

- Global equity markets maintained their upward trajectory in July 2023, bolstered by generally positive economic data, as well as investors' optimism that the U.S. Federal Reserve (Fed) may be able to curb inflation while piloting the economy to a soft landing.
- Global fixed-income assets saw mixed performance in July. Canadian bonds generally slumped, as corporate debt outperformed federal and provincial debt.
- While input-price inflation has decelerated significantly, we maintain our view that inflation pressures will remain persistent in labour-intensive service industries, at least until some slack opens up in the labour markets and spending by households fades more dramatically.

Economic Backdrop

Global equity markets maintained their upward trajectory in July 2023, bolstered by generally positive economic data, as well as investors' optimism that the Fed may be able to curb inflation while piloting the economy to a soft landing. Emerging markets outperformed developed markets during the month.

The Pacific ex Japan region was the top performer among developed markets in July, bolstered mainly by strength in Singapore. The Nordic countries lagged the overall market due to weakness in Finland. Africa led the emerging markets during the month, benefiting from strong performance in South Africa and Senegal. The Gulf Cooperation Council (GCC) countries-Bahrain, Kuwait, Oman, Qatar, Saudi Arabia, and United Arab Emirates-were the primary laggards among the emerging markets in July, hampered largely by underperformance in Oman.

As widely expected, the Fed increased the federal-funds rate by 25 basis points (0.25%) to a range of 5.25%-5.50% at its meeting in late July after pausing in its rate-hiking cycle in June. In a statement announcing the increase, the Federal Open Market Committee (FOMC) reiterated its commitment to reduce inflation to its 2% target rate and commented that it would "adjust the stance of monetary policy as appropriate if risks emerge that could impede the attainment of the Committee's goals." The FOMC also noted that the members "will take into account a wide range of information, including readings on labour market conditions, inflation pressures and inflation expectations, and financial and international developments." At a news conference following the release of the rate-hike announcement, Fed Chair Jerome Powell said, "We can afford to be a little patient, as well as resolute, as we let this unfold. We think we're going to need to hold, certainly, policy at restrictive levels for some time, and we'd be prepared to raise [interest rates] further if we think that's appropriate."

Global fixed-income assets saw mixed performance in July. Canadian bonds generally slumped, as corporate debt outperformed federal and provincial debt. Meanwhile, U.S. high-yield bonds registered positive returns and were the top performers within the U.S. market for the period.

Global commodity prices generally moved higher in July. The West Texas Intermediate (WTI) crude-oil spot price and the Brent crude oil price gained 15.8% and 13.3%, respectively, in U.S. dollar terms, amid expectations of dwindling supplies due to production output cuts from the Organization of the Petroleum Exporting Countries (OPEC). The gold spot price was up 4.1% for the month due to weakness in the U.S. dollar and investors' speculation that the Fed may pause its rate-hiking cycle at its meeting in September. Following a sizeable upturn in June, the New York Mercantile Exchange (NYMEX) natural gas price declined 5.1% in July after the International Energy Agency (IEA) estimated that demand for natural gas in Europe will fall 7% for the

2023 calendar year. The IEA attributed its forecast to lower consumption in the power sector and rapidly expanding renewable energy-generation.

Wheat prices climbed sharply in mid-July after Russia withdrew from an agreement to export Ukrainian grain through the Black Sea. The plan had authorized Ukraine to export roughly 33 million metric tons (36 million tons) of food by sea since August 2022. More than half of the exports were being delivered to emerging markets. The U.S. and its allies condemned Russia's pullout from the agreement. U.S. Secretary of State Anthony Blinken stated, "The result of Russia's action today weaponizing food, using it as a tool, as a weapon, in its war against Ukraine, will be to make food harder to come by in places that desperately need it." The wheat price subsequently fell later in the month amid some profit-taking by investors and as more grain flowed out of the country via land routes and the Danube River. The wheat price ended the month with a 2.3% gain.

In contrast to inflationary worries in most global economies, there are concerns that China may be experiencing a bout of *deflation*. According to the National Bureau of Statistics of China, the nation's consumer-price index (CPI) dipped 0.2% in June, and was flat compared to the same period in 2022. Food and consumer goods prices were down 0.5% and 0.3%, respectively, for the month. The 2.0% year-over-year increase in costs for food, tobacco and liquor was offset by a 6.5% decline in transportation and telecommunications prices. Additionally, China's producer-price index (PPI), which tracks the average change over time in selling prices received by domestic producers of manufactured goods, declined 5.4% year-over-year in June. Prices for the mining, raw materials, and processing industries fell by 16.2%, 9.5%, and 4.7%, respectively, during the previous 12-month period.

Central Banks

- The Bank of Canada (BoC) hiked its overnight interest rate by 0.25% to 5.00% following its July 12 meeting. This was the second consecutive rate increase following a brief two-meeting pause in the hiking cycle. In support of this decision, the BoC noted that, outside of energy costs, inflation is still broadly above the bank's target range. With no August meeting scheduled, the BoC's next meeting is set for September 6.
- The Fed increased the federal-funds rate by 0.25% to a range of 5.25% to 5.50% following its meeting in late July. There was speculation that the Fed may need to implement additional rate hikes in order to cool inflation given the ongoing strength in the U.S. economy. As of the end of July, CME's FedWatch Tool-which provides a gauge of the markets' expectations of potential changes to the federal-funds target rate while assessing potential Fed monetary policy actions at Federal Open Market Committee (FOMC) meetings- implied an 82% chance that the FOMC will leave the federal-funds rate unchanged at its meeting on September 19-20. The FedWatch Tool projected an 18% probability that the central bank will approve a 0.25% rate hike.
- In the Bank of England's (BOE) Financial Stability Report (FSR), which was released in July, the Financial Policy Committee (FPC) noted that U.K. banks are well-capitalized and maintain strong asset quality. However, the FPC also commented that some segments within the banking sector are more exposed to credit losses as borrowing costs rise, most notably commercial real estate lenders. The FPC stated that global commercial real estate markets "face a number of short and longer-term headwinds that are pushing down on prices and making refinancing challenging."
- The European Central Bank (ECB) increased its benchmark interest rate by 0.25% to 4.25% following its meeting on July 27. In a statement announcing the rate hike, the ECB's Governing Council noted, "The developments since the last meeting support the expectation that inflation will drop further over the remainder of the year but will stay above target for an extended period. While some measures show signs of easing, underlying inflation remains high overall. The past rate increases continue to be transmitted forcefully: financing conditions have tightened again and are increasingly dampening demand, which is an important factor in bringing inflation back to target [2%]."
- The Bank of Japan (BOJ) left its benchmark interest rate unchanged at -0.1% at its meeting on July 28. However, the central bank altered its yield curve control policy. While the BOJ will continue to allow the 10-year Japanese government bond (JGB) yield to fluctuate in a range of around +0.5% to -0.5% from its 0% target, the central bank indicated that this is now a *suggested* range. The BOJ set a rigid upper yield limit

of 1.0% for the 10-year JGB. The 10-year yield rose sharply following the BOJ's announcement, and ended July with a 0.20% increase to 0.60%—the highest level since April 2014.

Economic Data (unless otherwise noted, data sourced to Bloomberg)

- According to Statistics Canada, consumer prices rose (as measured by the change in the Consumer Price Index (CPI)) 0.1% for June, and increased 2.8% for the one-year period. The primary drivers of headline inflation were grocery prices and mortgage interest costs which were up 9.1% and 30.1%, respectively. Meanwhile, lower gasoline prices—down 20.6% year over year—and base-level effects served to moderate the rate of consumer inflation. Producer prices continued to decline in June. The Industrial Product Price Index (IPPI) and Raw Materials Price Index (RMPI) fell 0.6% and 1.5%, respectively in June. Year-over-year prices slumped 5.5% for the IPPI and plummeted 19.7% for the RMPI. While producer prices were lower across a wide range of products, lower costs for crude energy contributed the most to the price declines. The outlook for the Canadian labour market continued to dim in July as the economy shed 6,000 jobs. The unemployment rate was up 0.1% to 5.5%, marking the third consecutive monthly increase.
- According to the initial estimate from the Department of Commerce, U.S. gross domestic product (GDP) grew at a greater-than-expected annualized rate of 2.4% in the second quarter of 2023, up from the 2.0% rise in the first three months of the year. The largest increases for the second quarter were in consumer spending, nonresidential fixed investment (purchases of both nonresidential structures and equipment and software), and state and local government spending. These gains offset reductions in exports and residential fixed investment (purchases of private residential structures and residential equipment that property owners use for rentals). The government attributed the accelerated GDP growth rate to upturns in private inventory investment (a measure of the changes in values of inventories from one time period to the next) and nonresidential fixed investment. The Department of Labor reported that U.S. payrolls expanded by 209,000 in June, and the unemployment rate dipped 0.1 percentage point to 3.6%. Although the job growth for the month fell short of the market's expectations, the unemployment rate remained near its historical low of 3.4% reached in April of this year. The government, health care, and social assistance sectors saw the largest employment gains in June. Conversely, payrolls in the retail trade, and transportation and warehousing sectors declined modestly during the month. Average hourly earnings were up 0.4% in June and 4.4% year-over-year. The 12-month increase was marginally lower than the 4.5% annual rise in May. Inflation in the U.S. has continued to moderate. The Department of Labor reported that the U.S. consumer-price index (CPI) increased 0.2% in June, a slight uptick from the 0.1% rise in May. The CPI posted a year-over-year gain of 3.0%—the smallest annual increase since March 2021, and sharply lower than the 4.0% annual rise during the previous month. Nonetheless, the inflation rate still exceeds the Fed's 2% target. The slowing pace of inflation over the previous 12-month period was due to sharp declines in prices for fuel oil and gasoline, while food costs rose 0.2% in May and 6.7% year-over-year. Meanwhile, core inflation, as measured by the CPI for all items less food and energy, increased 0.2% in June, down from the 0.4% rise in May. The index was up 4.8% over the previous 12 months—significantly lower than the 5.3% year-over-year increase in May. The Conference Board's Consumer Confidence Index® rose 6.9 points to 117.0 in July—its highest level in two years—suggesting that consumers remain optimistic about the U.S. economy. The Expectations Index, an indicator of consumers' short-term outlook for income, business, and labour market conditions, climbed 8.3 points to 88.3 during the month. A reading above 80 indicates that consumers generally do not believe that there will not be a recession in the U.S. over the next 12 months. The Present Situation Index, which reflects U.S. consumers' views of current conditions in the business and labour markets, was up 4.7 points to 160.0 in July. The Conference Board noted that "confidence appears to have broken out of the sideways trend that prevailed for much of the last year. Greater confidence was evident across all age groups, and among both consumers earning incomes less than \$50,000 and those making more than \$100,000."
- According to the Office for National Statistics (ONS), consumer prices in the U.K. rose 0.2% month-over-month in June, down from the 0.7% increase in May. Inflation increased 7.3% over the previous 12-month period, down 0.6% from the 7.9% annual upturn in May. Food and non-alcoholic beverages, and restaurants and hotels, were the most notable contributors to the annual rise in prices. Core inflation, which excludes volatile food prices, rose at an annual rate of 6.4% in June, marginally lower than the 6.5% year-over-year increase in for the previous month. The ONS also reported that U.K. GDP dipped 0.1% in May, down from a 0.2% increase in April, and was flat over the previous three-month period. Production and construction fell

0.6% and 0.2%, respectively, in May, versus corresponding 0.2% and 0.9% declines in April. The S&P Global/CIPS Flash UK Manufacturing Output Index decreased 1.6 to a seven-month low of 46.5 in July due to lower demand, along with customer destocking (a planned reduction in stock or inventory). A reading below 50 indicates contraction in the manufacturing sector. The S&P Global/CIPS Flash UK Services PMI Business Activity Index declined 2.2 to a five-month low of 51.5 in June, but indicated expansion for the fifth consecutive month. The slowdown in the rate of growth resulted mainly from weaker residential property market conditions, as well as a decrease in consumer spending.

- Eurostat estimated that the inflation rate in the eurozone fell 0.2% to 5.3% for the 12-month period ending in July. Energy prices decreased 5.6% year-over-year in June, following a 1.8% decline in May. Prices for food, alcohol and tobacco rose 10.8%, but the pace of acceleration slowed from the 11.6% annual rate in June. Core inflation, which excludes volatile energy and food prices, rose 5.5% for the month, unchanged from June. Eurozone manufacturing remained in contraction territory in July, with the HCOB Flash Eurozone Manufacturing PMI Output Index falling 1.3 to 42.9—its lowest level in more than three years. The downturn was attributable primarily to a decline in new orders. Services activity in the eurozone expanded in June, but the HCOB Flash Eurozone Services PMI Business Activity Index dipped 0.9 to a six-month low of 51.1. According to Eurostat’s initial estimate, eurozone GDP was up 0.3% in the second quarter of 2023, improving from the flat growth rate in the first quarter, and increased 0.6% year-over-year. The economies of Ireland and Lithuania were the strongest performers for the second quarter, expanding 3.3% and 2.8%, respectively, while Sweden’s GDP contracted 1.5% during the period.

Index Data (July 2023)

- The S&P/TSX Composite Index gained 2.58%.
- The FTSE Canada Universe Bond Index returned -1.11%.
- The S&P 500 Index, which measures U.S. equities, rose 2.67%.
- The MSCI ACWI (Net) Index, used to gauge global equity performance, was up 3.11%.
- The ICE BofA U.S. High Yield Constrained Index, representing U.S. high-yield bond markets, returned 1.37% (currency hedged) and 0.89% (unhedged).
- The Chicago Board Options Exchange Volatility Index—a measure of implied volatility in the S&P 500 Index that is also known as the “fear index”—was little changed as it moved from 13.59 to 13.63.
- WTI Cushing crude oil prices—a key indicator of movements in the oil market—moved sharply higher from US\$70.64 to US\$81.80 a barrel to end July.
- The Canadian dollar was little changed at C\$1.32 per U.S. dollar. The U.S. dollar was modestly weaker versus the world’s other major currencies, ending July at US\$1.10 versus the euro, US\$1.29 against sterling, and at 142.08 yen.

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