DIVERSIFIED STRATEGIST PORTFOLIOS (TAX SENSITIVE)
QUARTERLY COMMENTARY

FOURTH QUARTER 2023

INCOME WITH MODERATE GROWTH

Financial markets ended the year on a strong note with gains across most major asset classes in the fourth quarter. Continued U.S. economic resilience, a healthy labor market backdrop and ongoing moderation in inflation helped boost investor hopes of a soft landing. The Federal Reserve did little to disrupt the soft landing narrative, with Fed Chair Powell implying that the Fed could be done hiking and expressing more optimism on the path of inflation at the December Fed meeting. Despite some market consternation around rising long-term interest rates in October, Treasury yields sharply declined in November and December. The 10-year Treasury yield declined over 100 basis points from its late-October peak, helping push broader fixed income index returns back into positive territory for calendar year 2023. Equities were also boosted by the decline in long-term rates with many areas of the equity markets posting double-digit gains for the quarter.

We made one change in asset allocation in the quarter. In December, we increased U.S. and emerging market equities, funded by decreases in cash and natural resources. This tactical change helped moderate our global equities underweight and modestly increased the risk profile of the portfolio. We removed our overweight to cash with the proceeds allocated to U.S. equities to pare back our underweight to the asset class given the more-favorable U.S. economic outlook and increased odds of a soft-landing-type economic outcome. The second part of this change reduced the size of our natural resources overweight and emerging market equities underweight – reflecting an improved outlook for emerging markets with more attractive valuations following a challenging period of performance. Currently, the portfolio has overweights in municipal high yield fixed income and natural resources, funded by underweights in inflation-linked fixed income, U.S. equities, developed ex-U.S. equities and emerging market equities. The portfolio ended the quarter with a slightly lower risk level than its strategic benchmark.

The portfolio underperformed in the quarter mainly due to strategic positioning and fund implementation in addition to more modest drag from tactical positioning. Strategic positioning weighed on performance largely due to cash and inflation-linked fixed income trailing investment grade fixed income. Tactical positioning was a detractor primarily due to headwinds from the overweight to natural resources, the previous overweight to cash (currently equal-weight) and the underweight to developed ex-U.S. equities, partially offset by benefits from the underweight to inflation-linked fixed income. Our municipal investment grade fixed income (NOTEX), our quality dividend U.S. equity (QDF) and our municipal high yield fixed income (NHYMX) were the main detractors in terms of fund implementation.

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