, if the Brexit outcome creates economic stress, the central bank is widely expected to provide an accommodative response. Neither the European Central Bank (ECB) nor the Bank of Japan held monetary policy meetings in February; minutes from the ECB's January meeting revealed rising concerns about weak economic growth..

Activity in the U.S. services sector accelerated significantly in February; manufacturing growth moderated, albeit to still-healthy levels. Total economic growth measured an annualized 2.6% during the fourth quarter, slower than the previous quarter but above expectations. U.K. manufacturing conditions settled into slow-growth territory in February. The British economy expanded by 0.2% in the fourth quarter of 2018 and 1.3% year over year. Eurozone manufacturing contracted in February after modestly gaining in the prior month, yet services growth accelerated. The unemployment rate was 7.8% in January, unchanged from the downward-revised December level. . Overall economic growth registered 0.2% in the fourth quarter and 1.2% year over year.

Portfolio Review

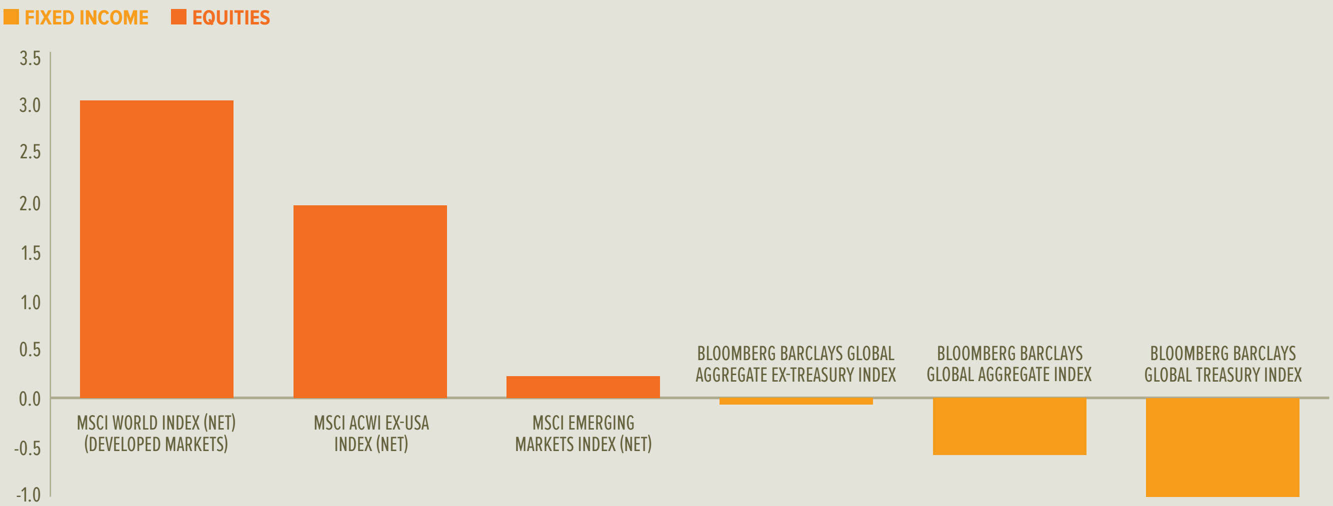
U.S. equities added to their 2019 gains in February, led again by small-company stocks. Our core large-cap strategy essentially matched the benchmark—held back by stable value exposure in a rising market environment, but helped by an overweight to information technology. Our core small-cap strategy produced strong absolute performance, yet lagged the benchmark due to stock selection within materials, financials and industrials; its value tilt also hurt relative returns. Overseas, our developed-market strategy performed well due to security selection in the U.K. and Japan, particularly information technology. Selection in consumer discretionary, financials and healthcare detracted. Our emerging-markets equity strategy fared well against the benchmark's modestly positive performance in February. Selection in Asia and South Africa helped, but detracted in Brazil.

U.S. investment-grade non-government fixed-income sectors outperformed U.S. Treasurys in February; our core fixed-income strategy matched the benchmark with flat performance. The strategy's duration remained long but drifted slightly lower during the month, which detracted as yields rose. Overweights to credit and agency mortgage-backed securities (MBS) contributed, while exposure to outperforming commercial MBS (CMBS) was mixed as a higher-quality bias came under pressure. The high-yield market was the best-performing segment of the fixed-income universe in February, and our high-yield strategy performed well. An allocation to collateralized loan obligations (CLOs) was the greatest contributor, followed by selection within media, while selection in telecommunications and healthcare detracted. Our emerging-market debt strategy performed well in a mixed environment where foreign-currency-denominated (external) debt gained and local-currency debt declined. An overweight to Egypt, especially its currency, contributed, as did an underweight to South Africa. An overweight to Turkey and an underweight to Ecuador detracted.

Manager Positioning and Opportunities

U.S. corporate earnings continued to increase during the period, but there are indications that the majority of growth has passed. Our core large-cap strategy remained underweight some of the largest-company stocks as we believe there are more attractively valued opportunities further down the company-size spectrum. We were also underweight utilities due to the sector's interest-rate sensitivity, high-debt balance sheets and low profitability. Our core small-cap strategy was slightly overweight stability; its momentum exposure continued to decrease in favor of value. Risk exposure was below the benchmark in anticipation of heightened volatility. Our international developed-market strategy moderately increased an underweight to materials and slightly decreased exposure to Japanese auto-parts and Irish stocks, while an underweight to U.K. stocks moved to neutral. Exposure to global-growth themes that emphasize technology and communications services remained intact, while financials surpassed industrials as one of the strategy's largest overweights. Defensive sectors remained underweight. Our emerging-market equity strategy also remained overweight to technology (slightly increased) and industrials (slightly decreased). Financials were the strategy's largest underweight primarily as a result of underexposure to large Chinese state-owned banks; positioning in China was also the genesis for an underweight to real estate.

Major Index Performance in February 2019 (Percent Return)



Sources: FactSet, Lipper

Within emerging-market debt, our strategy had a small overweight to local-currency assets as we continued to find attractive opportunities in foreign exchange.

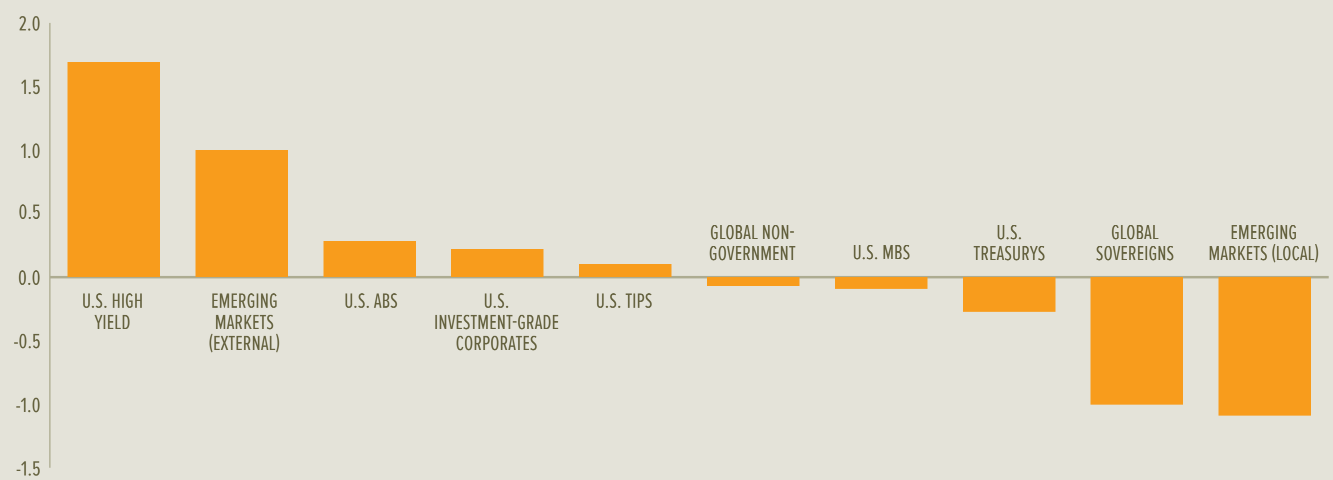
Our core fixed-income strategy was overweight the long end of the yield curve as inflationary pressures are likely to gradually advance; it continued to add exposure in the front end of the curve as we are nearing the completion of the Fed's interest-rate hike cycle. We selectively added to a modest corporate-sector overweight (concentrated in banks) amid ample issuance. Overweights to asset-backed securities and CMBS remained, along with an allocation to non-agency MBS, while we added to agency MBS. Our high-yield strategy retained an allocation to CLOs along with sizeable overweights to retail and leisure. Energy, financial services, services, basic industry, capital goods and banking were the strategy's largest underweights. Within emerging-market debt, our strategy had a small overweight to local-currency assets as we continued to find attractive opportunities in foreign exchange. Top country overweights were to Argentina, Egypt and Turkey, while top underweights were to the Philippines, Taiwan and Panama.

Our View

As painful as 2018 was for risk assets, their gyrations were not outside the norm. Rather, given our views that the global economy would continue to grow and that market participants were overreacting to the concerns of the day, we saw another important risk-on opportunity developing in equities and other risk assets. We therefore determined that a rebalancing of assets back toward undervalued equity classes was an appropriate and timely response.

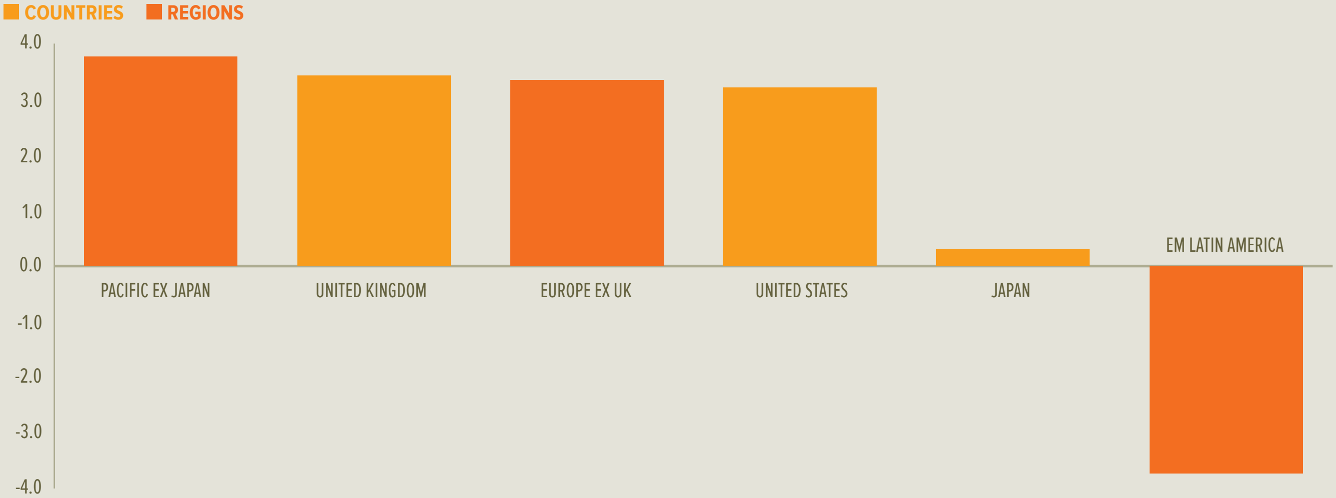
In our view, the U.S. economic position remains fairly solid. Points of strength include the improving economic position of U.S. households as labor markets tighten and real wage growth accelerates, while increased government spending has also helped. With Democrats controlling the House of Representatives and Republicans holding power in the Senate,

Fixed-Income Performance in February 2019 (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 February 2019 (Percent Return)



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

any fiscal-policy agreement made during a period of political gridlock will likely mean slightly more federal-government spending—not less.

Some Fed officials, including Chairman Jerome Powell himself, explicitly acknowledge that the federal-funds rate is now near a level that can be considered neither stimulative nor deflationary. The important thing to remember is that the central bank is adopting a wait-and-see approach to monetary policy and has ended the nearly automatic quarterly rate increases of 2017 and 2018.

We think the odds favored and should continue to favor a strong rebound in U.S. equity prices for the following reasons:

- The U.S. economy should continue to grow, and corporate earnings per share are expected to post a mid-to-high single-digit gain in 2019.
- Valuations for the S&P 500 Index declined from almost 19 times one-year forward earnings per share to an attractive level of almost 14 times following the decline in share prices.
- U.S. bond yields remain rather low and moved down again in late 2018, bolstering the case for riskier assets.
- Investor risk aversion increased sharply in late 2018, and we think much of the bad news of recent months is already reflected in stock prices—creating space for potential upside surprises on trade wars, the Fed's policy path, Brexit, corporate profits and elsewhere.
- We do not expect fiscal policy to be the strong catalyst for growth in the U.S. that it was in 2018, but the impact of political gridlock should still be mildly expansionary.

Although the European banking system is in better shape than it was in the immediate aftermath of the global financial crisis, it is still vulnerable at a time when the ECB is in a holding pattern, policy-wise, and has limited flexibility in the event of a financial emergency. A lack of enthusiasm for Europe's economic prospects is reflected in its equity-market valuations: the MSCI

European Economic and Monetary Union (EMU) Index price-to-earnings ratio dropped to less than 12 times from nearly 15 times at the start of the year. Note that European equities outperformed U.S. equities in the fourth quarter of 2018.

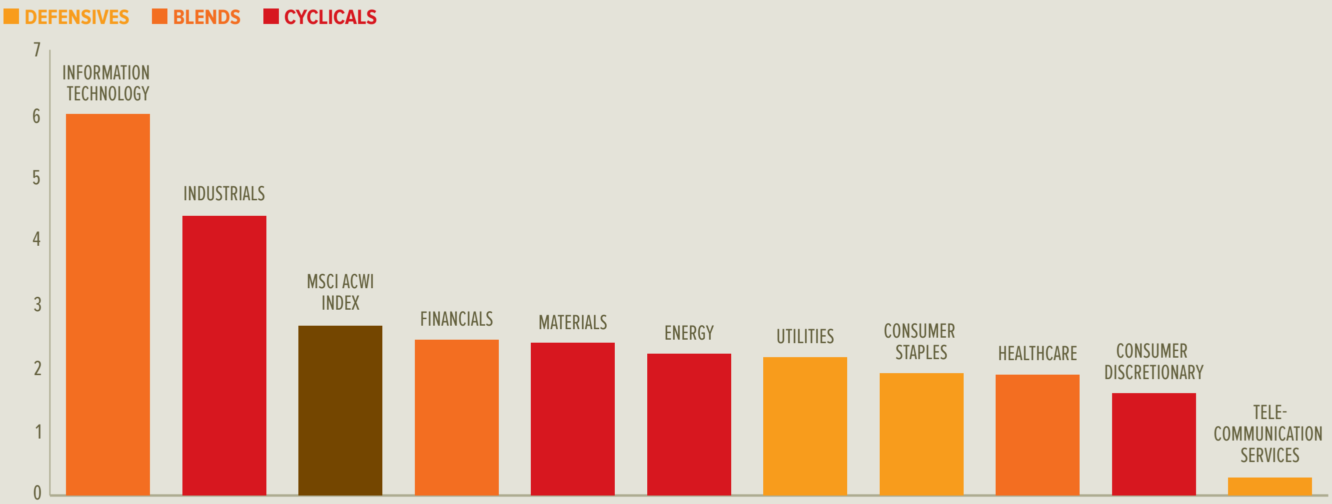
We are leaning on the optimistic side for emerging markets in 2019. The valuation piece is already in place, in our opinion, as the MSCI Emerging Markets Index price-to-forward-earnings ratio collapsed from 13 times at the end of January to 10.5 by year-end. But what could be the catalyst for a turnaround? Big debt expansions in China typically lead to big gains in emerging-market equities. The question is whether the Chinese government has the will to support increased debt issuance one more time.

It surely would be a big positive for the country if the threat of tariffs was negotiated away, but we're not holding our breath. When push comes to shove, the Chinese government will probably get even more aggressive in easing lending constraints if the situation warrants.

Commodity prices and the earnings of emerging-market companies are closely correlated in inverse fashion with movements of the U.S. dollar. For most of 2018, the U.S. dollar gained against other currencies, putting downward pressure on commodity prices and the earnings of energy and materials companies that are a large part of the MSCI Emerging Markets Index. In 2017, the opposite conditions held.

We are looking for another change in the dollar's trend in 2019. In our view, U.S. economic and corporate-earnings performance will move toward that of other developed countries. If there are positive developments in some of the pressure-point issues that have roiled markets, investment capital could flow away from the U.S. and back into the world—thereby removing an important source of support for the U.S. dollar and a big headwind from the rest of the world. This potential for a reversal in investment flows could accelerate if Fed policy becomes more dovish than currently projected by the central bank.

Global Equity Sector Performance in February 2019 (Percent Return)



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

The poor performance of risk assets in the fourth quarter can certainly prey on investors' emotions. But the global economy is not exactly in dire straits. Yes, there are an unusually large number of uncertainties and concerns, some of which could have a material impact on growth if the worst comes to pass. However, even in an extraordinarily unfavorable economic scenario in which the tariff wars with China and other countries deepen and the Fed raises the funds rate too far and too fast, we doubt that the U.S. economy would experience anything worse than a garden-variety recession by 2021. The economic and credit excesses that usually precede a deeper recession simply aren't to be found.

During periods of market volatility like the one we experienced at the end of 2018, investors should be mindful about the importance of sticking with a strategic and disciplined approach to investing that is consistent with personal goals and risk tolerances. Diversification is the key to that approach, and the construction of portfolios should be dictated by long-term capital market assumptions.

Ultimately, the value of these assumptions is not in their accuracy as point estimates, but in their ability to capture relevant relationships—as well as changes in those relationships as a function of economic and market influences.

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Glossary of Financial Terms

Dovish: Dovish refers to the views of a policy advisor (at the Bank of England, for example) who has a positive view of inflation and its economic impact, and therefore tends to favor lower interest rates.

Duration: Duration is a measure of a security's price sensitivity to changes in interest rates. Specifically, duration measures the potential change in value of a bond that would result from a 1% change in interest rates. The shorter the duration of a bond, the less its price will potentially change as interest rates go up or down; conversely, the longer the duration of a bond, the more its price will potentially change.

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.

Momentum: Momentum securities are those whose prices are expected to keep moving in the same direction (either up or down) and are not likely to change direction in the short-term.

Price-to-earnings ratio: The price-to-earnings ratio is the ratio of a company's share price to its earnings over the past 12 months, which can be used to help determine whether a stock is under- or overvalued.

Stability: Stability securities exhibit lower risk and higher quality, and can benefit from the power of long-term compounding as a result of the investors tendency to misprice lower risk.

Yield curve: The yield curve represents differences in yields across a range of maturities of bonds of the same issuer or credit rating (likelihood of default). A steeper yield curve represents a greater difference between the yields. A flatter yield curve indicates the yields are closer together.

Index and Benchmark 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 EMU Index captures large- and mid-cap representation across the developed-market countries in the EMU.

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 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 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 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 an unmanaged, market-capitalization-weighted index comprising 500 of the largest publicly traded U.S. companies and is considered representative of the broad U.S. stock market.

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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Diversification may not protect against market risk. There is no assurance the objectives discussed will be met. Past performance does not guarantee future results. Index returns are for illustrative purposes only and do not represent actual portfolio performance. Index returns do not reflect any management fees, transaction costs or expenses. One cannot invest directly in an index.

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