

THIRD QUARTER 2025

INCOME WITH MODERATE GROWTH

U.S. economic activity defied expectations for a slowdown despite clear signs of labor market deceleration. Outside of the labor market, U.S. economic data proved resilient across consumer-related activity and survey-related measures. However, U.S. job growth slowed to levels rarely observed outside of recessionary periods. A constrained labor supply helped prevent a sharp rise in the unemployment rate, but the moderation in employment was sufficient to prompt the first Federal Reserve rate cut of 2025. On the inflation front, tariff-related passthrough effects have remained manageable so far, allowing the Fed to focus more squarely toward supporting growth. Economic activity outside the U.S. also showed resilience at a time when most central banks continued easing policy. Most major asset class returns were positive in the quarter, with equities outpacing fixed income. Fixed income saw low-single-digit gains—helped by some tailwinds from both rates and credit. The upper-single-digit gain for global equities was supported by solid returns across each major region, with emerging markets leading. U.S. equities were boosted by the broader tech space as investor sentiment around the artificial intelligence (AI) narrative gained steam. Outside of tech, U.S. equity returns were lower but still broadly positive and areas such as small caps performed quite well. Emerging market equities were bolstered by tech-related exposure—particularly in China and broader Asia—and some help from the materials sector.

We made one change in asset allocation in the quarter. In September, we broadened our global equities overweight by adding to U.S. and emerging market equities. The increase to equities was funded by a reduction in inflation-linked fixed income, where we pivoted from equal-weight to underweight. The change reflected a preference to increase equity exposure with anticipated tailwinds from central bank easing at a time of overall economic growth resilience. Currently, the portfolio has overweights across each major global equity region, global listed infrastructure and cash, funded by underweights in municipal investment grade fixed income, inflation-linked fixed income and global real estate. The portfolio ended the quarter with a modestly higher risk level than its strategic benchmark.

The portfolio modestly underperformed in the quarter as small benefits from fund implementation and tactical positioning were unable to overcome strategic positioning headwinds. Strategic positioning was a detractor given weaker performance in municipal high yield fixed income versus global equities in addition to some drag from inflation-linked fixed income trailing municipal investment grade fixed income. Tactical positioning was a slight contributor as benefits from the investment grade fixed income underweight and the global equities overweight were somewhat offset by drag from the overweight to cash. Our quality dividend U.S. equity (QDF), our broader-based developed markets ex-U.S. factor tilt (TLTD) and the Franklin Dynamic Municipal Bond ETF (FLMI) were the main contributors in terms of fund implementation, while our global listed infrastructure (NFRA), our broader-based emerging markets factor tilt (TLTE) and our municipal investment grade fixed income (NOTEX) were the main detractors.

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