# QUARTERLY MARKET UPDATE

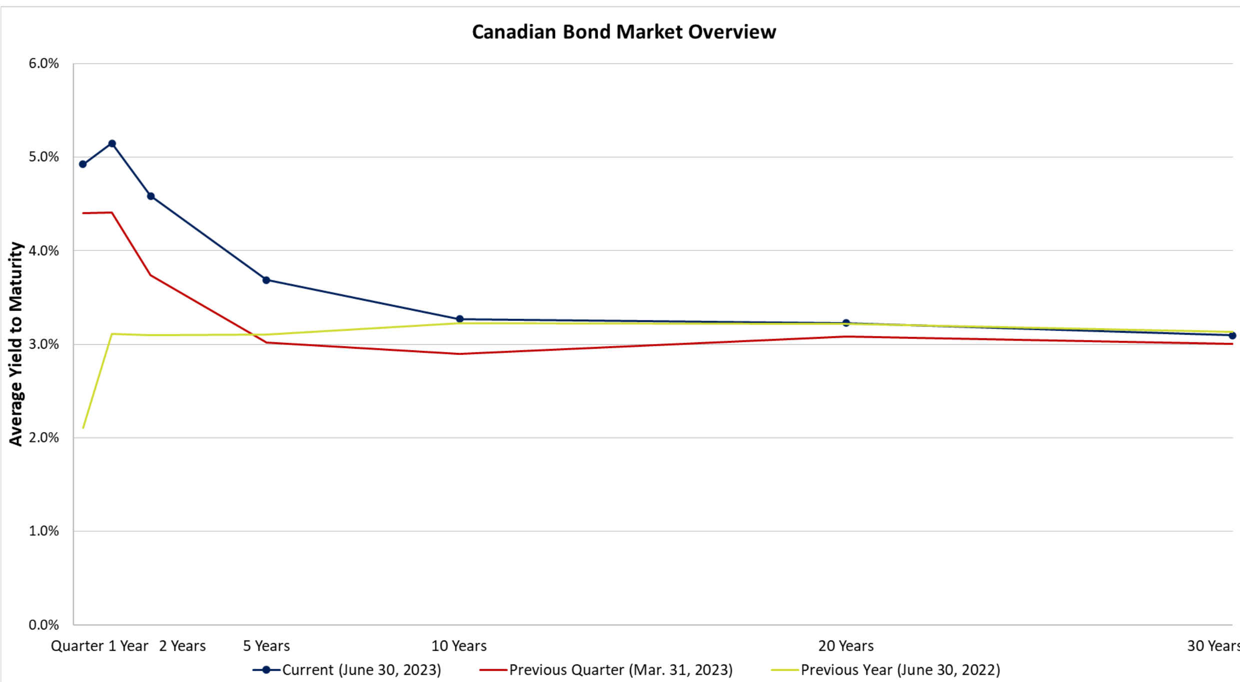
AS AT JUNE 30, 2023

*The following information is being provided as an overview of Vestcor Inc.'s (Vestcor) investment activities and the general financial market conditions experienced during the noted reporting period.*

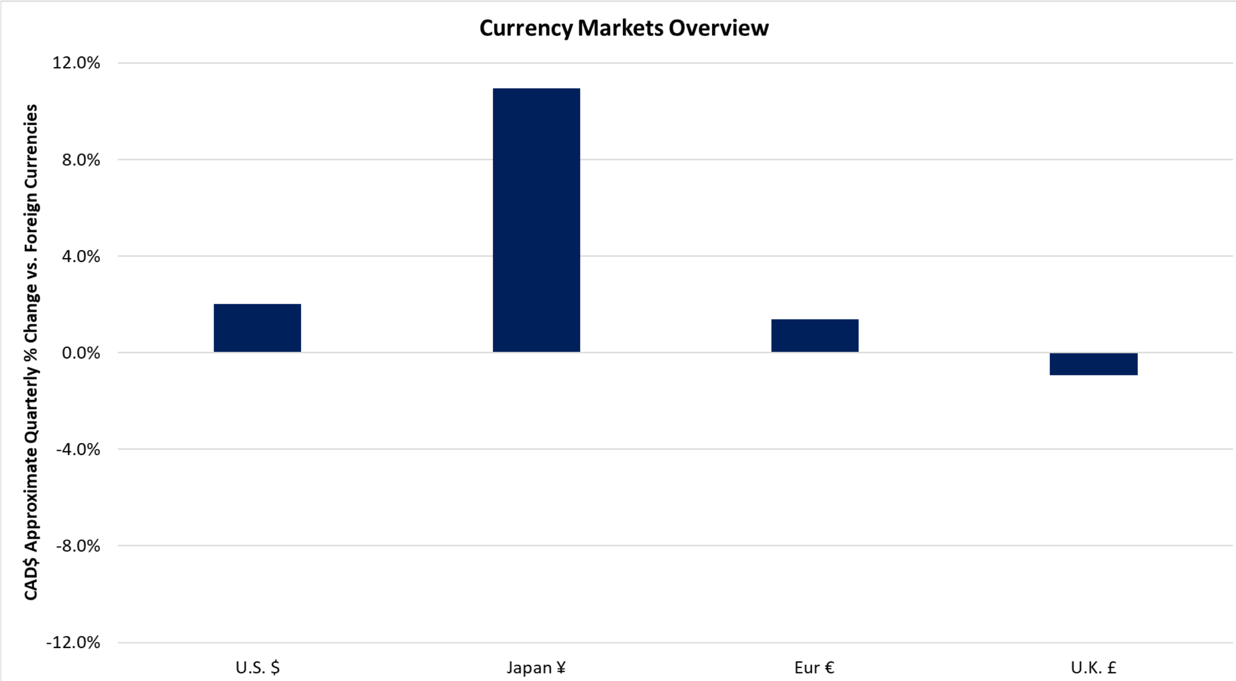
*Please note that the following material is specific to Vestcor activities and is presented for information purposes only. It does not constitute investment advice in any way, and no guarantee is provided as to its completeness or appropriateness. We recommend that readers consult a professional advisor with respect to their own specific financial matters.*

## Performance Overview

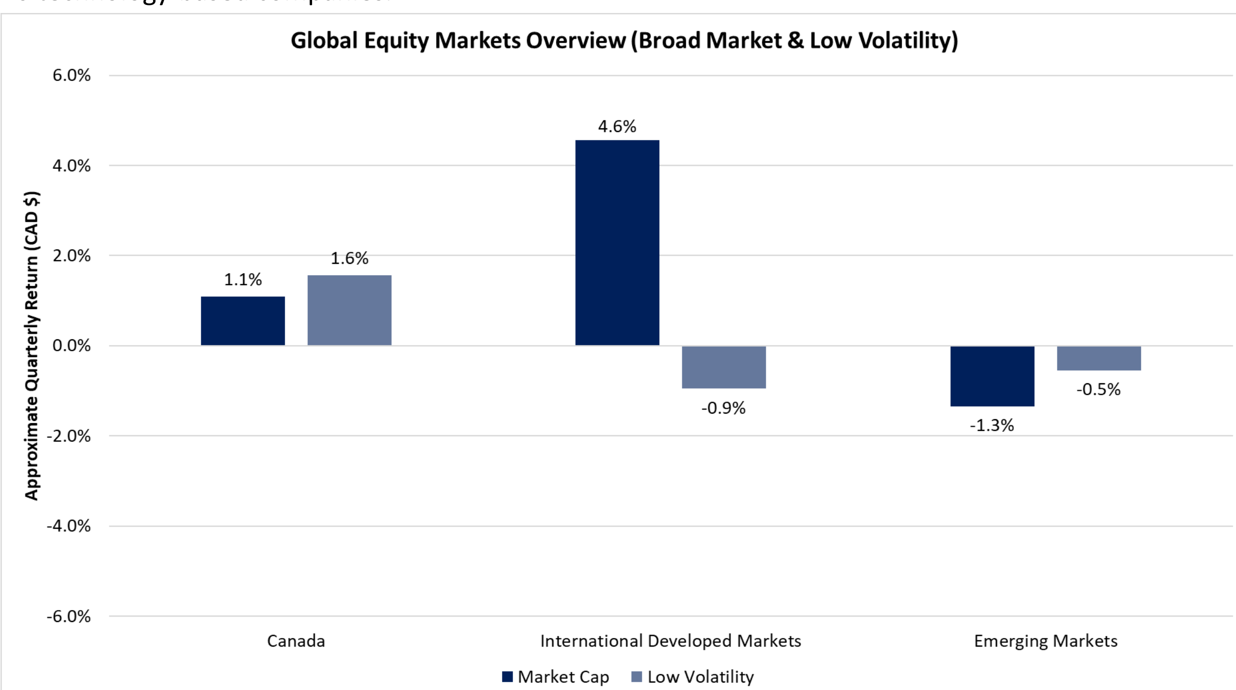
- Performance was mixed in the quarter, both between and within asset-class groups. Within equities, market-capitalization weighted large cap strategies had the strongest returns while small cap equity had negative performance. Fixed Income was negatively affected by rising bond yields causing Government Bonds to decline while Corporate Bonds found protection on falling credit spreads.
- Yields rose over the quarter and the curve further inverted with terms less than five years rising between 50 to 85 bps while long-term 30-year yields were mostly unchanged. During the period the Bank of Canada increased rates 25 bps to 4.75% and signaled further increases may be necessary, causing short to medium term bond yields to increase on the projection of interest rates being held higher for longer.




- Given this backdrop, the Canadian All Government Bond index had a negative return of -0.98% due to the increased yields. Corporate bonds outperformed government bonds over the period with index returns of 0.18% due to lower credit spreads over the period.
- The Real Return Bond index was flat with performance of -0.04%, outperforming government bonds due to gaining higher inflation adjusted interest income.
- In currency markets, the Canadian dollar appreciated relative to most major currencies, except for the British Pound. This generally resulted in overall currency contributions being negative.




- Public equity strategies had mixed performance. Areas of positive returns include domestic strategies, both market-cap weighted and Low Volatility, along with market-cap weighted International Developed Markets. Low Volatility strategies outperformed broader equity indexes in Canada and Emerging Markets while the International Developed Market strategy had a more challenging quarter due to particularly strong performance of large market-cap U.S. technology stocks which have a high weight in the broad market index. Over 80% of the total return for a U.S. large cap stock index so far in 2023 came from just 10 technology-based companies.




- Private real assets including real estate and infrastructure generally outperformed their public market counterparts. While private equity had generally strong returns it lagged public market counterparts.

Summary:

- Despite ongoing geopolitical noise and the turmoil experienced in the banking industry earlier in 2023, the global economy has appeared to remain quite resilient with continued growth, low unemployment, and gradually moderating inflation.
- Equity markets – particularly the higher volatility segments of the market - have rallied strongly in the first half, with the U.S. S&P 500 gaining more than 14% year-to-date in Canadian dollar terms compared to the technology-focused Nasdaq gaining over 36% in the same period.
- Longer term interest rates have been mostly rangebound in recent months, with the Canadian government 10-year bond starting the year with a yield of 3.3% and finishing the half yielding 3.27%. With continued central-bank tightening, yield curves are significantly inverted, with short term yields higher than long term yields.

Although market gains have continued through the first half of 2023, a significant amount of the outperformance has been concentrated in a few larger U.S. based technology companies. As a result, the median stock likely lagged market indexes quite significantly so far in 2023, leading to a challenging environment for active managers that were not overweight those select few companies. With these higher volatility assets leading the gains, the U.S. market (which has greater exposure to larger technology tech companies) has strongly outperformed the more commodity-focused domestic Canadian market year-to-date.

Although central banks have continued to tighten policy in the form of higher short term interest rates, economic performance has remained mostly strong in 2023. U.S. Nonfarm Payrolls have increased by just under 300,000 jobs per month so far this year, resulting in strong employment gains for the U.S. economy and a continued low unemployment rate remaining well below 4%. Economic growth also has continued to remain positive, although some indications would suggest that the tighter policy framework is starting to influence the underlying economy (as evidenced by the rise in corporate bankruptcies), and slower growth should be expected in the coming quarters as central banks work to continue to bring inflation down to their long-term target. This continues to be reflected as well in the strongly inverted yield curve, with short term rates significantly higher than long term rates, which suggests a somewhat bearish expectation for economic growth in the near to medium term.

However, while higher rates are apparently leading to reduced growth expectations, the most important issue for investors may be the length of time that short term rates need to remain elevated. Inflation has moderated significantly from its 2021-22 peak but remains uncomfortably higher than long run central bank targets. If CPI proves slow to return to the approximate 2% target favored by most central banks, then rates may need to remain higher for longer. Given the slightly moderating growth picture, and apparent increases in most measures of recession risk, this length of time that short term rates remain high could be the difference between a period of slightly below trend growth and a recession. However, despite the increased likelihood of slowing growth or outright recession, actual market risk has continued to moderate throughout the year. The VIX Index – a measure of equity market volatility based on option prices – dropped from a level above 20 at the beginning to the year to below 15 by mid-year, indicating that investors were accepting below average risk levels in equity markets for the first time since pre-COVID.

Overall, despite the warning signs about economic growth, investors have continued to look past most sources of risk in focusing on the long term. Equity market prices have rebounded strongly from the losses in 2022, and interest rates have remained somewhat rangebound year-to-date. As a result, even assuming somewhat lower than average long run equity returns, a 60/40 stock/bond portfolio likely continues to be well positioned to fund long term pension portfolios over the medium to long term assuming that central banks continue to work inflation down to long term average levels.