COLUMBIA THREADNEEDLE INVESTMENTS®

Columbia US Integrated Large Cap Value SMA Strategy

Characteristics of profitability, margins and cash flow generation will continue to be important for companies to fund their own growth. In such an environment, our multifactor approach focusing collectively on quality, valuation and catalysts should put us in good stead in selecting stocks.

Market overview

Stocks moved higher for the fourth quarter in a row, and multiple stock indices ended at all-time highs. The S&P 500 Index rose 5.89%, while the Nasdaq 100 Index gained 2.10% during the third quarter. Some mega-cap stocks lagged the market this quarter, as last quarter's extremely narrow concentration in returns reversed, and market breadth expanded. After lagging large caps during the first half of the year, small-cap stocks outperformed, with the Russell 2000 Index rallying 9.27%. All economic sectors except for energy were positive this quarter. With interest rates coming down, the best-performing sectors were utilities and real estate, which rallied 19.4% and 17.2%, respectively. Stocks in the industrials, financials, materials and the consumer sectors also did well. Information technology and communications services posted returns that were barely positive, as many of the mega-cap names in these sectors, which strongly lead the market earlier in the year, gave back some of their gains.

The biggest economic news of the quarter was the Federal Reserve's decisive start on the path to reducing interest rates with a 50-basis point cut in September. (A basis point is 1/100 of a percent.) This was driven by the alignment of both indicators of the Fed's dual mandate of containing inflation and maintaining employment. On the one hand, inflation continued to moderate as evidenced by the June and July Consumer Price Index reports. And in August, the Fed's preferred measure of inflation, the Personal Consumption Expenditure, also came in below expectations and at an annual rate that was much closer to the Fed's target. On the other hand, the employment picture continued to show some cracks, with nonfarm payroll gains sharply slowing and the unemployment rate moving up. Finally, with the estimate for second-quarter gross domestic product growth coming in at a solid 3%, the Fed likely felt that they may have pulled off a much hoped-for soft landing.

The second-quarter earnings reports painted a generally rosy picture of corporate health. For companies in the S&P 500 Index, about 80% beat estimates, and earnings grew 11.3% on average. Some companies highlighted challenges due to a slowdown in China as well as a reduction in travel-related spending. However, strong retail sales numbers indicated that the U.S. consumer, in general, has been willing and able to spend. In addition, at quarter end, the Michigan Consumer Sentiment Index was at a five-month high.

Geopolitical tensions around the world escalated substantially. The conflict in the Middle East now ensnares not just Gaza and the West Bank but also Lebanon, and the risk of direct involvement of Iran has heightened. The war in Ukraine continued unabated, and the country even launched a surprise incursion into Russian territory. In the U.S., the presidential campaign entered its final few weeks with what seems like no clear advantage to either side. While markets have thus far been not significantly affected by the upcoming election, there could be elevated market volatility when definitive results become known about the direction of the country.

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Outlook

On the heels of a receding pandemic, when inflation made its appearance in 2021, the Fed was forced to react with a series of aggressive interest rate hikes. With a potentially fragile economy and a labor market that may not yet have found firm footing, investors were rightfully concerned whether the Fed would be able to navigate that treacherous situation without forcing a recession. However, standing where we are now, they seemed to have threaded the needle almost perfectly. Starting with the bold 50-basis point cut in September, we are now on a path potentially lined with additional rate cuts in the coming quarters. This should provide a tailwind to the labor markets, consumer health and, as a result, the overall economy and the markets.

While there were some signs of raising delinquency rates in consumer credit and auto loans, spending remains robust and lower interest rates should provide an additional cushion to shore up the health of the consumer. Similarly, in the housing market where high mortgage rates significantly affected supply of existing homes, a reduction in rates should catalyze more transactions and continue to support this sector of the economy. However, the labor market, which was running hot only a few months ago, seems to be the relatively weakest link now and could be a source of risk for the markets.

The upcoming U.S. presidential election could be a source of market volatility. And the escalation of geopolitical tensions in the Middle East and Ukraine are another source of risk. Both wars can have an outsized effect on commodity prices, supply chain networks and, as a result, the broader global economy.

The influence of these macro-factors and themes on individual stock performance is undeniable. However, we also expect a return of focus and increased emphasis on company fundamentals and earnings. Especially with the potential of artificial intelligence (AI) adoption to transform businesses, companies in the same market space will experience varied fortunes depending on their individual successes, failures and prospects.

All of this leads us to believe that at the company level, those that can execute on their strategies, posting solid earnings and cash flows, are likely to be rewarded. Even with interest rate cuts, we expect rates to be at levels where cost of capital matters. Therefore, characteristics of profitability, margins and cash flow generation will continue to be important for companies to fund their own growth. In such an environment, our multifactor approach focusing collectively on quality, valuation and catalysts should put us in good stead in selecting stocks.

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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.
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The **NASDAQ 100 Index** is a collection of the 100 largest, most actively traded companies listed on the Nasdaq stock exchange.
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.