

Our philosophy of focusing collectively on strong fundamentals, attractive valuation and positive sentiment should put us in good stead in selecting stocks.

## Columbia Integrated US Dividend Income SMA Strategy

### Market overview

At the start of the quarter, markets were grappling with how policy makers would balance the pros and cons of a seemingly vibrant economy. A steady series of data points painted a picture of a resilient consumer, stable labor market and a growing economy. A higher-for-longer mantra took hold regarding interest rates, and the markets drifted from mid-year highs toward correction territory.

But inflation continued to cool, and the U.S. Federal Reserve chose to leave rates unchanged at its November meeting, and — critically — released projections that implied 75 basis points of easing next year. This implication caused a sudden and significant reversal in both equity and bond markets. The yield on 10-year Treasuries, which had briefly breached 5%, quickly retreated, ending the year below 4%, and 30-year mortgage rates dropped from over 8% to less than 7%. Equities also rallied, with the S&P 500 Index posting an almost 6% gain that week to start a streak of nine consecutive weekly gains through the end of the year.

During the quarter, the advance in U.S. equities was both strong and broad. The S&P 500 Index returned 11.69%, the largest quarterly gain since 2020, ending the year just shy of its all-time high. The Dow Jones Industrial Average and Nasdaq composite did even better, rallying more than 13% each, with the former closing 2023 at an all-time high. Small-cap stocks, which had lagged their large-cap counterparts earlier in the year, rose swiftly in December, with the Russell 2000 Index gaining 14.03% in the last quarter compared to a 11.96% gain for the large-cap Russell 1000 Index. Growth stocks benefited more from the change in the interest rate outlook, and the Russell 1000 Growth Index gained 14.16% compared to the Russell 1000 Value Index's still respectable gain of 9.50%.

All sectors except energy posted strong positive returns for the quarter. Those that were geared toward declining interest rates, including real estate, financials and information technology, did particularly well. The more defensive health care and consumer staples sectors had lower but still material positive returns. Despite the war in the Middle East following Hamas' attack on Israel, Brent oil prices fell by nearly 20% amid slowing global demand and robust supply. This resulted in the energy sector lagging the rest of the market.

### Quarterly portfolio recap

Sector allocation and security selection both detracted from performance versus the S&P 500 Index during the quarter. The strategy's overweight positions in real estate and industrials contributed the most to relative performance, while an overweight position in energy and an underweight position in information technology detracted from relative performance. Stock selection was strongest in financials and utilities, while stock selection detracted the most in consumer staples and communication services. Top individual contributors to relative performance for the quarter included Broadcom and Qualcomm, while top detractors from relative performance included Cisco and Marathon Petroleum.

## Outlook

After inflation made its fast and furious appearance about two years ago, markets were consumed by a series of worries — first stagflation, then a potential recession triggered by the Fed's restrictive policies. However, standing where we are now, the Fed seems to have pulled off a miracle — a soft landing. Inflation seems to be cooling, the economy is humming along and the threat of recession seems to have been postponed, if not averted. The markets are eagerly counting down the days to a rate cut, although risks remain. The full impact of interest rate increases is yet to fully percolate into different parts of the economy and will continue to do so at different rates. Additionally, in an election year, government policy will be an important focus for the markets and ongoing wars have the potential to move markets, particularly if they escalate. On the positive side, we will continue to watch the adoption of artificial intelligence (AI) and its impact on different industries. As the implications of AI adoption across the economy become clearer, they could contribute to increasing market breadth as less-obvious beneficiaries with the right strategy begin to share in the gains. Finally, so far, both the resolution of supply chain constraints and the drop in oil prices have been fortuitous in helping control inflation. However, with simmering geopolitical tensions, we might see them reverse.

At the company level, we continue to view this environment as favorable for our investment philosophy. In a more economically challenging, higher interest rate regime, companies that can execute on their strategies, post solid earnings, strong margins and generate abundant cash flow will continue to be rewarded. Our philosophy of focusing collectively on strong fundamentals, attractive valuation and positive sentiment should put us in good stead in selecting stocks.

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