Principal Asset Management℠

EDGE SMA EQUITY INCOME

Quarterly commentary

FIRST QUARTER 2024

Market review

U.S. equities started 2024 on a positive high note as stocks rallied into year-end as investors embraced the narrative of easing financial conditions and anticipated that the Federal Reserve (Fed) would begin to cut rates later in the year. The Russell 1000 Value Index returned +8.99% during the first quarter.

Performance was positive across U.S. large cap equities during the quarter with the Russell 1000 Value Index up +8.99% and the Russell 1000 Growth Index +11.41%. From a style perspective, growth continued to outperform again year to date in 2024. And from a sector standpoint 10 out of 11 sectors in the Russell 1000 Value Index posted a positive return with the Energy sector leading the way with a return of +13.81%. Financials (+13.15%) and Industrials (+11.82%) rounded out the top 3 sectors while the Real Estate sector (-0.91%) 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 in 2024.

Performance as of 3/31/2024

Annualized performance (%)	3-month	1-year	3-year	5-year	10-year	Since inception (1/1/1997)
Edge SMA Equity Income (gross)	8.20	20.91	8.32	11.53	10.58	10.05
Russell 1000® Value Index	8.99	20.27	8.10	10.30	9.00	8.58
Gross excess return	-0.78	0.65	0.22	1.23	1.57	1.46
Edge SMA Equity Income (net)	7.41	17.39	5.13	8.26	7.33	6.82
Net excess return	-1.57	-2.88	-2.97	-2.04	-1.67	-1.77

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

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. The company continued to return cash to shareholders in 2023 as MPC repurchased $11.6 billion of shares and raised their dividend 10%. MPC posted strong refining results and shares contributed to relative performance on the quarter.

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 in 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 Q4, KKR raised $31.4 billion, bringing their trailing two-year total to $150 billion, of which a mere $6 billion is associated with flagship strategies.

Taiwan Semiconductor Manufacturing Co (TSM) is the leading manufacturer of semiconductor chips. TSM is the dominant foundry worldwide with close to 55% market share and even stronger in leading edge technology. The company manufactures the chips for Apple, Broadcom, NVIDIA, and AMD. Shares contributed to relative performance as the company issued a strong second half guide driven by robust 3 and 5 nm demand, especially from home personal computers (HPC).

PACCAR Inc (PCAR) is a manufacturer of trucks under the Peterbilt, Kenworth, and DAF brands, and has a highly profitable parts segment. PCAR benefits from a strong dealership network and has paid shareholders a dividend every year since 1941. In 2023, PCAR recorded record revenues of $35 billion and rewarded shareholders with a special dividend of $3.20 in December along with a 50% stock dividend.

Trane Technologies (TT) is a global pure play on climate systems (Thermo King and Trane) and continues to see strong demand for their HVAC solutions in key verticals such as data centers, healthcare, education, and electronics. Management has stated they believe they are taking market share as their Q4 backlog hit $6.9 billion, 2.5 times historical levels.

As of 3/31/2024.

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

Apple Inc. (AAPL), manufacturer of Mac computers and iPhones, has done an excellent job expanding their ecosystem. The company's services segment continues to grow their install base which has topped 2 billion devices and represents over $20 billion in revenue. The company detracted from relative performance as investors grew concerned over iPhone demand in China and an antitrust case being brought against the company by the Department of Justice.

Roche Holding (RHHBY) is a leader in the development and commercialization of biopharmaceuticals with a focus on oncology and immunology. The company also operates a high-quality diagnostics business that we expect to pick up share from smaller peers. RHHBY detracted from relative performance as EPS came largely in line with estimates even though key products, like Actemra, Kadcyla and Vabysm, beat their sales estimates.

Magna International Inc. (MGA) is a diversified auto supplier with product across four main segments: body exteriors and structures, power and vision, seating, and complete vehicle assembly. MGA reported EBIT below consensus with their power and vision and seating segments, weighing on results.

Not owning **Berkshire Hathaway Inc. (BRK-B),** a non-dividend paying company, detracted from relative performance.

Novartis AG (NVS), a large Swiss pharma company, has a strong portfolio of blockbuster drugs including Kisqali, Cosentyx, and Tasigna, and an encouraging late-stage pipeline with a focus on oncology and immunology therapies. Novartis detracted from performance as Q4 EPS results were in line with expectations, and sales for Gilyena were lighter than expected.

As of 3/31/2024.

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Buys

Citigroup (C) is a global financial services company that serves over 100 million consumers and 90% of global Fortune 500 companies across more than 160 countries and jurisdictions. Under new CEO, Jane Fraser, the organization has become simpler and is focusing on five lines of business. The company has a market leading position in Treasury and Trade Services and top five positions in Markets and Banking. The other two primary business lines, U.S. Personal Banking and Wealth Management, have strengths, but the company is focused on correcting their deficiencies. Citigroup was added to the portfolio because we believe in the new vision of the CEO and believe that the changes she is making to the organization will unlock the power of the franchise and drive meaningful growth in profitability over our investment horizon.

Equity LifeStyle Properties (ELS) is an owner/operator of lifestyle-oriented properties consisting of manufactured home and recreational vehicle communities. ELS has a unique business model where they own the land upon which it provides the opportunity for customers to place factory-built homes including manufactured homes, cottages, or RVs, either on a long-term or short-term basis. Additionally, ELS owns marinas that provide boat slip and dry storage rentals. ELS was added to the portfolio as we like the company's dominant position and significant opportunities to consolidate the industry.

Halliburton Company (HAL) was purchased in the quarter. HAL is one of the world's largest providers of products and oil services provider in the U.S. and is taking share in the international markets. We believe HAL's expansion into solutions that are more technology-intensive should lead to improvement in operating margin and returns on capital over our horizon.

Hershey Company (HSY) is a leading confectionery manufacturer with candy brands, including Reese's, Kit Kat, and Jolly Rancher, in addition to HSYs snack brands of Skinny Pop, Pirate's Booty, and Dot's Pretzels. The stock has been hit hard recently over GLP-1 fears and soaring cocoa prices. The pullback in the stock gave us the opportunity to add this quality, top-line, and dividend grower.

Salesforce, Inc. (CRM) was added to the portfolio following the announcement the company would begin paying a dividend. Salesforce.com is the leading provider of customer relationship management (CRM) tools and invented the software as a service (SAAS) delivery model. CRM believes that the customer is in the center, and they want to provide tools for companies to have a 360-degree view of their customer, effectively closing the loop between sales, marketing and customer service.

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

The last year has been confounding for many investors as interest rates fluctuated, inflation decelerated, and the highly anticipated recession never materialized. Investors grappled with the implications of regional banking troubles, 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.

The start to 2024 has been no less confounding. Although it appeared inflation was abating and there were broad expectations among investors that the Fed was finished raising interest rates, we remain skeptical and believe that inflation could remain stickier than investors expect, and rates will probably remain higher throughout 2024 than investors are factoring into their current economic scenarios. If we are correct, investors will continue to contend with an economic outlook that remains far from predictable, and the debate by investors will center on the strength of the economy and the Fed's reaction to it. That could make the stock market more choppy than last year, although we are optimistic it will grind higher in 2024.

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, and expect it to continue in 2024, 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 move through 2024, we expect to see a divergence in performance between companies as they contend with the tension between growth and interest rates. This environment will 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.

Index Descriptions

Russell Investment Group is the source and owner of the trademarks, service marks & copyrights related to the Russell Indexes. Russell® is a trademark of Russell Investment Group.

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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