THIRD QUARTER 2023

INCOME WITH MODERATE GROWTH

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 U.S. equities, while decreasing municipal investment grade fixed income, developed ex-U.S. and emerging market equities in conjunction with our annual strategic asset allocation update. The strategic target to municipal investment grade fixed income shifted lower, with a commensurate increase to inflation-linked fixed income in addition to modest regional re-alignment within global equities. Through this tactical change, municipal investment grade fixed income tactical positioning moved from underweight to equal-weight – the tactical reduction occurred in order to move to the new (lower) strategic target. Furthermore, inflation-linked fixed income was increased to help calibrate our underweight (relative to the new strategic target weight), while the various equity changes were designed to more fully align our broad-based underweight to each major global equity region (U.S., developed ex-U.S., emerging markets). 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, developed ex-U.S. equities and emerging market equities. The portfolio ended the quarter with a moderately lower risk level than its strategic benchmark.

The portfolio outperformed in the quarter largely due to strategic positioning as slight drag from fund implementation was offset by additional modest support from tactical positioning. Strategic positioning benefited performance with support from inflation-linked fixed income and cash outperforming municipal investment grade fixed income as well as better returns in natural resources versus global equities. Tactical positioning modestly contributed to performance as benefits from the overweight to natural resources and the overweight to cash were somewhat offset by drag from the overweight to municipal high yield fixed income and the underweight to inflation-linked fixed income. Our global natural resources GUNR), our municipal high yield fixed income (NHYMX) and our target duration TIPS (TDTT) were the main detractors in terms of fund implementation, while our municipal investment grade fixed income (NOTEX) was the main contributor.

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