Principal Asset Management℠

EDGE SMA EQUITY INCOME

Quarterly commentary

FOURTH QUARTER 2023

Market review

U.S. equities finished on a high note as stocks rallied into year-end as investors embraced the narrative of easing financial conditions. The Russell 1000 Value Index returned +9.5% on the quarter and finished the year up +11.4%. The Federal Reserve (Fed) maintained the benchmark rate of 5.25%-5.5%, the highest level since 2001. Meaningful progress against inflation was made during the year with November headline CPI settling at 3.1%; and with inflation cooling, the Fed tweaked their December statements that indicated a dovish pivot. U.S. Treasury 10-year yields briefly hit 5% during the period, but following the Fed's updated statements, 10-year yields fell and finished the year at 3.9%. Against this backdrop, volatility (as measured by the CBOE VIX) fell to the lowest level since before the pandemic.

Performance was positive across U.S. large cap equities during the quarter with the Russell 1000 Value Index up +9.5% and the Russell 1000 Growth Index +14.1%. From a style perspective on the year, growth flipped the script after value dominated 2022, but despite the dramatic return differences over the past two calendar years, the Russell 1000 Value Index holds a slight edge up +1.5% versus the Russell 1000 Growth Index at +0.5%. From a sector standpoint, 10 out of 11 sectors in the Russell 1000 Value Index posted a positive return, with the real estate sector leading the way with a return of +17.1%. Financials (+15.6%) and information technology (+14.1%) rounded out the top 3 sectors, while the energy sector (-6.9%) fell in the red for the quarter.

As markets now move past peak earnings growth and headwinds remain, investors find themselves weighing the tension between growth and interest rates. While 2023 brought double digit returns across U.S. equities, we believe that investors will become more discerning by refocusing on fundamentals and higher-quality, dividend-paying companies.

Performance as of 12/31/2023

Annualized performance (%)	3-month	YTD	1-year	3-year	5-year	10-year	Since inception (1/1/1997)
Edge SMA Equity Income (gross)	10.88	12.08	12.08	8.32	12.13	10.09	9.82
Russell 1000® Value Index	9.50	11.46	11.46	8.86	10.90	8.39	8.32
Gross excess return	1.38	0.62	0.62	-0.54	1.23	1.70	1.50
Edge SMA Equity Income (net)	10.07	8.79	8.79	5.13	8.84	6.86	6.60
Net excess return	0.58	-2.67	-2.67	-3.72	-2.06	-1.54	-1.72

Past performance does not guarantee future results. Periods over one year are annualized. Net of fees reflects the gross returns reduced by an assumed maximum bundled fee of 3%. Indices are unmanaged and do not take into account fees, expenses, and transaction costs and it is not possible to invest in an index.

Top five contributors

KKR & Co Inc (KKR) is an alternative asset manager specializing in private equity, credit, and real estate. KKR's capital markets business and the use of their balance sheet to invest into their funds separates them from other managers in the industry. KKR purchased the remaining 37% of Global Atlantic in the quarter which provides the company greater access to more permanent capital. In Q3 KKR raised $14 billion bringing their trailing year capital raise to $54 billion, none of which has come from their flagship strategies.

Not owning **Exxon Mobil Corporation (XOM)**, the third largest weight within the Russell 1000 Value Index, contributed to performance as shares moved lower with the energy sector.

D.R. Horton, Inc. (DHI) is the largest home builder by volume in the U.S. with an extensive geographic footprint and leading market share in 4 of its top 5 markets. DHI provides homebuyers with a wide product breadth and an affordable price point. The company topped EPS expectations aided by homebuilding gross margins and announced a 20% dividend increase in the quarter. Shares contributed to relative performance as the stock hit new all-time highs as mortgage rates fell in December.

PNC Financial Services Group (PNC) has grown to be a top 10 bank in the U.S. based on assets as the company has spent much of the past decade investing in and modernizing their technology backbone. The company has expanded its geographic footprint as well with the acquisition of BBVA's U.S. operations which had more than 600 branches, many of which were in Texas, California, and Florida. PNC reported earnings above expectations as net interest income and expenses came in better than expected.

Alexandria Real Estate Equities (ARE) has carved out a niche within the office sector as the leading life science REIT specifically focused on lab office space. ARE leases primarily to pharma, life science and not-for-profit research institutions in key research clusters of San Francisco, Boston, New York City, Seattle, San Diego, and the Research Triangle. ARE contributed to relative performance as investors reacted positively to falling interest rates, as the real estate sector was the best performing sector within the Russell 1000 Value Index in the quarter.

As of 12/31/2023.

Source: FactSet. Information is based upon a Model (hypothetical) portfolio of the Edge SMA Equity Income strategy. Contributors and detractors do not represent all of the securities purchased, sold or recommended for the model portfolio during the quarter. It should not be assumed that recommendations made in the future will be profitable or equal the performance of the securities listed. Past performance is no guarantee of future results. Securities identified as contributors that were not held during the period represented acted as contributors to the active return due to the firm's decision to not invest.

Top five detractors

Marathon Petroleum Corporation (MPC) is the largest U.S. refiner with 16 refineries in the Midcontinent, West Coast, and Gulf Coast. The company's complex refining facilities located in key regions create high barriers to entry and gives them a cost advantage. MPC continues to invest in future growth with their Martinez Renewable Fuels facility, reaching Phase I production capacity of 260 million gallons per year of renewable fuels and Phase II construction progressing. MPC continued their impressive shareholder return story in the quarter as the company announced a 10% dividend increase and bought back stock equating to an annualized rate of 19% of share count.

Hormel Foods Corporation (HRL) is a protein focused branded food company with brands including Hormel, Spam, Jennie-O, Dinty Moore, Applegate, and Skippy with the number one market position in turkey, shelf stable meat, pepperoni, natural/organic deli meat, guacamole, and canned stew. HRL detracted from relative performance as investors reacted negatively to the company's investor day announcement that 2024 guidance included increased investments that could weigh on near-term growth.

Becton, Dickinson and Company (BDX) is the world's largest manufacturer of medical surgical products like needles and syringes and is focused on improving medical discovery, diagnostics, and the delivery of care. BDX benefits from its scale in manufacturing basic surgical products and also has a nice recurring revenue diagnostics business. Shares detracted from relative performance on the quarter as investors focused on short-term guidance which is below current estimates, however the company remains on track to exceed 2025 operating margin targets.

EOG Resources (EOG) explores for, develops, produces, and markets crude oil, natural gas liquids (NGLs), and natural gas primarily in major producing basins including the Permian, Eagle Ford, and Bakken. Technology is a core competency for EOG that gives the company a cost advantage resulting in initial production rates exceeding industry averages. EOG has committed to return 60% of its annual free cash flow to shareholders, including a significant portion of that return coming in the form of regular and special cash dividends. The company detracted from relative performance as energy prices fell in the quarter.

Not owning **Intel Corporation (INTC)** detracted from performance as shares moved higher in the quarter.

As of 12/31/2023.

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Buys

Reliance Steel & Aluminum Co. (RS) was added to the portfolio. RS is a value-added distributor of steel and aluminum products. They sell their products to over 100,000 customers in smaller contract sizes where service and delivery speeds are a key differentiator for their business. In addition, they are a disciplined buyer of small competitors in adjacent markets that enhances their growth and profit profile.

Sells

There were no sells during the quarter.

Quarterly buys and sells represent all new purchases and full liquidations of securities for the model portfolio for the previous quarter. It should not be assumed that securities identified above will prove to be profitable. Any reference to a specific investment or security does not constitute a recommendation to buy, sell or hold such investment security.

Outlook

2023 proved confounding for many investors as interest rates fluctuated, inflation decelerated, and the highly anticipated recession never materialized. The 10-year Treasury rate traveled round trip from 3.8% to 5% and back to 3.9% while investors grappled with the implications of an intense but relatively short-lived regional banking crisis, a rising U.S. government debt burden, a war in Israel, geopolitical tension with China, a broad-based inventory correction, concerns about the health of the commercial real estate market, and the highest mortgage rates in over 20 years. At the same time, easing supply chain pressures, falling transportation and commodity costs, resilient consumer balance sheets, and a still healthy labor market painted a more favorable picture. With so many forces moving in different directions, there is no playbook to rely on for these unique times and it's no wonder that many forecasts coming into the year missed the mark.

We expect 2024 to be no less confounding. With inflation abating and the broad expectation that the Fed is done raising interest rates, 2023 came to a close with a surge of investor optimism driving the S&P 500 within a hair of its all-time high. But the economic outlook is far from certain. The opposing forces at work on the economy will continue to fuel a tension between growth and interest rates, creating a backdrop that will require fundamental, bottom-up investing to drive outperformance.

At Principal Edge, our focus is on identifying quality businesses across sectors that have advantaged characteristics and are trading at valuations that will allow them to outperform their sector peers over our 5-year investment horizon. As we saw in 2023, fluctuations in macroeconomic data make forecasting sector-level outperformance extremely challenging, but we find that quality businesses tend to endure the test of time. Our focus remains on pre-identifying quality businesses we would like to own and then waiting to buy them when they are off the market's radar. While short-term performance can fluctuate with the vagaries of the market, quality investing at reasonable prices has been a long-term recipe for success.

As we look to 2024, we expect to see a divergence in performance between companies as they contend with the tension between growth and interest rates. This environment has the potential to be good for some and very challenging for others. If there is a resurgence of inflation, pricing power and strong balance sheets will be paramount. If inflation continues to abate, some will retain price while others will be forced to give back the pricing that was hard won in the higher inflation environment and growth concerns could arise. Either path creates both opportunities and pitfalls. With a playbook that is no more certain this year than last, our dominant eye remains on company-level fundamentals and investing in advantaged businesses that can do it all: maintain a strong balance sheet, generate ample free cash flow, outmaneuver the competition, invest in long term growth, and consistently return capital to shareholders along the way.

The financial market outlook is based on current market conditions. There is no assurance that such events or projections will occur and actual conditions may be significantly different than that shown here. The potential for profit is accompanied by the possibility of loss.

Index Descriptions

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The Russell 1000 Value Index measures the performance of those Russell 1000 companies with lower price-to-book ratios and lower forecasted growth values.

Hypothetical/Model Portfolio Objectives The Model Portfolio has been designed to seek a relatively high level of current income and long-term growth of income and capital by investing primarily in mid- and large cap U.S. companies. The portfolio is benchmarked to the Russell 1000 Value Index. The volatility of the index is materially different from that of the model portfolio. Volatility of the model may be subject to loss and investment results portrayed in the model may vary. Individual cannot invest directly in the index.

Hypothetical/Model Portfolio Construction The Model Portfolio has been constructed by selecting companies that have a capacity to pay dividends, consistently grow dividends over time, and/or demonstrate commitment of shareholders.

Disclosures

Past performance is no guarantee of future results. Investing involves risk, including possible loss of principal. Equity markets are subject to many factors, including economic conditions, government regulations, market sentiment, local and international political events, and environmental and technological issues that may impact return and volatility. Dividends are not guaranteed. Small- and mid-cap stocks may have additional risks including greater price volatility.

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Actual client portfolios holdings may differ because of account size, client-imposed investment restrictions, the timing of client investments and market, economic and individual company consideration. Actual holdings will vary for each client and there is no guarantee that a particular client's account will hold any or all the securities presented. The specific securities identified herein do not represent all the securities purchased, sold, or recommended to advisory clients and there is no assurance that investments in the securities identified and discussed will be profitable.

This strategy is only provided through separately managed accounts program sponsors. Clients should consult their financial professional before making any investment decisions. Financial professionals should consider the appropriateness of the manager, strategy and program for its clients on an initial and ongoing basis.

Principal Global Investors ("PGI") acts as a discretionary investment manager or non-discretionary model provider in a variety of separately managed account or wrap fee programs ("SMA Program") sponsored by either broker-dealers or another financial services firms ("Sponsor"). When acting as a discretionary investment manager, PGI is responsible for implementing trades in SMA Program accounts. When acting as a non-discretionary model provider, PGI's responsibility is limited to providing non-discretionary investment recommendations of model portfolios to the SMA Program Sponsor who may utilize such recommendations in connection with its management of SMA Program accounts. In such model SMA Programs ("Model Programs"), it is the Sponsor, and not PGI, which serves as the investment manager to, and has trade implementation responsibility for, the Model Program accounts.

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