Principal Asset Management℠

EDGE SMA CONCENTRATED MID CAP

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 Mid Cap index returned +12.8% on the quarter and finished the year up +17.2%. 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. equities during the quarter as the market breadth broadened out. Small and mid-cap companies finished especially strong in the final two months with the Russell 2500 Index up +20.6% versus the Russell 1000 Index, which returned +14.7%. From a sector standpoint 10 out of 11 sectors in the Russell Mid Cap Index posted a positive return with the real estate sector leading the way with a return of +16.8%. Financials (+16.0%) and information technology (+15.2%) rounded out the top 3 sectors, while the energy sector (-0.4%) fell into 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 companies.

Performance as of 12/31/2023

Annualized performance (%)	3-month	YTD	1-year	3-year	5-year	10-year	Since inception (8/1/2007)
Edge SMA Concentrated Mid Cap (gross)	13.13	19.03	19.03	7.29	13.18	11.68	10.62
Russell Midcap® Index	12.82	17.23	17.23	5.92	12.67	9.42	8.71
Gross excess return	0.31	1.80	1.80	1.37	0.51	2.26	1.91
Edge SMA Concentrated Mid Cap (net)	12.31	15.55	15.55	4.13	9.86	8.40	7.37
Net excess return	-0.51	-1.67	-1.67	-1.79	-2.81	-1.02	-1.34

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

Fair Isaac Corp. (FICO) is the owner of the FICO credit score and provider of decision management solutions. The company executed well during the quarter and continues to raise pricing. In addition, the company benefited from a decline in interest rates which investors expected would lead to higher activity in its scores business due to increased transactions and higher refinancing activity.

Bank OZK (OZK) is a full-service bank focused on short-term construction loans. We like the company's niche focus, strong credit quality, and stringent underwriting standards. Despite concerns about the commercial real estate market and increased funding costs, OZK beat expectations with strong revenue growth while payoffs slowed. OZK also hiked its dividend during the quarter.

Brunswick Corp (BC) is a consumer discretionary company that is focused on the boating industry. It manufactures boats under the Bayliner, Sea Ray, Meridian, Boston Whaler, and other brands. The company also makes Mercury engines and has a parts and services business. While the company missed its revenue expectations, it grew net income. Management's enthusiasm about its normalizing U.S. pipeline, strong free cash flow generation, and a stronger than expected consumer all helped investor sentiment during the period.

Fidelity National Financial (FNF) is the largest U.S. title insurance and transaction service provider to the real estate and mortgage industries, with subsidiaries such as Fidelity National Title, Chicago Title, and Alamo Title. It also provides annuities and life insurance products through its F&G subsidiary. Despite the headwinds to title volumes from higher rates, the company has been quick to adjust its cost structure which led to margins coming in above street estimates and shares contributing to relative performance. The company beat expectations with higher-than-expected margins in an environment where residential home purchase applications hit their lowest level since 1995. In addition, the F&G business has acted as a hedge against higher rates and continued to show impressive growth.

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 Franisco, 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 Mid Cap Index in the quarter.

As of 12/31/2023.

Source: FactSet. Information is based upon a Model (hypothetical) portfolio of the Edge SMA Concentrated Mid Cap 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.

Top five detractors

Helmerich & Payne (HP) provides drilling solutions and technology to onshore and offshore wells. HP detracted during the quarter as rig counts remained low. The company also decreased its earnings estimates due to elevated operating costs and lower than expected profitability in its international markets.

Kinsale Capital Group, Inc. (KNSL) is a property and casualty insurance company that operates in the excess and surplus lines segment. We believe that the company had an advantaged business model including core competencies in underwriting and claim handling. During the quarter, the company's top line growth slowed from 40% to 33%. Given the higher historical growth, the company had a higher multiple which was impacted by the slowdown in growth as well as higher interest rates.

STERIS plc (STE) is a provider of infection prevention products and services. The company provides healthcare, life science, and service solutions such as sterilizers and washers, surgical tables, gastrointestinal endoscopy accessories, and services including equipment installation, maintenance, and repair solutions. We like the company's exposure to the secularly expanding infection protection area as well as the shift towards recurring revenue. Despite beating expectations and reiterating guidance, its contract sterilization business was weaker than expected which weighed on profitability. Additionally, destocking in the dental area led to falling revenues in the segment.

FMC Corp. (FMC) provides agricultural solutions including herbicides, insecticides and miticides, fungicides, harvest aids, and other crop chemicals used for seed corn, potatoes, sorghum, sweet corn, cotton, tobacco, sunflowers, grapes, and other related products. FMC detracted from performance as sales and profits came in lower than forecasted, as customers rapidly destocked as the cost of carrying inventory rose dramatically due to higher interest rates.

Cable One, Inc. (CABO) provides rural customers access to cable video and voice services for both residential households and businesses. During the quarter, the company missed expectations as it navigates the final stages of the decline in video subscriptions.

As of 12/31/2023.

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Buys

There were no buys during the quarter.

Sells

Peloton Interactive, Inc. (PTON) was eliminated during the quarter. We believe the turnaround to re-focus the business on subscriptions, partnerships, and new commercial business by new management is going to take longer than expected. We made the decision to exit the small position.

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 MidCap Index measures the performance of the 800 smallest companies in the Russell 1000 Index.

Hypothetical/Model Portfolio Objectives The Model Portfolio has been designed to seek long-term growth of capital by investing primarily in U.S. companies in the mid-capitalization range. The portfolio is benchmarked to the Russell Midcap 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. Individuals cannot invest directly in an index.

Hypothetical/Model Portfolio Construction The Model Portfolio has been constructed by selecting companies that have positive fundamental characteristics and possess the ability to grow from mid to large capitalization companies.

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. Mid-cap stocks may have additional risks including greater price volatility. The strategy may have an increased potential for loss because its portfolio includes a relatively small number of holdings. Movements in the prices of the individual assets may have a magnified effect on the portfolio.

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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.

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