Investment Narrative

Quarter Ending September 30, 2023

Markets had a healthy rally in the first half of the year but entered a cooling down period over the third quarter. Equity markets softened and bond prices continued their downward trend, making this quarter another difficult environment to find positive returns. Inflation ticked higher over the quarter but showed promising signs of containment. Even though inflation has improved significantly since 2020, it is still above the target that the Federal Reserve ("Fed") has set out. As such, the Fed implemented an additional 0.25% rate increase in July bringing the Federal Funds Rate to 5.50%. Due to the inverse relationship between bond prices and interest rates, bond prices dropped. With how far rates have moved up and how much inflation has cooled, there is a theory that the Fed will soon cease their rate hikes and bond prices will stabilize. With bond yields at their highest levels in the last decade plus and the possibility of rate hikes stopping, the attractiveness of bonds increased as investors looked for opportunities to reduce equity risk while still being able to garner a meaningful return. The core fixed income asset class began yielding higher returns than equities for the first time in the last two decades. Portfolio managers trimmed their overall equity exposure and increased allocations to the fixed income markets to take advantage of the attractive risk-reward profile. There was also some rotation within the equity markets from growth stocks to value stocks. Growth stocks, mainly in the technology sector, were the main drivers of the equity rally at the start of the year. This pushed valuations higher and ultimately made them very expensive and less attractive. Simultaneously, valuations of value stocks became very cheap and started to fall back in favor.

Even though inflation has showed signs of containment and GDP growth for the quarter was strong, other economic indicators signaled a possible upcoming weakness in the economy. The main driver of the U.S. economy is the health of the consumer. Consumer spending remained strong over the quarter; however, investors grew wary after seeing a steady decline in personal saving rates and an increase in consumer loans/credit. This implies that consumers have spent most of their savings and are now reliant on high-interest credit to afford their lifestyles. Signs of a stretched consumer in addition to a more difficult financing environment for companies, strengthened the prevailing market thesis of an upcoming slow down in the economy – a headwind for the equity markets. As a result of the uncertainties surrounding the Fed's path forward with interest rates and the overall strength of the economy, Q3 was a difficult environment to navigate with almost all asset classes delivering negative returns. The broad U.S. stock market, which is tracked by the S&P 500 Index, was down 3.3%, the U.S. small cap market, which is represented by the Russell 2000 Index, was down 5.1%, and the U.S. bond market, which is reflected by the Bloomberg U.S. Aggregate Bond Index, was down 3.2%.

The international developed and emerging markets were in a similar environment as that in the U.S. Inflation proved to be stubborn in the U.K. and the Eurozone, and was still rampant in some emerging market countries. The European Central Bank ("ECB") and Bank of England ("BOE") continued to face a difficult balancing act of curbing inflation without causing a recession. International developed countries showed continued resiliency over the quarter, which was driven by strength in their service sectors. Toward the end of the quarter, the services sector started to moderate and lose its bolstering effect. Unlike the U.S., the Eurozone economy has already shown material signs of slowing down with elevated levels of

unemployment, weakening service sector health and depressed manufacturing levels. Emerging markets exhibited a similar set of risks as those in the international developed countries, but economic forecasts looked a bit more favorable. The thesis is that some of the emerging market countries are expected to benefit from a global trade transition away from China, but investors are not totally convinced yet. Valuations in developed and emerging markets are more attractive compared to those in the U.S., however, grim economic conditions and uncertainties of the immediate future did not amass a huge demand for international equities. As such, Q3 saw a decrease in international equity prices. The non-U.S. developed markets, which is tracked by the MSCI EAFE Index, was down 4.1%, and the emerging markets region, which is represented by the MSCI Emerging Markets Index, was down 2.9%.

Endowment

The Endowment portfolio was down 1.5% for Q3, lagging its policy index by 0.2%. The majority of the underperformance was driven by its allocations in the public equity markets, specifically global equities and domestic large-cap equities. All of the publicly traded assets classes in the portfolio were negative for the quarter, and the exposure to less-liquid markets is what helped moderate the overall return for the quarter. Asset classes that helped buoy the Endowment were real assets, hedge funds, private equity and private credit.

Non-Endowment

The Long-Term portfolio was down 2.5% for the quarter which was in line with the policy index that was down 2.4%. Without any exposure to private markets, the portfolio was at the mercy of the public markets. All the asset classes were negative for the quarter but the main contributors to the slight underperformance against the benchmark were the allocations in domestic large-cap equity, lengthened duration within the fixed-income book and manager performance in the hedge fund book.

The Medium-Term portfolio saw a 2.3% loss and underperformed its policy index by 0.3%. Performance was mainly linked to the portfolio's manager selection for emerging-market equities and real assets. The portfolio's fixed-income managers also positioned themselves to take advantage of a pause in rate hikes and eventual rate cuts; this positioning was slightly punished this quarter due to the additional rate hike in July, but is attractive on a longer-term basis. With the portfolio being weighted 70% to fixed income, it will be difficult to find positive returns as long as the Fed continues increasing rates.

The Intermediate-Term portfolio was down 1.7%, lagging its policy index by 0.3%. Being concentrated in intermediate-duration bonds resulted in another difficult quarter for the portfolio due to July's rate hike and continued uncertainty on where rates will go next.

The Short-Term portfolio was up 1.3%, in line with its policy index. Since the portfolio is 100% allocated to money market funds, increases in rates are favorable to the portfolio and pose less risk/volatility to movements in interest rates. The Fed's stance on rates being higher for longer will be a tailwind for the portfolio.

The Sustainable Endowment and Non-Endowment portfolios were down 5.2% underperforming their benchmark by 1.4%. The sole detractor of performance in these portfolios are the allocations to the fossil

fuel-free global-equity strategy. The equity manager had a difficult time in the 2022 environment where energy stocks were the best performing asset class for the year. Confidence remained hopeful that performance would turn for the better once energy prices cooled, however, that thesis has not panned out. As such, the investment team is currently exploring options to upgrade the portfolios' fossil fuel-free equity allocation and bolster the return profile of both portfolios.