Stocks fell sharply. Equities declined during the quarter as a resilient U.S. economy fueled expectations that interest rates would remain higher for longer than previously expected. In addition, rising interest rates made bonds an attractive alternative to stocks, especially for investors seeking income.

Stocks declined across the board. Growth stocks fared slightly better than value stocks among large-cap stocks but sharply underperformed in the small-cap universe. Large-cap stocks outperformed small- and mid-cap stocks for the second-consecutive quarter.

Computers and peripherals benefited performance. Positioning in the industry helped drive information technology sector performance. An underweight allocation to Apple relative to the benchmark was helpful as the consumer electronics company lagged on weaker iPhone demand.

Health care was a top contributor. Sector performance was helped by lack of exposure to a health care equipment and supplies stock, which lagged on concerns that the new weight-loss drugs would limit procedures. Stock selection and an overweight allocation among providers and services relative to the benchmark also aided performance, led by UnitedHealth Group.

Building products detracted from relative performance. Stock selection in the industry hampered performance in the industrials sector. Johnson Controls International was a key industry detractor. Stock choices among electrical companies also weighed on performance.

Key Contributors

ConocoPhillips. Energy stocks were strong, supported by higher oil prices, as a result of stronger economic growth and larger supply cuts from both Saudi Arabia and Russia. Although this oil company reported a softer quarter than expected, we believe the disappointing results were more than offset by optimism for its capital return program and future project growth cadence.

Schlumberger. We believe this oil field services company is well positioned with a significant portion of its revenues derived from international sources, where growth has been stronger relative to North America. Schlumberger, which has benefited from rising oil prices, demonstrated strong margins and cash flow above market expectations.

Prudential Financial. Life insurers such as Prudential outperformed relative to the benchmark. We think rising interest rates should drive income going forward and that concerns about commercial real estate exposures have so far proven to be manageable.

Key Detractors

Johnson Controls International. This maker of fire, security and other products lowered revenue growth and free cash flow guidance, which we believe sparked significant stock underperformance compared to the benchmark.

NextEra Energy. This utility lagged relative to the benchmark throughout the quarter. The stock sold off after its affiliate cut its dividend growth expectations due to pressure from higher interest rates. This news sparked fears among investors that a higher cost of capital could hinder returns and slow its progress in renewable projects.
Generac Holdings. The stock of this maker of at-home standby generators declined. Generac reported results that were below analyst expectations and lowered its guidance for the year as consumers have been cautious about purchasing large-ticket items.

Notable Trades

Electronic Arts. We expect to see strong traction in the recently rebranded EA Sports FC (formerly FIFA) title that we think will allow EA to capture more of the economics of the game. We initiated a position in the electronic game provider.

Morgan Stanley. We established a position in Morgan Stanley as our research indicated it has continued to grow and scale its wealth management business, which we think should boost organic growth, increase returns and lead to higher valuation. Relative to peers, we also view Morgan Stanley as a leader in managing environmental, social and governance (ESG) risks in its lending, financing and investing divisions.

Ball. We eliminated our position in this aluminum can manufacturer as our research indicated overall volumes declined due to changing consumer preferences.

NIKE. We exited our position in this athletic apparel maker as we believed its sustainability scores weakened and financials deteriorated.

Portfolio Positioning

Our process uses analysis aimed at identifying growing large-cap companies that we believe have demonstrated sustainable corporate policies. Rather than screen out certain industries or sectors, we seek to identify companies with the strongest growth and ESG characteristics in each sector. As a result of this approach, our sector and industry allocations reflect those areas of the market where we believe we are finding opportunities at a given time.

Inflation and recession risk suggest difficult, volatile conditions ahead. We think markets will continue to deal with the contrasting risks of higher inflation and interest rates, even as the global economy teeters on the verge of recession. Nevertheless, we continue to believe that well-run businesses in strong positions with respect to their competition and sustainability practices are best able to navigate current conditions.

Few positioning changes. We maintained what we believe is a relatively balanced approach to sector exposures with only modest overweights and underweights relative to the benchmark.

We have identified certain industries in information technology that we think are attractive. Our process is focused on identifying companies that we characterize as ESG leaders with improving financial strength. Accordingly, our research has led us to discover opportunities in the IT services, semiconductors and semiconductor equipment, software, and electronic equipment, instruments and components industries.

We continue to favor health care. We have found attractive holdings in managed health care, biotechnology and life sciences tools and services holdings, as we believe these areas will likely be more insulated from the current inflationary environment. In addition, these businesses have historically held up better in recessionary environments.
Many of American Century’s investment strategies incorporate the consideration of environmental, social, and/or governance (ESG) factors into their investment processes in addition to traditional financial analysis. However, when doing so, the portfolio managers may not consider ESG factors with respect to every investment decision and, even when such factors are considered, they may conclude that other attributes of an investment outweigh ESG considerations when making decisions for the portfolio. The consideration of ESG factors may limit the investment opportunities available to a portfolio, and the portfolio may perform differently than those that do not incorporate ESG considerations. ESG data used by the portfolio managers often lacks standardization, consistency, and transparency, and for certain companies such data may not be available, complete, or accurate.

**ESG Definitions**

- **ESG Integrated:** An investment strategy that integrates ESG factors aims to make investment decisions through the analysis of ESG factors alongside other financial variables in an effort to deliver superior, long-term, risk-adjusted returns. Therefore, ESG factors may limit the investment opportunities available, and the portfolio may perform differently than those that do not incorporate ESG factors. Portfolio managers have ultimate discretion in how ESG issues may impact a portfolio’s holdings, and depending on their analysis, investment decisions may not be affected by ESG factors.

- **ESG Focused:** An investment strategy that focuses on ESG factors seeks to invest, under normal market conditions, in securities that meet certain ESG criteria or standards in an effort to promote sustainable characteristics, in addition to seeking superior, long-term, risk-adjusted returns. This investment focus may limit the investment opportunities available to a portfolio. Therefore, the portfolio may underperform or perform differently than other portfolios that do not have an ESG investment focus. ESG-focused investment strategies include but are not limited to impact, best-in-class, positive screening, exclusionary, and thematic approaches.

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