SECOND QUARTER 2020
GROWTH WITH MODERATE INCOME

Financial markets rebounded sharply in the second quarter, helped by ongoing monetary and fiscal policy support, economic re-openings globally and improvement in both manufacturing-related and consumer-related economic data. The coronavirus remains a key concern for investors, with the continued rise in global virus cases recently driven by the U.S. and various emerging market countries. Global equities finished the quarter up almost 20%, following a steady upward climb from early April through mid-June that stalled in the last few weeks of the quarter on concerns that financial markets were becoming too optimistic on the economic recovery. In fixed income markets, U.S. interest rates were mostly unchanged throughout the quarter, while credit spreads improved markedly given broad-based credit support from the Federal Reserve.

We made two changes in asset allocation in the quarter. In May, we shifted to a neutral risk stance by reducing our U.S. equity, high yield fixed income and global real estate allocations, while increasing our cash, investment grade fixed income and inflation-linked fixed income allocations. The tactical change was primarily driven by a view that financial markets were overestimating the resilience of the global economy given the extent of coronavirus-related economic disruption. In June, we further reduced our U.S. equity allocation with the proceeds spread across investment grade fixed income and high yield fixed income. This tactical change brought the portfolio to moderately underweight risk overall based on our view that markets continue to be too optimistic on the near-term economic recovery and are not appropriately considering additional risks around the U.S. election and U.S.-China tensions. In addition, we made one fund implementation change in May, where we replaced our investment grade fixed income mutual fund (NOFIX) with our investment grade fixed income ETF (BNDC). This fund implementation change allows us to utilize a fixed income strategy that offers a more nimble investment approach and more direct exposure to the investment grade fixed income asset class. BNDC uses a fund-of-funds approach that allows our fixed income team to more easily implement its views on interest rates and bond market sector positioning. Finally, this update also moves us to an all-ETF portfolio overall, as ETFs bring attractive efficiencies when at a sufficient level of assets and liquidity compared to a mutual fund. Currently, the portfolio has a large overweight in high yield fixed income and a smaller overweight in global listed infrastructure, funded by underweights across inflation-linked fixed income, emerging market equities, natural resources and developed ex-U.S. equities. The portfolio ended the quarter with a moderately lower risk level than its strategic benchmark.

Performance for the quarter was negatively impacted by fund implementation, partially offset by some benefits from tactical positioning and strategic positioning. Strategic positioning was helped primarily by risk assets significantly outperforming risk control assets, partially offset by weaker returns in high yield fixed income relative to global equities. Tactical positioning helped performance since benefits from the previous underweight to investment grade fixed income (currently equal-weight), the underweight to inflation-linked fixed income and the prior overweight to U.S. equities (currently equal-weight) outweighed some drag from the overweight to high yield fixed income. Our quality low volatility U.S. equity strategy (QLV), our quality low volatility developed markets ex-U.S. equity strategy (QLVD) and our quality low volatility emerging markets equity strategy (QLVE) were the main detractors in terms of fund implementation, while our current and prior investment grade fixed income fund implementation (BNDC and NOFIX), our value-scored high yield fixed income strategy (HYGV) and our global natural resources strategy (GUNR) were the main contributors.

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