October 2023 market state: Neutral

MONTHLY MARKET STATE UPDATE

We use rules-based, quantitative methods to identify four distinct market environments, described as capital preservation, neutral, bullish and highly bullish. Each market state is generally characterized by a combination of yield-oriented fixed-income signals and equity signals:

- **Capital Preservation Market State**: Yield signals: Unusual, Equity signals: Normal
- **Neutral Market State**: Yield signals: Normal, Equity signals: Normal
- **Bullish Market State**: Yield signals: Normal, Equity signals: Favorable
- **Highly Bullish Market State**: Yield signals: Unusual, Equity signals: Favorable

We believe adjusting portfolio risk exposure based on this rules-based market-state classification process can lessen market-related losses when markets are down and still capitalize on opportunities when conditions are favorable.

Asset allocations are included for illustrative purposes only, subject to change and are not intended to be representative of any particular investment. Asset allocation varies by product and may not include all of the asset classes shown.

Current factors impacting the market state

**EQUITY SIGNALS**

- **Momentum**: Looks at a ratio of short-term to medium-term momentum and seeks levels above 1 for a risk on signal.
  - Global equity momentum decelerated further in September. Short-term price momentum remained narrowly above the longer term trend to end the month, allowing this signal to maintain a green light reading for a ninth consecutive month.

- **Volatility**: Tracks a ratio based on short-term versus medium-term levels of equity volatility and compares the ratio to a median level.
  - Equity volatility continued its ascent higher in September, as short-to-medium-term readings registered near median levels. This signal remains green at month end but only by a slim margin.

- **Relative valuations**: Earnings yield for stocks versus government bond yields
  - Forward earnings yield measures for stocks moved higher in the month, as equity prices pulled back. However, bond yields also increased in notable fashion during the month. In contrasting stocks’ earnings yield figures with government bond yields, the relative valuations for domestic large-cap stocks continue to look challenged, keeping the market state in neutral.

**YIELD SIGNALS**

- **Real yields**: Compares nominal Treasury bond yields with the headline rate of inflation (CPI).
  - Levels of real yields have improved this year, and this signal no longer delivers extreme readings. With meaningfully higher bond yields over the past year and headline inflation moving noticeably lower in recent quarters, this signal turned green seven months ago after having spent nearly two years in red. Current year-over-year headline CPI is registering near 3.7%.

- **Yield curve**: Measures the slope of the yield curve by comparing medium- and long-term yields.
  - The yield curve measure we track inverted in March of 2022 and remained inverted at the end of September 2023, registering in the bottom decile of long-term historical values. While ultra short government bond yields remained stable, mid-to-long-dated government bond yields moved noticeably higher in the month. With this signal delivering inverted readings, it warrants close attention and some caution for investors.
Why we’re staying in Neutral

For October, the market state classification remains in Neutral.

- **Yield signals continue to deliver mixed readings.** Real yields have improved on the back of lower headline inflation readings this year and currently register in a normal range. However, the yield curve remains inverted, so this signal input still warrants some caution.

- **Global equity momentum decelerated further in September,** and this factor input now remains in favorable territory by a narrow margin.

- Comparing earnings yields for stocks to government bond yields, **relative valuations for domestic large-cap stocks remain challenged** and weigh on the overall market state designation, keeping it anchored in neutral.

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<th>Market states over trailing 12 months</th>
<th>2022 Nov</th>
<th>2022 Dec</th>
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Historic market states November 2022 to October 2023. Source: Columbia Management Investment Advisers, LLC based on internal model. Historical occurrences may not reflect future market conditions.

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