FUND SPOTLIGHT

Global Managed Volatility Fund.

Why Low Volatility?

Our research, which began nearly 20 years ago, and has since been validated by other notable investors, indicates that lower-volatility stocks typically deliver market-like returns over the long-term, considerably less volatility and smaller drawdowns than the market as a whole. Low-volatility strategies typically have significant weights to defensive sectors, such as consumer staples, healthcare and utilities, while allocating smaller amounts to volatile sectors, such as information technology, consumer discretionary and industrials.

Low-volatility equities are particularly attractive to investors who prefer to be at the lower end of the risk/return spectrum. These investors care about absolute risk—that is, they are more concerned about the risk of losing money than the risk of underperforming some market index.

For example, if their goal is to avoid losses greater than a certain amount (say, 10% or 20% of the portfolio's value), low-volatility strategies may be especially compelling. That is not to say that low-volatility strategies are limited to the most conservative portfolios. Even the most aggressive investors may benefit from an allocation that is designed to dampen portfolio volatility.

A goals-based tool

Many investors measure their fund performance relative to an index, determining their investment success or failure based on whether the fund outperformed or underperformed the benchmark. As goals-based investors, we would argue that is not the optimal way to view performance. Rather, investors should be seeking to mitigate losses and make progress toward their goals. A low-volatility investment should be a particularly attractive goals-based asset-allocation option. This is true no matter what the goal is—retirement, university tuition, vacation house or some other objective.

Exhibit 1

What will it take to earn your money back?

Loss	Required gain to recover
10%	11%
20%	25%
30%	43%
40%	67%
50%	100%
60%	150%
70%	233%
80%	400%
90%	900%

If an investor loses 10% on an investment, it will require an 11% gain to recoup that loss. A 50% loss would require a return of 100% to break even. A loss of 90% would require a gain of 900% — or 10 times the initial loss.

$$\text{Required Gain to Return to Initial Value} = \frac{\text{Initial Value}}{\text{Initial Value}\,(1 - \text{Initial Loss})} - 1$$

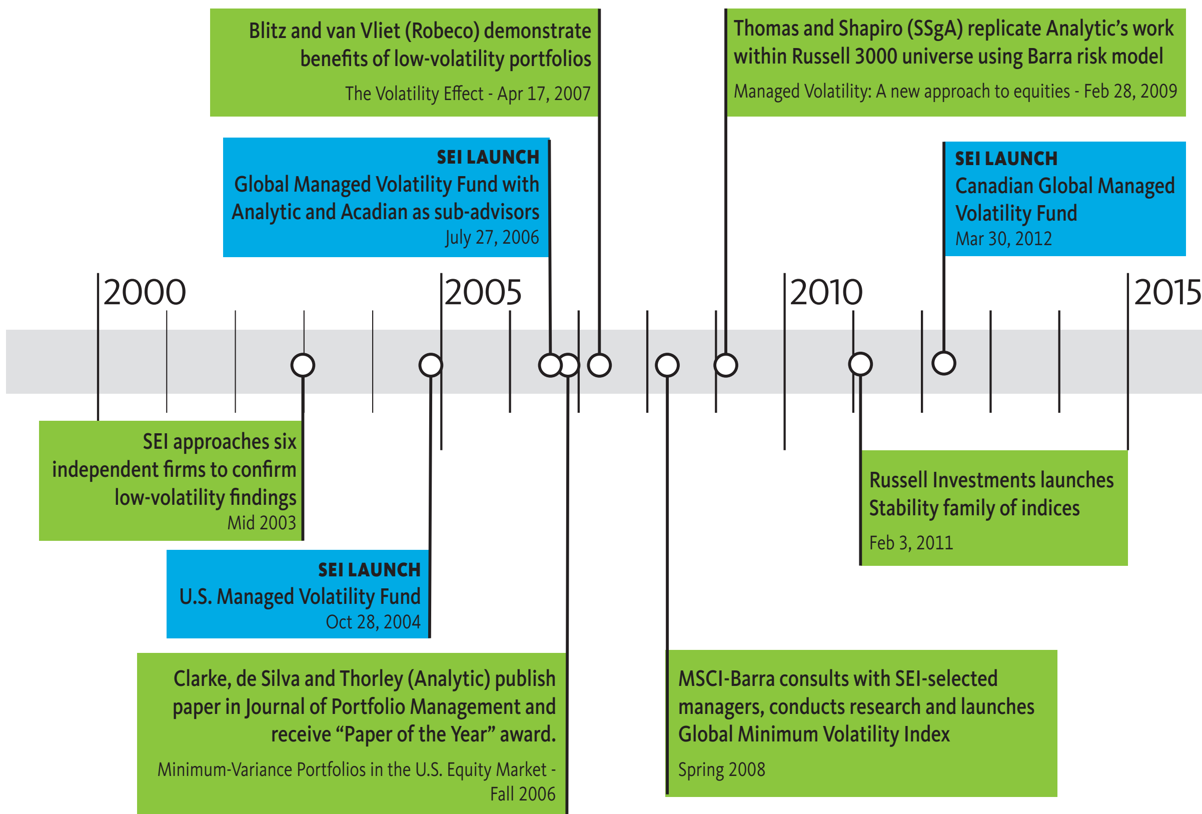
Source: SEI

Why SEI Global Managed Volatility?

Early innovators

SEI was an early innovator in the managed-volatility space, engaging with six independent investment firms to confirm our low-volatility findings. By the end of 2004, SEI had launched the first of what would become numerous managed-volatility funds. Analytic Investors (now part of Wells Fargo Asset Management) was one of those six firms and became an original sub-advisor for SEI's first managed-volatility fund launched in the United States; it still manages assets for that fund today.

Exhibit 2: SEI's Managed Volatility: An Evolution That Began With Early Innovation



It's managed volatility, not minimum volatility

Over the past decade-plus, the investment industry has seen a proliferation of low-volatility equity strategies. There are numerous indexes, exchange-traded funds (ETFs) and active funds that seek to minimize volatility. Rather than follow this approach, we prefer to optimize risk-adjusted returns as measured by the Sharpe Ratio. We believe that by allowing for slightly more than the minimum possible amount of volatility, we can increase expected returns by enough that the Sharpe Ratio for our Global Managed Volatility Fund is higher than those of minimum-volatility options. In our view, over a long-term horizon, a strategy that maximizes risk-adjusted returns should ultimately provide market-like returns with significantly less volatility.

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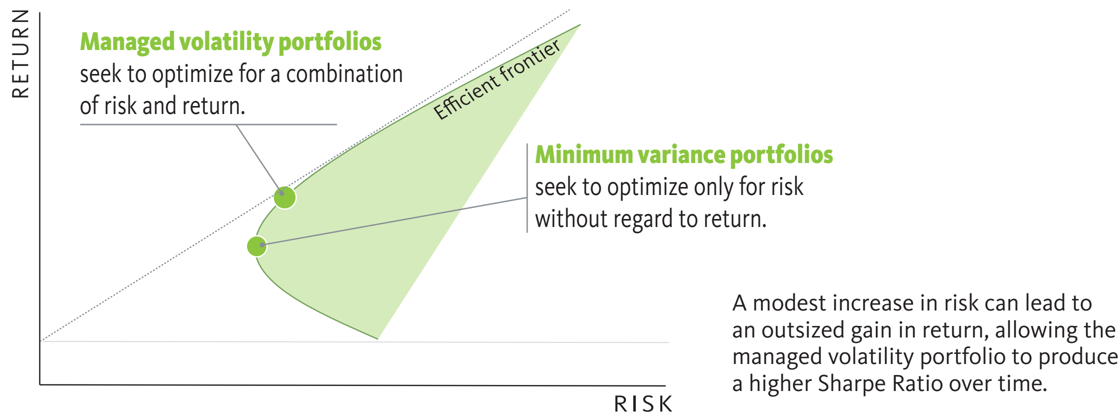
Exhibit 3: Comparing Minimum Variance With Managed Volatility



Active management

SEI's managed-volatility strategies are often compared to passively managed ETFs, but we believe that active management is important in the space. ETFs certainly offer a cost-effective option—but, as previously noted, they are generally just a minimum-volatility implementation as opposed to actively optimizing risk/return. Within our framework for equity alpha sources (that is, drivers of excess returns relative to a benchmark), it probably comes as no surprise that we choose sub-advisors that exhibit characteristics of the stability alpha source. But it is fairly rare to find an asset manager that purely exhibits just one alpha source. Our global managed volatility sub-advisors (Acadian Asset Management LLC and LSV Asset Management) often exhibit secondary alpha sources of value or momentum. This provides additional potential opportunity for excess returns of minimum-volatility portfolios.

Suggested Implementation

Lower-risk equity allocation

We believe our strategy can, over time, provide about a 25% reduction in volatility compared to broad-market indexes. Historically, this has typically resulted in significantly smaller drawdowns for managed volatility relative to the indexes. From a behavioural finance perspective, smaller drawdowns can help investors stay invested and resist the urge to time markets. This may also result in higher risk-adjusted returns over the long term, potentially making Global Managed Volatility an attractive asset-allocation option for any investor. More conservative investors, or those with goals that have shorter time horizons, may find this a particularly compelling way to add equities to their portfolio while not taking on full equity risk. Still, the potential to reduce volatility also has merits for more aggressive investors and those with longer investment time horizons.

Higher income than traditional equities

While our Global Managed Volatility Fund does not specifically seek to own stocks with higher dividends, empirical evidence suggests that stocks with higher dividends generally have less volatile total-return patterns due to the higher-dividend rate. As such, the Fund often invests in these types of stocks and can typically be expected to out-yield its traditional broad-market benchmark. This makes for an attractive equity allocation for income-oriented investors who still want equity exposure.

To learn how to add SEI's Global Managed Volatility Fund to your clients' portfolios, contact your relationship manager.

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