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 municipal 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 municipal investment grade fixed income and a modest reduction in global equities. As a part of this tactical change, the municipal 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 municipal 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 slight drag from tactical positioning was mostly offset by slight benefits from fund implementation. Strategic positioning helped performance with support mainly from inflation-linked fixed income and cash outperforming municipal investment grade fixed income. Tactical positioning modestly weighed on performance as headwinds from the underweight to inflation-linked fixed income and the overweight to municipal high yield fixed income outweighed benefits from the overweight to cash. Our municipal investment grade fixed income (NOTEX) was the main contributor in terms of fund implementation, while our municipal high yield fixed income (NHYMX) and our target duration TIPS (TDTT) were the main detractors.