THIRD QUARTER 2023

INCOME

Global equities followed a choppy trajectory throughout the third quarter with July gains giving way to losses in August and September as interest rates pushed higher globally later on in the quarter. In the U.S., the broader economic narrative continued around resilient – but slowing – growth and moderating inflation, with both investors and the Federal Reserve interpreting these dynamics as more likely to lead to higher-for-longer monetary policy. Outside the U.S., Europe and to a greater extent, China, faced incremental growth headwinds. Central banks globally are approaching peak policy rates as policymakers have to carefully assess future growth concerns and the lagged impacts from their prior tightening with still-elevated core inflation. Overall, financial market returns were largely negative for the quarter with a few asset classes such as cash, high yield fixed income and natural resources seeing slight-to-modest gains.

We made one change in asset allocation in the quarter. In August, we increased inflation-linked fixed income and decreased investment grade fixed income in conjunction with our annual strategic asset allocation update. The strategic target to inflation-linked fixed income shifted higher, with a mostly commensurate decrease in investment grade fixed income and a modest reduction in global equities. As a part of this tactical change, the investment grade fixed income tactical positioning moved from underweight to equal-weight given interest rates were near the upper end of our forecasted range – the tactical reduction occurred in order to move to the new (lower) strategic target. Inflation-linked fixed income was increased to help calibrate our underweight (also relative to the new strategic target weight). Currently, the portfolio has overweights in high yield fixed income, cash and natural resources, funded by underweights across inflation-linked fixed income, U.S. equities and developed ex-U.S. equities. The portfolio ended the quarter with a slightly lower risk level than its strategic benchmark.

The portfolio outperformed in the quarter largely due to strategic positioning as additional modest benefits from tactical positioning mostly offset some modest drag from fund implementation. Strategic positioning benefited performance with support from inflation-linked fixed income and cash outpacing investment grade fixed income as well as high yield fixed income outperforming global equities. Tactical positioning helped performance with support from the overweight to high yield fixed income and the overweight to cash outweighing some drag from the underweight to inflation-linked fixed income. Our diversified investment grade fixed income (BNDC) and our target duration TIPS (TDTT) were the main detractors in terms of fund implementation.

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