Columbia Integrated US Large Cap Value SMA Strategy

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Market overview

U.S. equities continued their ascent in the second quarter, with technology stocks up over 13%, as measured by the Nasdaq Composite Index. Most importantly, despite inflation readings continuing to exceed the U.S. Federal Reserve's target of 2%, the Federal Open Market Committee (FOMC) held rather than hiked rates at its June meeting. This maintained the federal funds target rate's upper bound at 5.25%. This was the first meeting with no action since the Fed began increasing rates for this cycle in March 2022. Despite the pause, the federal funds futures curve is currently anticipating one more 25 basis point (bp) increase by the September 2023 meeting. (A basis point is 1/100 of a percent.) Fed Chair Powell has stated that at least two more 25 bp increases may be warranted. With the U.S Treasury yield curve remaining inverted, many investors continued to believe that a recession was inevitable. However, stable corporate earnings and employment data spurred discussions of a possible "soft" or "no" landing, which supported equity returns during the quarter. The housing market has also been supportive of continued economic growth, with May housing starts reaching levels not seen since 1990. Further, inflation metrics have begun cooling, with the May 2023 Personal Consumption Expenditures Index (PCE) coming in at +3.8% year over year. This is the smallest rate of increase since April 2021.

At the current pace of economic growth, with first quarter 2023 U.S. real gross domestic product (GDP) growth clocking in at 2% year over year, hopes for Fed rate cuts have been pushed out to mid-2024. This increases the possibility of a higher-for-longer short-term rate scenario taking hold.

The markets, while broadening somewhat since the first quarter still remain relatively narrow, with the 15 largest stocks in the S&P 500 Index driving nearly 86% of the overall return year to date. The artificial intelligence (AI) theme played a significant role, propelling returns in the information technology and communication services sectors. Growth continued to outperform value during the second quarter. However, June saw an improvement in value's relative performance versus growth, and small caps outperformed large caps for the month. Overall, nine of eleven S&P 500 global industry classification standard (GICS) sectors had positive returns, with only energy and utilities in negative territory for the quarter. Information technology and consumer discretionary led sector performance for the S&P 500 Index.

Quarterly portfolio recap

Companies with attractive fundamentals and strong investor interest characteristics contributed the most to model performance for the period. Security selection and sector allocation both contributed to performance relative to the Russell 1000 Value Index for the period. The strategy's overweight in the communication services sector and underweight in the utilities sector contributed to relative returns, while the strategy's overweights in the consumer staples and health care sectors detracted from relative returns. Stock selection was strongest within the industrials and communication services sectors, while security selection within financials and real estate detracted from relative performance. Top individual contributors for the quarter included Meta and Owens Corning, while AES and Sealed Air were among the largest individual detractors.

Outlook

The possibility remains that some of the abundant cash, estimated at over $8 trillion, parked in money market funds may come back into the market if investors' fear of missing out becomes strong enough. Many investors currently appear satisfied with the certainty presented by higher yields at the front end of the yield curve. The failed Russian coup attempt in late June, combined with increasing geopolitical risks has potentially tempered investor enthusiasm for taking on additional equity risk.

Continued higher short-term interest rates have placed a premium on companies with more resilient business models as the cost of funding rises. With earnings facing an uncertain outlook in many sectors, factors such as profitability and quality remain attractive within our models relative to historical trends. As the economy is likely to face a slower rate of growth over the second half of the year, we continue to focus on companies with strong fundamentals trading at attractive valuations for our portfolios.

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Market risk may affect a single issuer, sector of the economy, industry or the market as a whole. Generally, **large-cap** companies are more mature and have limited growth potential compared to smaller companies. In addition, large companies may not be able to adapt as easily to changing market conditions, potentially resulting in lower overall performance compared to the broader securities markets during different market cycle. **Value** securities may be unprofitable if the market fails to recognize their intrinsic worth or the portfolio manager misgauged that worth. The strategy may invest significantly in issuers within a particular **sector,** which may be negatively affected by market, economic or other conditions, making the strategy more vulnerable to unfavorable developments in the sector.

Holdings and characteristics are based on the model portfolio and are subject to change at any time. Individual account performance, holdings, and characteristics may differ from information shown. References to specific securities are included as an illustration of the investment management strategy and are not recommendations. Holdings may represent only a small percentage of the portfolio. It should not be assumed that any particular security was or will prove to be profitable or that decisions in the future will be profitable or provide similar results to the securities discussed.

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The **Standard & Poor's 500 Index** (S&P 500 Index) is an unmanaged list of common stocks which includes 500 large companies.

The **Nasdaq Composite Index** is a market capitalization-weighted index of more than 2,500 stocks listed on the Nasdaq stock exchange.

The **Personal Consumption Expenditure (PCE) Index** measures monthly changes in the price of consumer goods and services as a means of analyzing inflation.

The **Russell 1000 Value Index** includes the subset of companies in the Russell 1000 Index with lower price-to-book and lower forecasted growth. An investment cannot be made directly in an index.

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

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