SEI New ways. New answers.®

SEI—A Global Pioneer in Managed-Volatility Investing

DECEMBER 2019

Snapshot

- Managed-volatility strategies seek to capitalize on a well-documented risk-reward anomaly in equity markets.
- At SEI, we are pioneers and consistent innovators in this space.
- Our first managed-volatility fund celebrated its fifteenth anniversary in October 2019.

Managed-volatility approaches to investing, which are based on a long history of empirical evidence, offer investors a compelling way to pursue stock-market-like returns with less volatility. We launched our implementation of this investment style in the U.S. more than 15 years ago in 2004, and have since continued to innovate as managed volatility has evolved.

Brief history of an anomaly

The foundations of modern portfolio theory were first laid in the 1950s and 1960s. One of the core ideas in those early days was that the expected return on an investment should be commensurate with its risk, typically measured in terms of volatility. The idea was intuitive and straightforward: Investors should demand a greater return for holding an asset that has a more volatile (less predictable) pattern of returns.

However, in the ensuing decades, this assumption was subjected to intense scrutiny. Analysis of real-world market data found that investors generally appeared to systematically overpay for higher-volatility securities and underpay for lower-volatility ones. Said another way, returns on high-volatility stocks were notably lower than prevailing finance theories predicted, while returns on low-volatility stocks were unexpectedly higher. This was a significant and surprising finding—seemingly an anomaly, in financial parlance—that has been confirmed by subsequent studies using data from other time periods and other markets as actually being quite typical. At SEI, we also saw a compelling upshot: An investor might be able to earn better-than-expected returns for a given level of risk.

SEI's innovative, pioneering approach

As empirical evidence of this so-called anomaly continued to accumulate, the potential investment opportunity became apparent. In our view at SEI, by investing in a portfolio of lower-volatility stocks and avoiding those that are higher volatility, a portfolio manager should be able to improve the balance between risk and return. We seized upon this opportunity by launching the U.S. version of our managed-volatility strategy—the first of its kind, we believe—on October 28, 2004.

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In addition to pioneering this approach, we brought our manager-of-managers framework to the space—which, among other things, provides us with access to the best thinking of a large number of leading investment managers. Our manager-of-managers framework also allows us to diversify manager-specific risk and to tilt manager allocations in response to economic or market conditions. It additionally provides multiple levels of portfolio monitoring, from individual management firms to SEI's portfolio managers and SEI's Risk Management team. Our manager-of-managers expertise has enabled us to work closely with leading investment managers to test, build, implement and further develop our managed-volatility approach—and we have been pleased with the results.

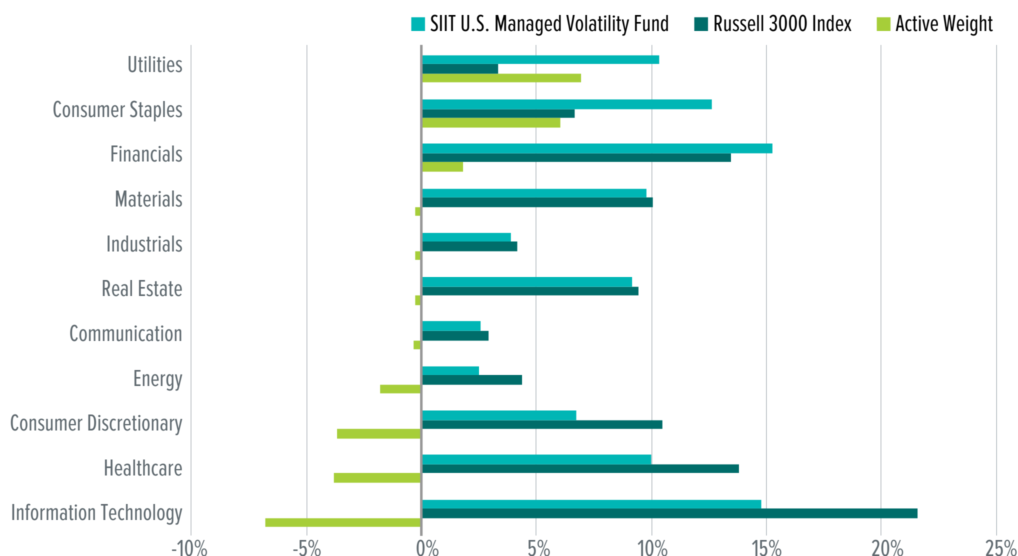
We also offer tax-managed versions of our U.S. and global offerings. In a very real sense, SEI has helped pioneer the managed-volatility revolution.

The managed-volatility revolution

Our initial embrace of a managed-volatility approach required an interesting change of mindset. Traditional investment management focuses on a portfolio's expected return relative to a benchmark; at the same time, it tries to limit the portfolio's divergence from that benchmark. By doing so, a manager accepts that its portfolio will probably experience benchmark-like volatility. In contrast, when developing our managed-volatility approach, we focused directly on risk. Each of our managed-volatility offerings has a volatility-reduction target compared to its benchmark.

We determined that in order to achieve this objective, our managed-volatility strategies should be sector and industry agnostic. As a result, our sector allocations tend to differ significantly from the broader market. We often dramatically overweight less-volatile sectors and heavily underweight those that are more volatile. For example, as illustrated in Exhibit 1, the average weights of certain sectors within our SIIT U.S. Managed Volatility Fund (the Fund) diverged substantially from those in the Russell 3000 Index. The Fund was overweight utilities, consumer staples and financials stocks, and underweight the information technology, healthcare, consumer discretionary and energy sectors.

Exhibit 1: Sector allocations can diverge significantly

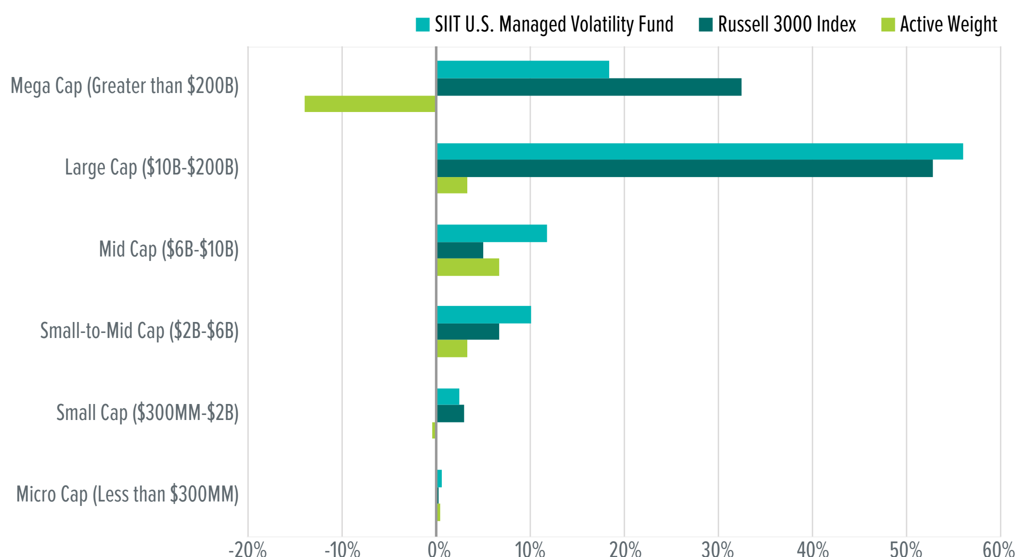


Average sector weights during 6/30/2019-9/30/2019
Sources: SEI, FactSet

Over short periods of time, our sector-agnostic philosophy can lead to significant return disparities between a managed-volatility portfolio and its benchmark. However, over long periods, we expect returns to be similar to those of the broader stock market (of course, there is no guarantee this will be the case). It is important to note that shifts in sector and industry behavior do occur. When we or one of our managers see this happening, we will adjust our portfolio accordingly. Our process is empirical and data-driven; we are neither wed to nor averse to certain sectors simply because they behaved a certain way in the past.

Differences between Fund and benchmark characteristics are further apparent in their distinct market-cap exposures, as one can be vastly different from the other. Over the quarter ending September 30, 2019, the Fund was generally underweight mega-cap stocks and overweight to smaller-cap names compared to its benchmark (Exhibit 2).

Exhibit 2: Portfolio makeup leaned toward small caps



Average sector weights during 6/30/2019-9/30/2019
Sources: SEI, FactSet

Solid performance with downside mitigation

We have found that one of the historical benefits of a well-designed managed-volatility strategy has been an improvement in risk-adjusted returns. Risk-adjusted returns, which can be calculated in different ways, are meant to show the return an investor receives per unit of risk assumed. (Risk is typically measured as the standard deviation, or average dispersion, of a portfolio's returns.) All else equal, a higher risk-adjusted return indicates that a portfolio has struck a better balance between risk and reward.

As shown in Exhibit 3, the U.S. Managed Volatility Fund has done just that. Since the Fund's inception on December 31, 2008, its average monthly return has been 1.10%—only slightly lagging the average monthly returns of its benchmark. However, our strategic focus is on the standard deviation and risk-adjusted returns for the Fund and the benchmark over the same period. The standard deviation of Fund returns was 3.02%, which was lower than that of its benchmark by more than 25%. This lower volatility enhanced the Fund's risk-adjusted returns, as the Fund's return per unit of standard deviation was 0.36—significantly higher than the 0.29 generated by the benchmark.

Exhibit 3: Monthly return statistics

	Average Return (%)	Standard Deviation (%)	Risk-Adjusted Return
SIIT U.S. Managed Volatility Fund	1.10	3.02	0.36
Russell 3000 Index (USD)	1.19	4.07	0.29

Sources: SEI, Russell
Monthly returns span 12/31/2008 to 9/30/2019
Risk-adjusted return is average return divided by standard deviation.

Standard Performance (as of 9/30/2019)

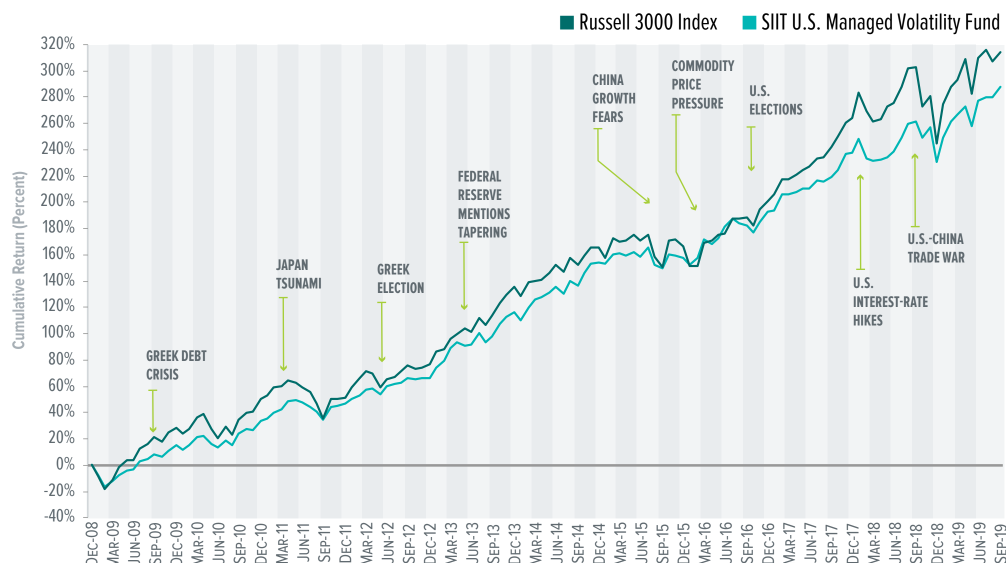
	1 Year	5 Year	10 Year
SIIT U.S. Managed Volatility Fund	7.43	10.40	13.61
Russell 3000 Index (USD)	2.92	10.44	13.07

The performance data quoted represents past performance. Past performance does not guarantee future results. The investment return and principal value of an investment will fluctuate so that an investor's shares, when redeemed, may be worth more or less than their original cost and current performance may be lower or higher than the performance quoted. For performance data current to the most recent month end, please call 1.800. DIAL.SEI or visit our website at www.seic.com/fundprospectuses.

As implied by these return statistics, long-term performance has been solid. In fact, although a managed-volatility investor should not expect this to be the norm, the U.S. Managed Volatility Fund has managed to outpace its benchmark on a cumulative basis over the last 10 years (as of 9/30/2019).

As shown in Exhibit 4, the Fund did not suffer as badly as its benchmark during the sharp mid-2011 correction or the abrupt market decline in the fourth quarter of 2018. Since inception, in negative months for the benchmark, the Fund and the benchmark have averaged -2.28% and -3.72%, respectively.

Exhibit 4: Solid long-term performance



Sources: SEI, Russell
Monthly returns span 12/31/2008 to 9/30/2019. Class A shares
Past performance is not a guarantee of future results.

This potential downside protection is another appealing feature of a managed-volatility approach. Intuitively, if a portfolio is less volatile than the overall market, then it should lose less value during a steep market decline. This cannot be guaranteed, of course. But in the 2011 market correction, the Fund's maximum drawdown was less than that of the Russell 3000 Index by 8%. More recently, during the fourth-quarter selloff in 2018 that saw many global indexes near bear-market territory, the Fund's maximum drawdown was approximately 6% less than that of its benchmark.

We believe our low-volatility approach can serve investors well and can help to lessen the impact of market uncertainty. As always, we think it's important that investors carefully consider all investment options and select investments based on their individual needs and goals.

Important Information

This material represents an assessment of the market environment at a specific point in time and is not intended to be a forecast of future events, or a guarantee of future results. This information should not be relied upon by the reader as research or investment advice and is intended for educational purposes only.

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To determine if the Funds are an appropriate investment for you, carefully consider the investment objectives, risk factors and charges and expenses before investing. This and other information can be found in the Funds' summary and full prospectuses, which may be obtained by calling 1-800-DIAL-SEI or by visiting www.seic.com/fundprospectuses . Read it carefully before investing.

There are risks involved with investing, including possible loss of principal. Diversification may not protect against market risk. There is no assurance the goals of the strategies discussed will be met. International investments may involve risk of capital loss from unfavorable fluctuation in currency values, from difference in generally accepted accounting principles or from economic or political instability in other nations. Investments in smaller companies typically exhibit higher volatility.

Index returns do not reflect any management fees, transaction costs or expenses. Indexes are unmanaged and one cannot invest directly in an index.

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