SECOND QUARTER 2025
INCOME

Global markets contended with a turbulent macroeconomic landscape, largely shaped by evolving U.S. policy initiatives. After market consternation following early-April news of reciprocal tariffs, investor sentiment on the issue improved following eventual de-escalation efforts including 90-day pauses and emphasis on trade talks. Despite these efforts, the persistence of elevated tariffs and policy uncertainty continued to reshape the global economic environment. Consensus forecasts, led by U.S. revisions, shaved global growth expectations and pushed inflation projections higher. Global economic activity, while distorted by trade data and front-loading ahead of tariffs, proved relatively resilient. Inflation pressures were subdued across several major economies, but core inflation rates remain technically above central bank targets. Financial markets performed well in the second quarter with gains across most major asset classes. Equity markets proved quite resilient with double-digit gains for U.S. equities despite a 10%-plus sell-off in early April. U.S. equities received a substantial boost from megacap tech, given the resurgence in optimism around AI adoption. The U.S. dollar weakened throughout the quarter, benefitting returns for non-U.S. equity indexes in dollar terms. Fixed income returns were positive but much lower than equities. U.S. credit spreads tightened while longer-term interest rates were modestly higher, resulting in a more favorable setup for high yield fixed income versus investment grade.

We made two changes in asset allocation in the quarter. Across tactical changes in April and May, we reduced risk and moved closer to neutral with changes in a number of asset classes, while still remaining modestly overweight global equities overall. In aggregate, the changes included moving from overweight to equal-weight in U.S. equities, high yield fixed income and global real estate, and moving to overweight in non-U.S. developed market equities and cash. We also slightly increased our investment grade fixed income and inflation-linked fixed income allocations. The April changes reflected a preference to avoid de-risking too quickly after the early April equity market sell-off, while the May changes were also influenced by the subsequent recovery in equity markets and concern that markets were possibly too optimistic on trade negotiation progress. Currently, the portfolio has overweights in global listed infrastructure, cash and developed ex-U.S. equities, funded by an underweight in investment grade fixed income. The portfolio ended the quarter with a slightly higher risk level than its strategic benchmark.

The portfolio underperformed in the quarter with drag mainly from strategic positioning and fund implementation, partially offset by some support from tactical positioning. Strategic positioning weighed on performance as inflation-linked fixed income trailed investment grade fixed income plus some headwinds from risk assets outperforming less-risky asset classes. Tactical positioning helped performance largely due to the overweight to non-U.S. developed market equities, partially offset by the previous overweight to global real estate (currently equal-weight) and the previous overweight to U.S. equities (currently equal-weight). Our quality dividend U.S. equity (QDF) was the main detractor in terms of fund implementation, while our diversified investment grade fixed income (BNDC) was the main contributor.