Summer 2022

COLUMBIA THREADNEEDLE INVESTMENTS

INVESTOR NEWSLETTER

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Cover story:

Is the U.S. economy heading into a recession?

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Shining a light on mid-cap value

As interest rates rise, investors may look to floating-rate funds

FEATURED STORIES

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ALSO INSIDE

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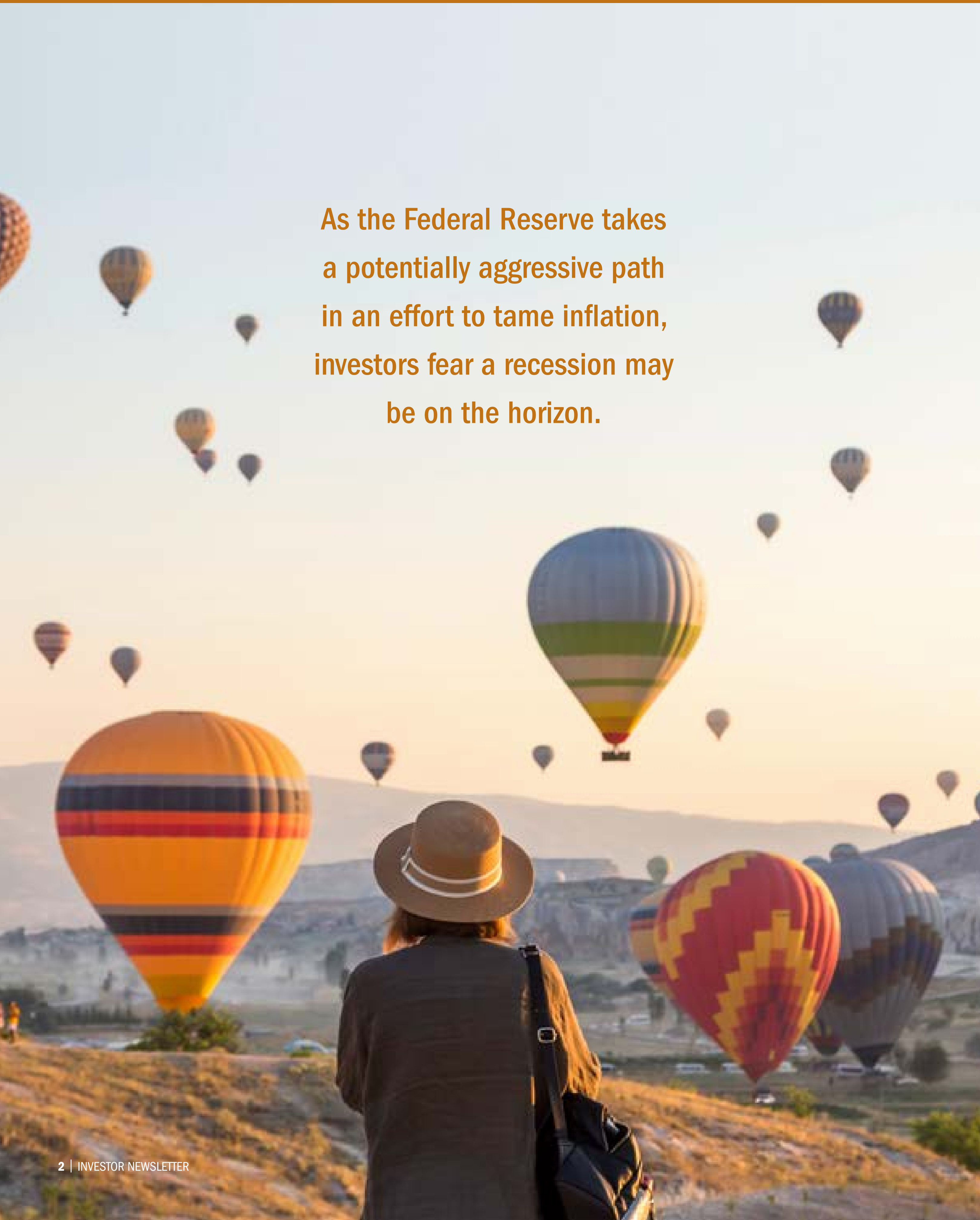
Columbia Threadneedle Investor Newsletter is published quarterly online and features timely articles covering economic trends, investment strategies and solutions, and service changes.

As the Federal Reserve takes a potentially aggressive path in an effort to tame inflation, investors fear a recession may be on the horizon.



IS THE U.S. ECONOMY HEADING INTO A RECESSION?

What is a recession?

A recession is a significant decline in activity spread across the economy, lasting more than a few months, visible in industrial production, employment, real income and wholesale-retail trade, according to the National Bureau of Economic Research (NBER). An economy is generally considered to be in a period of recession when it experiences negative GDP growth over two consecutive quarters. Recessions are part of the normal cycle of business, part and parcel of economic expansion and contraction. They can be triggered by any number of financial, psychological or fundamental economic stresses, such as:

- **A sudden economic shock:** Sharp and unexpected events can result in serious economic damage, such as when OPEC cut off oil supplies to the United States without warning in the 1970s or, more recently, the COVID-19 pandemic and the invasion of Ukraine by Russia.
- **Asset bubbles:** Irrational investor exuberance during periods of strong economic growth can artificially inflate asset prices. When the bubble bursts and optimism turns to worry, panic-selling can bring the market to its knees.
- **Excessive debt:** Increasing debt defaults and large-scale bankruptcies can sink the economy, such as when the housing bubble burst in the mid-2000s, leading to what was dubbed the "Great Recession."
- **An excess of inflation:** Inflation is the steady rise in the price of goods over time. As prices rise, a currency's purchasing power decreases. However, if prices rise too much or too quickly, that creates a stress on the economic system, which can ultimately lead to a deceleration in economic growth.

The United States has experienced as many as 48 recessions throughout its history, with the first dating back to 1785 when the business boom that followed the American Revolution ended. Many believe the overexpansion, heavy debts and post-war deflation that occurred during that time, coupled with a lack of credit, a sound currency and the absence of significant interstate trade, caused businesses to call for a stronger federal government.

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Recession fears on the rise

For the last two years, inflation has been a worry for the markets. To combat higher than expected inflation, the Fed has been broadcasting an aggressive position on hiking the fed funds rate. Markets are expecting several hikes, bringing the central bank's overnight rate to 2.00%–2.25% by the end of 2022.

Recession fears became headline news when the yield on the 2-year Treasuries briefly rose above the yield on the 10-year Treasuries. Historically, some yield curve inversions have foreshadowed a recession.

But a single yield curve inversion on its own is an imperfect recession predictor: an inversion may precede a recession, but not all inversions culminate in a recession. Taking a broader look at the economy, we believe that although the fundamentals remain strong — particularly the labor market — there's an expanding list of risks to growth, including the ending of fiscal and monetary stimulus, sanctions on Russia and the war in Ukraine. With this increased concern about a recession, it's important to recognize that not all recessions are the same. They have different drivers, which can impact their duration and severity.

In the current environment, calibrating monetary policy precisely enough to slow growth but not cause a downturn is a significant challenge for central banks given the relatively blunt tools at their disposal. Investors may be concerned that policymakers are playing catch-up and may end up tightening interest rates well above what the economy can handle.

Bottom line

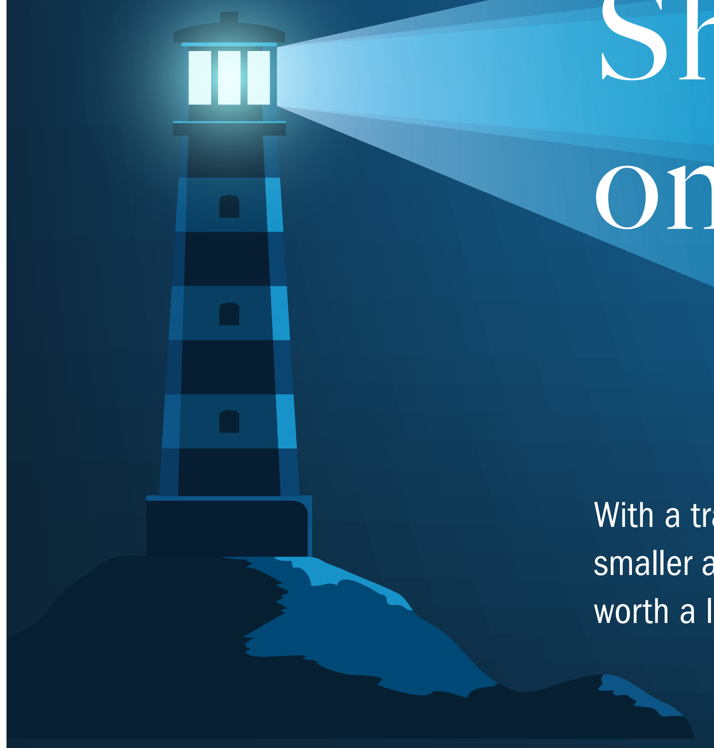
Given the macroeconomic headwinds, we expect growth to slow to "near trend" levels this year from the very high growth rate in 2021. In fact, first quarter GDP numbers released in late April showed an unexpected decline of 1.4%, but this was mostly due to technical factors and not necessarily recessionary. Underlying trend growth, as measured by private domestic demand, was solid and still above trend. But in the coming quarters, rising rates and declining real incomes could take a bite out of consumer spending and result in further slowdowns. Our base case is that we avoid recession, but the risks are rising.

Visit the Columbia Threadneedle blog for further insight on what lies ahead for the U.S. economy and more.

NOT ALL RECESSIONS ARE THE SAME

Type of recession	Drivers	Economic and financial impact	Examples
Financial	Bursting bubble in the financial sector	■ Large declines in GDP ■ Big drawdowns in equities and other risk assets ■ Tend to last longer	■ 2007–2008 financial crisis ■ Tech-led recession in early 2000s
Classic or real-imbalances-led	Unwinding of consumption or capital investment bubbles	■ Mild contraction in GDP ■ Average (25%) equity drawdown ■ Typically short-lived	■ Early 1990s
Central-bank-led	Over-tightening of monetary policy	■ Similar to classic recessions in terms of growth, equity drawdowns and duration	■ Great Depression ■ 1979–1981

Source: Columbia Threadneedle Investments.



Shining a light on mid-cap value

With a track record of outperformance relative to both smaller and larger companies, mid-cap stocks could be worth a look for value investors.

KARI MONTANUS
Senior Portfolio Manager,
Head of Focused Mid Cap Value and Focused Small Cap Value Team

There's a part of the equity market that is often overlooked despite long-term compelling performance: mid-cap value.

The equity investment conversation typically focuses on the rotation between large-cap and small-cap stocks or between growth and value. But for value investors, mid-cap — which is used to describe companies with a market capitalization of between $450 million to $70 billion — deserves specific consideration.

Mid-cap stocks have unique attributes, combining the return potential of smaller companies with the management and operational stability of established businesses. This historically has resulted in consistently higher risk-adjusted performance relative to small- and large-cap value stocks.

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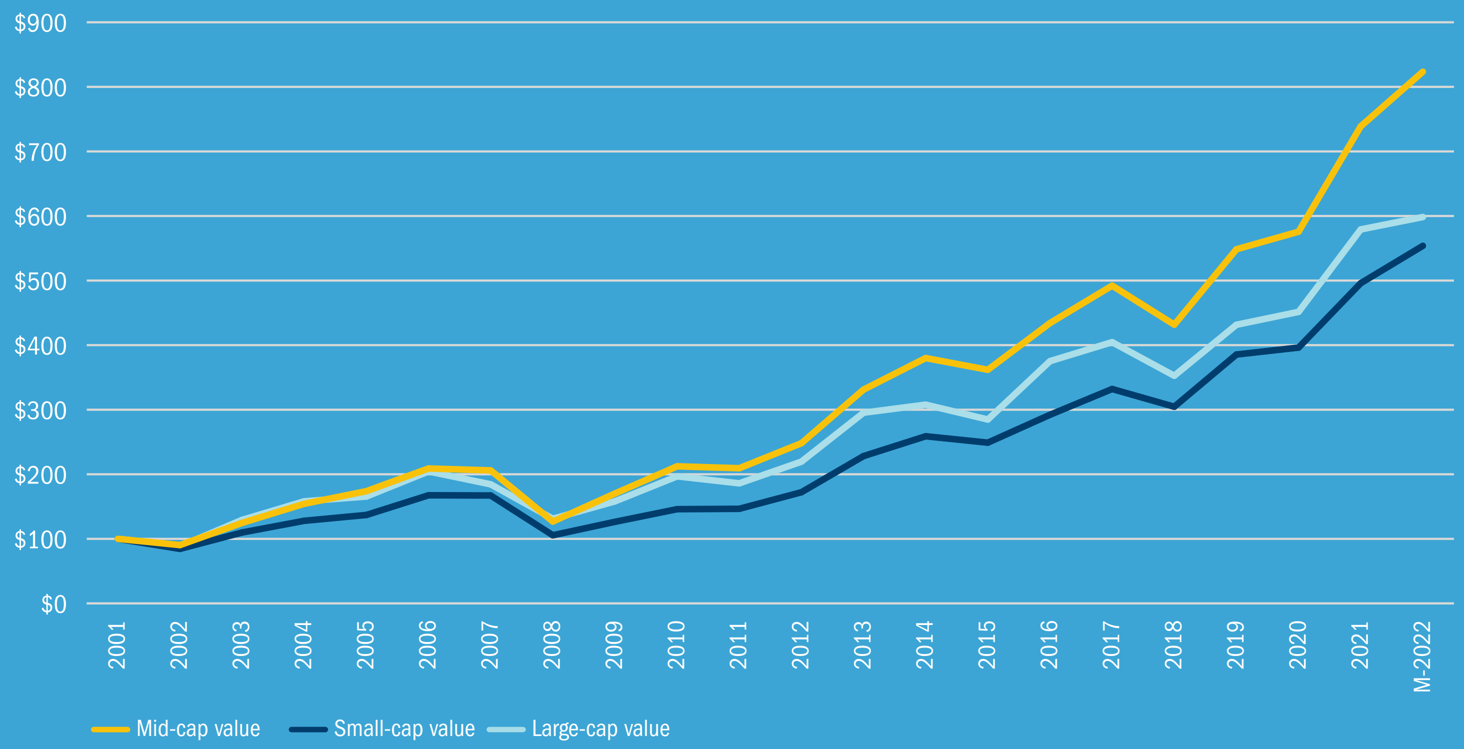
MID-CAP VALUE STOCKS HAVE CUMULATIVELY OUTPERFORMED THEIR SMALL- AND LARGE-CAP VALUE COUNTERPARTS

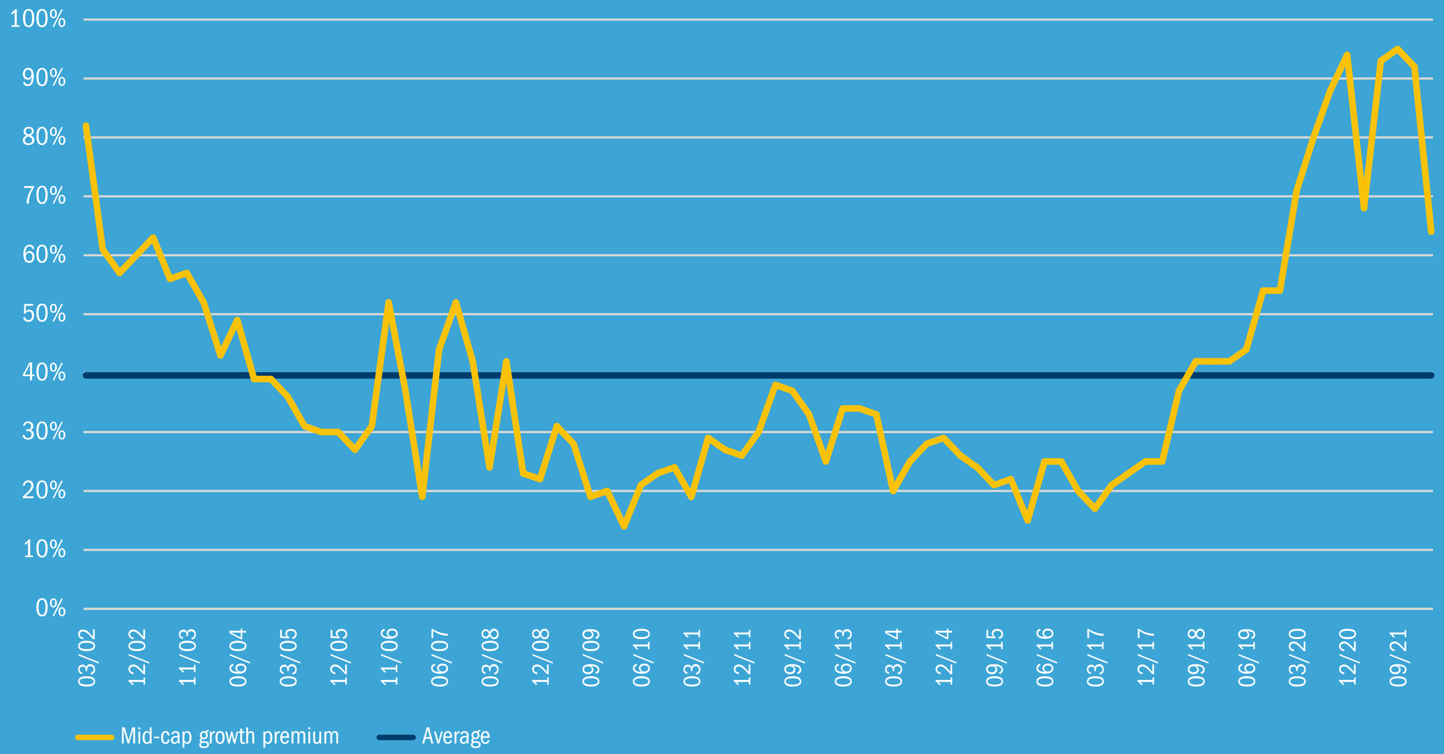
Growth of $100, 01/01/02–03/31/22



Source: Morningstar Direct, 03/31/22. Mid-cap value is represented by the Russell Midcap Value Index, an unmanaged index that measures the performance of those Russell Midcap Index companies with lower price-to-book ratios and lower forecasted growth values. Small-cap value is represented by the Russell 2000 Value Index, an unmanaged index that measures the performance of those Russell 2000 Index companies with lower price-to-book ratios and lower forecasted growth values. Large-cap value is represented by the Russell 1000 Value Index, which is an unmanaged index that measures the performance of those Russell 1000 Index companies with lower price-to-book ratios and lower forecasted growth values. It is not possible to invest directly in an index. Past performance is no guarantee of future results.

MID-CAP VALUE STOCKS ARE HISTORICALLY LESS EXPENSIVE THAN MID-CAP GROWTH STOCKS

Forward price-to-earnings ratio of mid-cap growth stocks over mid-cap value stocks



Source: FactSet, 03/31/93–03/31/22. Mid-cap value is represented by the Russell Midcap Value Index, an unmanaged index that measures the performance of those Russell Midcap Index companies with lower price-to-book ratios and lower forecasted growth value. Mid-cap growth is represented by the Russell Midcap Growth Index, an unmanaged index that measures the performance of those Russell Midcap Index companies with lower price-to-book ratios and lower forecasted growth values. It is not possible to invest directly in an index.

Why mid-cap value in the current environment

While past performance is no guarantee of future results, persistently high inflation and rising interest rates historically have tended to benefit mid-cap value companies. Sectors typically associated with value stocks, such as financials, materials and energy, generally have outperformed relative to growth in rising-rate environments — and particularly so in the current environment since mid-2020. Mid-cap value also remains cheap relative to growth stocks and compared to history.

Bottom line

Mid-cap stocks may present a compelling opportunity for value investors, based on historically higher risk-adjusted returns relative to small- and large-cap value. We believe mid-cap value remains reasonably valued on a relative basis and is well-positioned for the challenges and opportunities of the current market environment.

To learn more about mid-cap offerings at Columbia Threadneedle Investments, visit the links below:

- Columbia Mid Cap Index Fund
- Columbia Select Mid Cap Growth Fund
- Columbia Select Mid Cap Value Fund

Read the recent Barron's article featuring Columbia Select Mid Cap Value Fund and portfolio manager Kari Montanus for further insight on how this fund has outshone its peers.

AS INTEREST RATES RISE, INVESTORS MAY LOOK TO FLOATING-RATE FUNDS

The appeal of floating-rate loans usually peaks when interest rates are rising. But they may help diversify portfolios in any environment.

Floating-rate loans are known by many names, including bank loans, senior loans and leveraged loans. They're typically extended to companies with higher levels of debt relative to cash flow, and because of this, they carry greater credit risk than investment-grade bonds. But unlike traditional bonds, floating-rate loans don't make a fixed-interest payment, or coupon, each period. Instead, their coupons reset every 30 or 90 days, floating up or down with the changes in prevailing interest rates.

This floating feature makes loan prices less sensitive to shifts in interest rates, so flows into floating-rate loan funds tend to increase when the Federal Reserve is actively raising rates in response to a growing economy and improved labor market. And, as you can guess, this trend tends to reverse when rates are falling.

Historically, floating-rate loans have outperformed in rising and flat interest-rate environments. When rates are rising, the median annual return for floating-rate loans, as gauged by the Credit Suisse Leveraged Loan Index, has exceeded the return on U.S. Treasuries and the Bloomberg U.S. Aggregate Bond Index by more than 6 percentage points.

But what's possibly overlooked is that floating-rate loans have also delivered attractive absolute and relative performance regardless of the broader interest-rate environment. Because yield is such a significant component of total return, floating-rate loans also have outperformed U.S. Treasuries and the Bloomberg Aggregate Bond Index when rates are flat. It's only when rates fall that we have seen floating-rate loans underperform.

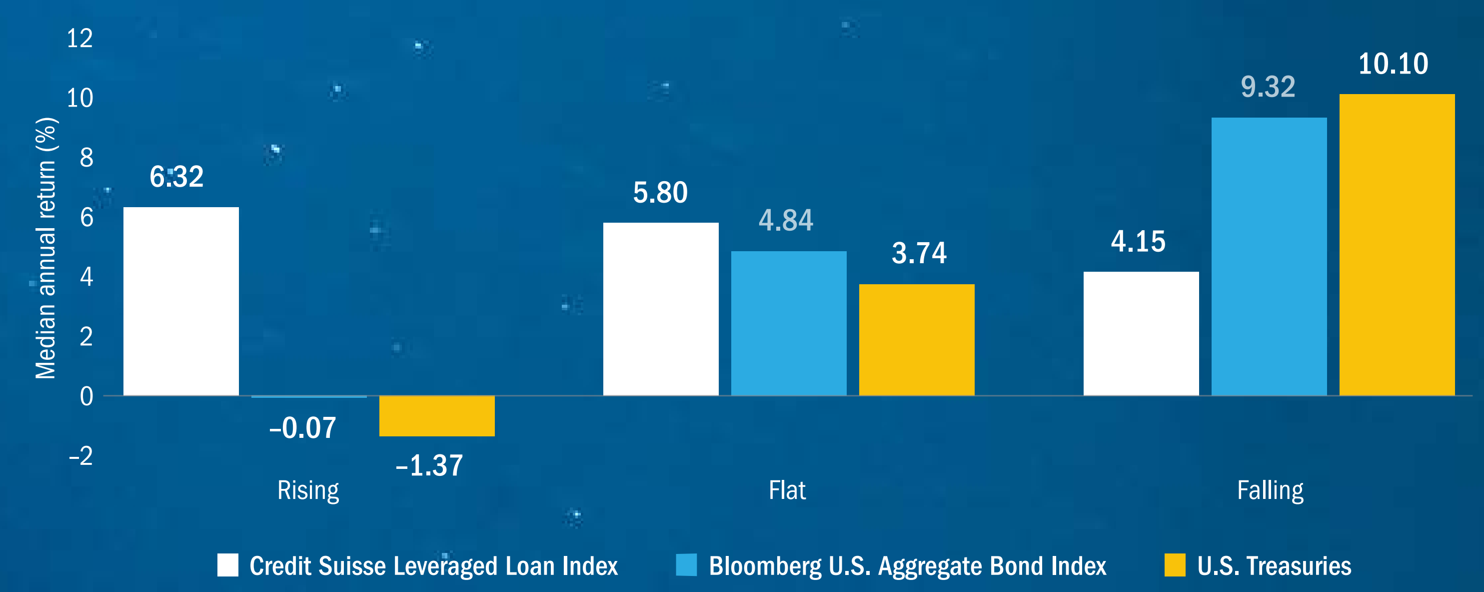
Floating-rate loans may add diversification in any interest-rate environment.

Although their interest-rate-related benefits are what drive investors' flows into and out of the asset class, floating-rate loans can help diversify a portfolio at any time — and this benefit can be overlooked. Most of the return in floating-rate loans comes from their exposure to credit risk (exposure to corporations), while the Bloomberg U.S. Aggregate Bond Index gets most of its return from duration risk (interest-rate sensitivity). So, historically they've had low correlation to each other and behave differently in different market environments.

Bottom line

Floating-rate loans are popular when interest-rates are rising, but they may have diversification benefits in any interest rate environment. Diversification does not assure a profit or protect against loss. To learn more, download our investor-friendly primer on floating rate loans.

FLOATING-RATE LOANS IN RISING, FLAT AND FALLING RATE ENVIRONMENTS



Source: Credit Suisse and Bloomberg Indices. "Rising" indicated by an increase of more than 50 bps. "Falling" indicated by a decrease of more than 50 bps. Data reflects rolling 12-month periods from 01/31/93 through 12/31/21. **Past performance is not a guarantee of future results.**

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The Bloomberg U.S. Aggregate Bond Index is a market-value-weighted index that tracks the daily price, coupon, pay-downs and total return performance of fixed-rate, publicly placed, dollar-denominated and non-convertible investment-grade debt issues with at least $250 million par amount outstanding and with at least one year to final maturity.

The Credit Suisse Leveraged Loan Index tracks the investable market of the U.S.-dollar-denominated leveraged loan market. It consists of issues rated "5B" or lower, meaning that the highest rated issues included in this index are Moody's/S&P ratings of Baa1/ BB+ or a1/BBB+. All loans are funded term loans with a tenor of at least one year and are made by issuers domiciled in developed countries.

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

AFTER A FED FUNDS RATE HIKE, WHAT COULD HAPPEN TO OTHER INTEREST RATES IN THE ECONOMY?

MORTGAGES/ HOME LOANS

Adjustable-rate mortgage/home equity loans are linked to the prime rate. So, homeowners are likely to experience higher rates.

CREDIT CARDS

Interest rates on credit card balances are likely to increase.

STUDENT LOANS

If the Fed Funds Rate goes up, so will interest rates on private student loans. Variable loans will increase first. Federal student loans are fixed and will not be affected.

CAR LOANS

A borrower's credit history has more of an impact on car loans than the Fed Funds Rates, although car loans could be affected by higher Treasury yields.

CDs/SAVINGS RATE

Interest rates on bank savings and CDs could rise. But banks, which are flush with deposits, may not be quick to pass along the prime rate increase to savers.

Online banks, which are competing more aggressively for deposits, may increase those rates sooner.

Get more of our Latest Insights on our Columbia Threadneedle blog.

Source: Columbia Management Investment Advisers, LLC.

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COLUMBIA THREADNEEDLE INVESTMENTS

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* Source: Columbia Threadneedle and BMO GAM (EMEA) as of March 31, 2022.

Source of all data unless specified otherwise: Columbia Threadneedle and BMO GAM (EMEA) as of March 31, 2022.

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