THIRD QUARTER 2023

GROWTH WITH 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 both developed ex-U.S. and emerging market equities in conjunction with our annual strategic asset allocation update. In addition to modest regional re-alignment within global equities, the strategic target to municipal investment grade fixed income shifted lower, with a commensurate increase to inflation-linked fixed income. This moved our municipal investment grade fixed income tactical positioning from underweight to equal-weight at a time when interest rates were near the upper end of our forecasted range. In the tactical change specifically, inflation-linked fixed income was increased to help calibrate our underweight (relative to the new strategic target weight), while non-U.S. equities were reduced to better align with our existing underweight to U.S. equities. 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 mainly due to strategic positioning in addition to more modest benefits from tactical positioning and fund implementation. Strategic positioning benefited performance with help from stronger returns in natural resources relative to global equities as well as inflation-linked fixed income outperforming municipal investment grade fixed income. 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 quality large cap U.S. equity (QLC), our broader-based developed markets ex-U.S. factor tilt (TLTD) and our municipal investment grade fixed income (NOTEX) were the main contributors in terms of fund implementation, while our global natural resources (GUNR), our municipal high yield fixed income (NHYMX) and our global quality real estate strategy (GQRE) were the main detractors.

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