



## October 2011 Market and Performance Update

*By: SEI Investment Management Unit*

### Summary

- **News of a eurozone deal and positive U.S. economic data were welcomed by investors before the mood began to turn sour toward the end of the month.**
- **Short-lived positive sentiment led October's rebound in the global equity and bond markets.**
- **In a reversal of the summer's fortunes, equity and riskier fixed-income investments performed best.**

Global equity and bond markets experienced a positive month. The markets witnessed a reversal of investor sentiment from preceding months and again began to favor riskier assets. News of a eurozone deal to help tackle the mounting debt crisis and positive U.S. economic data releases helped to foster an optimistic mood. While market volatility had cooled for much of October, things began to turn sour as the month drew to a close, with the markets once again changing direction due to reports of rising borrowing costs in Italy.

### Economic Backdrop

Market sentiment improved throughout October as investors were comforted by news that Europe's leaders were working on a way to coordinate their efforts to support the eurozone and European banks. By the end of the month, an agreement aimed at preventing the Greek debt crisis from spreading to larger eurozone economies was announced, helping to further boost investor confidence. Under the proposed deal, banks holding debt in the troubled country would accept a 50% loss on their returns, and would be expected to raise more capital as protection against losses from other potential government defaults. As part of the same package, it was also announced that the European Financial Stability Facility (EFSF, the eurozone's main bailout fund) would be boosted from €440 billion to approximately €1 trillion. The head of the EFSF also began attempts to persuade China and other international countries to invest in the rescue deal.

Upbeat economic news, particularly concerning the U.S., played a part in fostering October's positive market returns. Stronger-than-expected economic data releases and upbeat corporate earnings reports eased fears that the U.S. was on the brink of another recession. U.S. gross domestic product readings for the third quarter of 2011 were reported at 2.5%, in line with expectations. More importantly, growth was significantly higher than had been recorded for the second quarter, which tracked a 1.3% rise. Although still higher than hoped, U.S. unemployment levels shrunk in both September and October, and manufacturing output also exceeded expectations. Despite the good news, however, consumer sentiment in the U.S. dropped in October, signaling that a degree of investor caution remained.

## Market Impact

Bond markets reversed as volatility calmed. After falling out of favor during the risk-adverse summer months, high-yield and emerging market debt led in October. Corporate bonds (particularly Financials) also benefited from improved sentiment, and while still in positive territory, global government bonds brought up the rear. Consequently, credit spreads tightened during the period. Within government bonds, demand for traditional “safe haven” issuers, such as the U.S., U.K. and Germany, remained relatively steady, but declined for struggling eurozone nations. As a result, yields for Italian, Spanish and Greek government debt rose for the month.

Equity markets rebounded strongly in October, with gains witnessed almost across the board. Market volatility gradually decreased throughout the month as investor risk aversion waned. Globally, the return to positive market sentiment resulted in pro-cyclical sectors leading the rally. As a result, Energy, Materials and Financials all performed particularly well after lagging in recent months. More defensive sectors, such as Utilities and Health Care, struggled in comparison. Reflecting increased investor risk appetite, emerging markets also outperformed developed markets for the month.

## Index Data

- The Dow Jones Industrial Average index gained 9.72%.
- The S&P 500 Index posted a 10.93% return.
- The NASDAQ Composite Index returned 11.19%.
- The MSCI AC World Index gained 10.71%.
- The Barclays Capital Global Aggregate Index was up 1.33%.
- 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,” fell from 42.96 to 29.96.
- WTI Cushing crude oil prices, a key indicator of movements in the oil market, rose from \$79.20 a barrel at the end of September to \$93.19 by October 31.
- The euro strengthened against most currencies in October, while the Japanese yen weakened. The U.S. dollar gained against the Japanese yen, but fell against the euro and sterling. The U.S. dollar ended the month at \$1.61 against sterling, \$1.39 versus the euro and at 77.978 yen.

## Portfolio Review

SEI’s equity portfolios benefitted from the positive sentiment inspired by the prospect of a resolution to the European sovereign debt crisis against the backdrop of a generally positive corporate earnings season. In large-cap equity, solid stock selection in the Consumer Discretionary and Information Technology sectors drove relative outperformance. An underweight to the Utilities sector helped performance in small-cap equity, while Information Technology contributed through company-specific performance in semiconductors. In international equity, an overweight to Canada and an underweight to Japan were the greatest contributors to performance, while the underweight to Pacific ex-Japan and the U.K. detracted.

SEI’s fixed-income portfolios fared well during a month that saw investor sentiment teeter between optimism and pessimism regarding a potential resolution to eurozone issues. In core fixed income, a short duration posture benefited performance as Treasury yields rose across the curve. In high-yield bonds, security selection in the Consumer Cyclical sector—especially among specialty retail companies—enhanced performance. In emerging-market debt, an allocation to local currency debt added to returns, particularly in Brazil, Colombia and Mexico, all of which benefited from a rally in local currencies as investor risk appetite increased.

## Contributors

- Stock Selection in Large-Cap Equity – *specifically within the Consumer Discretionary and Information Technology sectors*
- Financial Sector Holdings in Small-Cap Equity – *real estate and diversified segments were particularly beneficial*
- Country Allocation in International Equity – *positive results were driven by an overweight to Latin America and an underweight to Japan*
- Allocation to Corporate Debt in Emerging Markets Debt – *this sector benefited from more risk appetite*

## Detractors

- Defensive Growth Posture in Large-Cap Equity – *an overweight to Consumer Staples detracted from performance*
- Consumer Discretionary in Small-Cap Equity – *mainly due to stock-specific challenges in the media segment*
- Stock Selection in International Equity – *particularly within Consumer Discretionary and Materials*
- Service Sector Picks in High-Yield Bonds – *especially among regional gaming names that suffered project-specific difficulties*

## Manager Positioning and Opportunities

SEI's portfolio managers aim to provide diversified sources of excess return for our portfolios through solid investment-manager selection and portfolio construction. In large-cap equity, managers have overweights to the Information Technology and Consumer Discretionary sectors as they believe an attractive opportunity set is still present in these areas. In small-cap equity, the exposure to Technology is most evident in the Internet software and services segment, though it is worth noting that managers have trimmed the underweight to semiconductors. International equity managers increased the overweight to Consumer Discretionary while reducing the overweight to Materials. The underweights to Financials and Consumer Staples were extended.

In investment-grade fixed income, the overweight to non-agency mortgage-backed securities is expected to continue as securities in these sectors are attractively priced relative to conservative assumptions. High-yield debt managers have maintained an allocation to bank loans due to their more defensive positioning and event-driven opportunities. In emerging-markets debt, managers are repositioning at the margin and will stay strategically positioned in corporate and local debt.

## Our View

Despite the uncertainty and the recent pain, we continue to favor stocks over bonds. Although the economic outlook has been downgraded by economists, we believe the data still supports a positive view of overall business activity in the U.S., the European core economies and developing markets. Equities are expected to benefit from continued earnings growth and exceptionally low valuations. We favor high-yield bonds over Treasuries and investment-grade debt. High-yield bonds appear priced for a recession that we do not think will materialize. We remain neutral to emerging-market debt and equity. With regard to emerging-market equity, economic growth prospects remain an important positive factor, but we believe that valuations relative to developed markets are somewhat expensive.

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