American Century Investments®

U.S. Small Cap Dividend SMA

Quarterly Commentary

Portfolio Review

Stocks rallied. During the quarter, investors weighed hopes for a Federal Reserve (Fed) pivot against fears of continued Fed tightening and its impact on the economy and corporate earnings. Large-cap stocks outperformed small-cap stocks for the quarter, and value stocks outperformed growth stocks across capitalizations.

Economic data were mixed. Inflation moderated, but core inflation remained well above the Fed's 2% target. The Fed continued to raise rates, but hopes of a near-term end to Fed tightening faded in light of the possible risk of wage inflation. The U.S. economy grew at a revised 3.2% annual rate in the third quarter, but data released in December showed signs of softening, and earnings outlooks became more pessimistic.

Health care outperformed. Allocation decisions and stock choices added to performance compared with the benchmark. Patterson Cos., a distributor of dental and animal health solutions, posted solid results, spurring its shares to outperform the market. The portfolio also benefited from a lack of exposure to biotechnology stocks.

Industrials contributed. Security selection was key to the portfolio's strong results across the sector compared with the benchmark. Notable individual contributors included architectural glassmaker Tecnoglass and high-tech defense contractor Leonardo DRS.

Recession worries weighed on banks. Concerns about peaking earnings and a potential recession led investors to take profits on their bank holdings after a stretch of strong performance. Certain stock choices and our overweight in the banking industry relative to the benchmark led to broader underperformance in financials compared with the benchmark. Preferred shares of Compass Diversified Holdings also hurt results.

We're finding what we believe are attractive businesses at compelling valuations. Our search for opportunities has led us to overweights in the financials, information technology and materials sectors relative to the benchmark. Meanwhile, we are underweight in health care and real estate.

Key Contributors

Spectrum Brands Holdings. The household goods company rallied as worries the government would block the planned sale of its hardware and home improvement business began to abate. We remain confident in Spectrum's plans to transform and strengthen its business with this transaction.

ChampionX. The provider of equipment and chemicals for energy production rallied on stronger-than-expected results. We believe the results demonstrate the company's quality and stability.

Tecnoglass. This manufacturer of architectural glass for the commercial and residential markets continues to post strong results as it gains market share. The company's competitive advantage of manufacturing in Colombia has allowed it to maintain better product availability than its peers.

Goal and Strategy

Seeks to invest in small-cap, income-producing companies temporarily selling at a discount.

Portfolio Management Team

	Start Date	
Name	Industry	Company
Jeff John, CFA	1991	2008
Ryan Cope, CFA	2009	2009

Top 10 Holdings (%)

Hess Midstream LP	2.44
Spectrum Brands Holdings Inc	2.34
Umpqua Holdings Corp	2.29
EVERTEC Inc	2.29
Home BancShares Inc/AR	2.24
Pacific Premier Bancorp Inc	2.20
Graphic Packaging Holding Co	2.14
Avnet Inc	2.12
FNB Corp/PA	2.08
Tapestry Inc	2.06

As of 12/31/2022

The holdings listed should not be considered recommendations to purchase or sell a particular security. Equity holdings are grouped to include common shares, depository receipts, rights and warrants issued by the same company. Fund holdings subject to change.

Key Detractors

Popular. Shares of Puerto Rico's largest bank underperformed compared with the benchmark as its tangible book value declined due to rising interest rates. This led the bank to postpone its normal capital return action plan by six months. We continue to believe the bank's stock is attractively priced.

Enviva. During the quarter, a short report questioned the benefits of Enviva's biomass-based feedstock alternative to fossil fuels. The report weighed on its shares, but Enviva refuted the claims, and our analysis confirms the long-term viability of its operations and its ability to generate strong and growing cash flow.

Compass Diversified Holdings (pfd). The company's preferred shares underperformed compared with the benchmark during the quarter as investors rotated out of cyclical businesses during a period of market weakness. Compass' portfolio of niche consumer discretionary and industrial businesses continued to deliver solid results.

Notable Trades

Cousins Properties. We initiated a position in this office real estate investment trust (REIT), which holds an attractive collection of properties in its primary markets, Atlanta, Austin, Texas, and Nashville, Tennessee, in our view. Despite post-pandemic headwinds for the office sector, Cousins benefits from a portfolio of relatively new buildings with fewer near-term lease expirations than its peers.

Selective Insurance Group. We initiated a position in this property and casualty insurance carrier that focuses on commercial accounts with low to medium hazard risks. With a strong underwriting history and limited exposure to states with high catastrophic losses, we believe the company has room to grow through existing agents and by entering new markets.

Cadre Holdings. A manufacturer of safety products for first responders and the military, Cadre Holdings posted strong quarterly results. However, the company's valuation began to reflect the underlying business quality and strength, so we sold our position in favor of companies with more attractive risk/reward potential.

Highwoods Properties. We rotated from Highwoods to Cousins in this portfolio due to our belief that the potential range of outcomes for Cousins is narrower. Both companies are office REITs with attractive Sun Belt exposure, in our view.

Positioning for the Future

The portfolio seeks to invest in small-cap, higher-quality, dividend-paying companies selling at a discount to fair value. Our process is based on individual security selection, but broad themes have emerged.

Overweight financials. We hold a large overweight in this sector relative to the benchmark, and that overweight is distributed across a number of industries. We maintain overweights in banking (and have been adding to this on recent underperformance) and diversified financial services. In contrast, we are underweight in mortgage finance and have no exposure to mortgage REITs. We continue to hold a large absolute weight in Compass Diversified Holdings, which we view as materially undervalued on a sum-of-the-parts basis. A portion of the sector overweight is driven by a number of noncommon share holdings (straight and convertible preferred shares). These are intended to enhance the rate of return of the portfolio while reducing volatility.

Overweight in industrials. Our overweight relative to the benchmark is driven by attractive stock-specific opportunities. We continue to own a diverse set of higher-quality companies in machinery, distribution, commercial services and aerospace and defense. We believe they should be able to weather market and economic volatility and generate alpha through multiple cycles.

Attractive valuations in information technology. Our overweight position in this sector relative to the benchmark is driven by our conviction in a number of unique and attractively valued opportunities. Our portfolio holds stocks that have been driven down to attractive valuations due to cyclical reasons, trade war fears, operational miscues and most recently by the turmoil in the markets created by the conflict in Ukraine. In addition to their compelling valuations, we believe these are attractive businesses, particularly in the software industry and in the electronic equipment, instruments and components industry.

Underweight health care. We continue to be underweight in this sector relative to the benchmark as valuations are not presenting attractive risk/reward opportunities. A significant portion of our underweight in this sector is also driven by our lack of exposure to biotechnology. We will likely remain materially underweight since biotechnology, which now accounts for 5.61% of the benchmark, does not fit our process regarding quality and strength. In addition, biotechnology companies generally are not dividend payers.

Few opportunities in real estate. We remain underweight relative to the benchmark in this sector because few stocks offer attractive risk/reward opportunities.

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Portfolio holdings are as of the date indicated, and subject to change without notice. Data provided by American Century Investments and FactSet, unless otherwise noted. Material presented has been derived from industry sources considered to be reliable, but their accuracy and completeness cannot be guaranteed.

Historically, small- and/or mid-cap stocks have been more volatile than the stocks of larger, more established companies.

Investment return and principal value of security investments will fluctuate. The value at the time of redemption may be more or less than the original cost. Past performance is no guarantee of future results.

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