THIRD QUARTER 2020

GROWTH WITH ENHANCED INCOME

Financial markets continued to rebound in the third quarter, helped by ongoing improvement in consumer and business-related economic data. Investors assessed a number of developments including COVID-19 in addition to the U.S. election outlook and prospects for additional fiscal stimulus in the U.S. Global equities exceeded pre-virus highs in the quarter – though a down month in September reduced the quarterly gain to about 8%. Across regions, U.S. equities generally topped their non-U.S. peers with help from continued strong performance in large technology companies. Central bank policy globally remains extremely accommodative with little in the way of policy changes in the quarter, though the Federal Reserve announced an update to its inflation targeting framework. U.S. interest rates remained stable throughout the quarter, while credit spreads declined overall despite a modest uptick in September.

We made one change in asset allocation in the quarter. In August, we updated the portfolio to reflect our annual strategic asset allocation update in addition to modestly re-aligning our equity allocations resulting in similar positioning across U.S. and non-U.S. equities. The change affected a number of asset classes across the portfolio including increases to non-U.S. equities, inflation-linked fixed income, high yield fixed income and cash along with decreases to natural resources, U.S. equities and investment grade fixed income. The portfolio positioning remains consistent with a moderately underweight risk tactical stance. The tactical asset allocation approach of the Growth with Enhanced Income Portfolio focuses on positioning appropriately for the current financial market and economic backdrop with a focus on downside mitigation.

The portfolio underperformed in the third quarter mainly due to headwinds from strategic positioning and fund implementation. Strategic positioning weighed on performance since high yield fixed income and real assets failed to keep pace with global equities. Fund implementation in the portfolio is geared towards providing additional income. This approach weighed on performance mainly due to headwinds in factor-based equity fund implementation. In equity fund implementation, our quality dividend U.S. equity strategy (QDF) and our quality dividend international equity strategy (IQDF) detracted from performance as the yield factor generally trailed the broader equity market benchmarks both in the U.S. and outside the U.S. Our value-scored high yield fixed income strategy (HYGV) was a modest contributor to performance, partially offsetting some of the drag from the equity fund implementation.