Columbia US Integrated Large Cap Value SMA Strategy

Our multifactor approach focusing collectively on quality, valuation and catalysts should put us in good stead in selecting stocks.

Market overview

Equity markets started the new year by moving higher with expanded breadth. The primary driver of the market move was investors' perception that the incoming administration would favor deregulation, lower corporate taxes and be friendlier to growth. The S&P 500 Index hit multiple all-time highs during the first half of the quarter.

The second half of the quarter saw a marked shift in risk sentiment. Trade tensions with Canada and Mexico, along with the risk of a broader tariff regime with the potential to substantially impact both growth and inflation, triggered an anti-momentum selloff. The S&P 500 Index suffered a drop of more than 10% from its peak before recovering modestly.

For the full quarter, the S&P 500 Index dropped 4.27%, while the Nasdaq Composite Index sank by more than 10%. The "Magnificent Seven" (Alphabet, Amazon, Apple, Meta Platforms, Microsoft, NVIDIA, Tesla), which had dominated market indices during the past few years, collectively fell more than 20% from their December 2024 peaks. But small-cap securities, which generally lagged large caps over the same period, were not spared either. The Russell 2000 index fell 9.48% during the quarter. With increasingly hawkish commentary coming from the U.S. Federal Reserve, investors turned to value securities over growth securities. There was a wide dispersion between the Russell 1000 Growth Index, which dropped 10.00%, and the Russell 1000 Value index, which was among the rare U.S. market indices that ended in the black for the quarter, rising 2.14%. In contrast with the U.S., international markets showed remarkable resilience, with both developed (MSCI EAFE Index) and emerging markets (MSCI Emerging Markets Index) rallying 6.86% and 2.93%, respectively.

Sector performance showed significant dispersion during the quarter, with a more than a 23% difference in return between the best- and worst-performing sectors. Despite overall market weakness, only 4 of the 11 equity market sectors had negative returns. Defensive sectors, such as health care, consumer staples and utilities, posted strong positive returns. The financials and real estate sectors that are positively exposed to interest rates staying higher for longer also did well. Energy was the best-performing sector, as energy companies were sought out for their ability to act as an inflation hedge. Conversely, communication services, information technology and consumer discretionary lost substantial ground, ranging from -6% to -14% returns. Many stocks in these sectors had previously benefited from enthusiasm about artificial intelligence (AI), but investors chose to take profits amid growing concerns about AI capital expenditure requirements and the timeline for realizing benefits. This marked a strong reversal in the winners and losers from the previous quarter.

Corporate earnings reports largely beat estimates in proportions consistent with historic trends, but there were more reports with potential slowdowns in the guidance offered by management. As a result, we saw negative earnings revisions throughout the quarter, with consensus earnings-per-share (EPS) estimates for the S&P 500 Index declining. The resilience of the economy post-pandemic was primarily driven by a strong consumer. However, during the first quarter, consumer sentiment declined every month and fell to its lowest level in more than two years. Consumer expectations for inflation during the next year also jumped significantly. The labor market continued to be robust, however, with non-farm payrolls showing no significant signs of a slowdown. Before the new tariff regime created another layer of uncertainty, the Fed was still on track to cut interest rates twice this year.

Outlook

We entered 2025 after two years of substantially above-average equity market returns. The new year added three more all-time highs for the S&P 500 Index to the 57 all-time highs the index posted in 2024. Prudent investors questioned whether valuations were frothy and if the rally had legs. Among reasons for optimism were a potentially friendly regulatory environment and the secular tailwind of AI adoption across industries. However, as of the end of the first quarter, the most significant forward driver of financial markets was likely to be U.S. tariff policy.

At this point, it appears that broad-based and sizable tariff imposition is more likely to be a serious policy proposal rather than a negotiating tactic to extract concessions from global trading partners. Tariffs are inflationary and can cause substantial disruptions to demand patterns and supply chains. They can negatively affect consumer spending and weaken the labor market; the resilience of both have thus far been the wind in the sails of the economy. Tariffs add enormous additional uncertainty to the earnings prospects of companies across the entire spectrum of the economy.

When inflation reared its head after the pandemic, the Fed had to walk a tightrope between bringing prices down and pushing the economy into a recession. After three years, we can say the Fed successfully avoided a hard landing. However, as it navigates the last mile of the inflation reduction journey, the introduction of tariffs has the potential to take the Fed back several steps. This increases the risk of stagflation, where economic growth is limited and inflation remains high.

While tariffs can also cause disruptions to AI adoption, we believe AI will remain an important investment theme. Given the technology’s substantial benefits in improving productivity, it will continue to transform businesses, although potentially at a slower pace. The largest companies have invested hundreds of billions of dollars in capital expenditures to compete for new revenue opportunities. As the returns from those investments become clearer, markets will reward those with the best strategy and execution.

The influence of government policy and other macroeconomic factors and themes on individual stock performance is undeniable. However, predicting the effects consistently can be a challenge at a moment of high uncertainty. At a time like this, focus and increased emphasis on company fundamentals and earnings potential can add value. At the company level, firms that can navigate this environment, execute on their strategies and post solid earnings and cashflows are likely to be rewarded. Companies with nimble operations that have options to pivot to alternative suppliers or markets when disruptions occur will prove more resilient. Characteristics of profitability, margins and cash-flow generation will continue to be important for companies to fund their own growth, with operational flexibility and supply chain adaptability becoming increasingly critical differentiators. In such an environment, our multifactor approach, which focuses collectively on quality, valuation and catalysts, should put us in good stead in selecting stocks.

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Indices shown are unmanaged and do not reflect the impact of fees. It is not possible to invest directly in an index.

The **Russell 1000 Index** tracks the performance of 1,000 of the largest U.S. companies, based on market capitalization.

The **Russell 1000 Growth Index** is an unmanaged index that measures the performance of those Russell 1000 Index companies with higher price-to-book ratios and higher forecasted growth values.
The **Russell 1000 Value Index** measures the performance of those Russell 1000 Index companies with lower price-to-book ratios and lower forecasted growth values.

The **Standard & Poor's 500 Index** (S&P 500 Index) is an unmanaged list of common stocks which includes 500 large companies.
The **Russell 2000 Index** measures the performance of the small-cap segment of the U.S. equity universe. The Russell 2000 Index is a subset of the Russell 3000® Index representing approximately 10% of the total market capitalization of that index. It includes approximately 2000 of the smallest securities based on a combination of their market cap and current index membership.
The **National Association of Securities Dealers Automated Quotation (NASDAQ) Index** measures the performance of all NASDAQ domestic and international based common type stocks listed on the NASDAQ Stock Market calculated under a market capitalization weighted methodology index.
The MSCI EAFE Index (Europe, Australasia, Far East) is a free float-adjusted market capitalization index that is designed to measure the equity market performance of developed markets, excluding the US & Canada.
The **MSCI Emerging Markets** Index is a free float-adjusted market capitalization index that is designed to measure equity market performance of emerging markets.