

Investment Update: Market Volatility Continues

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From a market perspective, the month of May had more than its fair share of challenges. The Dow Jones Industrial Average fell 7.92% for the month, the worst percentage decline for the month of May since 1940. In addition, markets have been highly volatile, as shown by the Chicago Board Options Exchange Volatility Index (VIX), a measure of implied volatility in the S&P 500 Index that is also known as the “fear index;” it rose from 22 at the end of April to 33 by the end of May. From continued gloom cast by the sovereign-debt crisis in peripheral Europe to the “Flash Crash” on May 6, when U.S. blue-chip stocks made a staggering 1,000-point decline before recovering a majority of the drop by the end of the day, it is easy to see why investors remain cautious.

Our View

In SEI’s view, the market correction that occurred during the month of May is hard to stomach but not unexpected. The global economy should continue to fight its way forward, but it won’t be uniform across regions. Although the U.S. economy is demonstrating resilience and emerging markets are continuing to lead in terms of economic growth, European economies are struggling due to the ongoing problem of large levels of government debt. The sovereign debt crisis in peripheral Europe remains a major risk to our outlook. This situation still needs to be resolved, as it has contributed to the dramatic fall of the euro and poses problems for large U.S. companies, which have on average 25% of their revenues with direct exposure to Europe. We expect that problems in Greece and other southern European countries will persist as these nations work to cut government spending and increase their competitive advantages. Yet, even in Europe, positive economic reports are emerging from France and Germany.

SEI Investment Strategy Positioning

At the beginning of the year, we began positioning many of our portfolios toward high-quality securities in anticipation of changing market dynamics. The ability to tilt our portfolios in accordance with where we believe the global markets and economy are headed is intended to produce consistent returns for investors. An overview follows regarding how each of SEI’s major asset classes is positioned:

- In our U.S. equity portfolios, we remain bullish on equities while favoring higher-quality stocks. These types of companies normally fare better in periods of downward market pressure because they generally have less debt and have better capabilities for capturing and keeping market share. In our non-U.S. equity portfolios, our managers continue to hold positions in quality companies and countries. Selection is key with respect to both geography and currency.
- In our global fixed-income portfolios, we are generally cautious, with an underweight to both the euro and debt issued by the Eurozone. Like our equity portfolios, we are emphasizing high-quality securities. As global spreads have tightened over the past year, we have used this opportunity to reduce risk in our fixed-income portfolios.
- In our alternative investment portfolios, we remain focused on maintaining overall low beta and seeking alpha without taking on meaningful directional market exposure. The next phase of the economic cycle is likely to result in increased dispersion between winners and losers, creating relative value opportunities. We actively manage our portfolios to take advantage of these opportunities across asset classes. In the short term, our significant exposure to tactical trading is designed to take advantage of higher volatility and exploit market dislocations during periods of uncertainty.

Summary

At the beginning of the year, the market favored riskier assets, so our high-quality focus was not rewarded. When the markets rebounded sharply in March 2009, risk appetite soared and deeply discounted, lower-quality names led the way. Although this trend continued in the first few months of 2010, investor uncertainty has recently increased, meaning greater market volatility. In the current environment, we expect low-quality assets to lag; therefore, we have transitioned our portfolios to hold securities issued by high-quality companies. SEI promotes an approach to investing that uses diversified asset allocations in an effort to generate consistent returns over a certain time horizon in accordance with an investor's risk profile. We do not believe the month of May is a harbinger of a bear market; instead, we believe that the market correction should be viewed as an opportunity to buy at a lower price. We continue to monitor day-to-day events while looking towards a longer horizon.

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