Portfolio Strategy

Carillon Clarivest Capital Appreciation Fund Q1 2022 Commentary

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Summary

- The Carillon Family of Funds spans a range of investment objectives and asset classes designed for long-term investors.
- Q1 2022 was marred by tragedy on a global scale and investors encountered three months of volatile trading induced by persistently high inflation, rising rates, and Russia's invasion of Ukraine.
- Over the last 12 months many investors anchored to the long-term growth trends while discounting value's recent strength, and more importantly the reasons behind it.

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Market Overview

The first quarter of 2022 was marred by tragedy on a global scale. Against this backdrop, investors encountered three months of volatile trading induced by persistently high inflation, rising rates, and Russia's invasion of Ukraine.

The U.S. stock and bond markets appear to be conveying different assessments of the outlook, leaving investors to decide which view will prevail. The S&P 500 Index came roaring back from a near-13% decline and finished the quarter off 4.6% after a rebound that defied worries over tighter monetary policy and geopolitical concerns. Many stock investors shrugged off a brief inversion of the U.S. Treasury yield curve: a phenomenon that has predicted past recessions.

The biggest economic development in March came from the U.S. Federal Reserve (FED), which raised interest rates for the first time in almost four years after slashing them to near-zero at the onset of the pandemic. The move was expected as Fed Chairman Jerome Powell had signaled a March rate hike, and investors took it in stride. The Fed envisions hiking rates throughout 2022 and reducing its record $9 trillion balance sheet in an effort to tame inflation. Fixed income markets currently expect the Fed will lift rates another 2.25% in 2022. The concern, though, is that it may go too far and spark a recession.

The Fund does not invest in securities traded in markets outside the United States, but, given the interconnectedness of global markets, we monitor macroeconomic developments abroad for potential impacts to the U.S. large-cap companies that are our focus. Similar to the Fed, in response to rising inflation, the European Central Bank outlined plans to end bond purchases by the end of September. Bank President Christine Lagarde indicated that a first interest rate rise could potentially come this year, saying rates would rise “some time” after asset purchases had concluded. Data showed annual eurozone inflation at 7.5% in March, up from 5.9% in February.[1]

Canada stands to benefit from rising commodity prices, particularly energy prices. The International Monetary Fund’s gross domestic product growth forecast for 2022 is 4.1%, but commodities inflation adds uncertainty to this outlook. The Bank of Canada has begun rate normalization, raising its overnight target rate by 0.25% in March to 0.50%, and has signaled that additional hikes are forthcoming. Markets are pricing a further six to seven hikes in 2022. Household debt, however, has risen since the pandemic and households are now more susceptible to aggressive rate hikes.

Share prices in China were sharply lower in the quarter while shares in Hong Kong, South Korea, and Taiwan also fell. The number of COVID-19 cases spiked despite the Chinese government pursuing one of the world’s strictest virus elimination policies. The city of Shanghai, with a population of 25 million, went into a partial lockdown at the end of the quarter in a bid to curb a surge in cases, prompting fears that other parts of the country also could go into lockdowns.

Despite their geographical proximity, Russia is a relatively small trading partner for Japan, accounting for around 1% of exports and 2% of imports.[2] Imports are primarily energy from Russia, especially natural gas, while exports are predominantly auto-related, and most auto makers are now moving to suspend those trade channels. The yen weakened sharply against all major currencies in March, reaching a six-year low against the U.S. dollar. Although interest rate differentials have widened this year, the scale and timing of the yen's weakness is surprising given the currency's typical historical role as a safe-haven asset at times of uncertainty.

Commodities jumped in the first quarter, driven by sharply higher prices for Brent crude oil and natural gas following Russia's invasion of Ukraine. The energy sector outperformed amid rising global demand and fears of supply curbs. Within agriculture, wheat and corn had sharp price gains on fears that supplies could be hit by the conflict as Russia and Ukraine account for around 30% of global wheat exports.[3] Within industrial metals, the prices of nickel, aluminum and zinc were sharply higher in the quarter. Not surprisingly, in precious metals, gold and silver achieved gains over the quarter.

Portfolio Review

At the start of the quarter, the Carillon ClariVest Capital Appreciation Fund (the "Fund"), as compared to the Russell 1000® Growth Index, was most overweight the information technology and healthcare sectors and most underweight communication services and real estate. At the end of the quarter, the portfolio remained most overweight information technology and healthcare and most underweight communication services and real estate. Within the universe of the Russell 1000 Growth Index, energy performed the best while communication services and materials lagged.

Best Securities	**Average Weight (%)**	**Contribution to Return (%)**
AbbVie	1.80	0.37
Marathon Oil	0.64	0.25
CF Industries	0.55	0.24
McKesson	0.92	0.21
Bristol-Myers Squibb	1.09	0.19
Worst Securities		

Meta Platforms	2.59	-1.15
Microsoft	8.86	-0.63
Home Depot	2.01	-0.62
EPAM Systems	0.40	-0.59
Teradyne	1.15	-0.44

As of March 31, 2022. The information provided above should not be construed as a recommendation to buy, sell, or hold any particular security. The data are shown for informational purposes only and are not indicative of future portfolio characteristics or returns. Portfolio holdings are not stagnant and may change over time without prior notice. Past performance does not guarantee future results. Please note that the holdings identified do not represent all of the securities purchased, sold, or recommended for the fund. They are provided for informational purposes only. Carillon Tower Advisers, ClariVest Asset Management, their affiliates, or their respective employees may have a position in the securities listed. Please contact Carillon at 800.421.4184 to obtain the calculation's methodology and/or a list showing every holding's contribution to the overall fund's performance during the measurement period.

Stock selection contributed the most while sector allocation was also positive. An underweight to communication services and an overweight to energy helped performance, while an underweight to consumer staples and an overweight to materials detracted. Stock selection was strong within healthcare and materials but was weak within information technology and industrials.

AbbVie (ABBV) is a research-based biopharmaceutical company. Shares gained after the company reported earnings that missed revenue but beat earnings-per-share estimates. Discussion around the report was mixed but skewed positive.

Marathon Oil (MRO) increased its quarterly dividend and executed an impressive share buyback that blew by the target it originally announced.

CF Industries (CF) manufactures and distributes nitrogen fertilizer. The stock rose as Russia's invasion of Ukraine accelerated already rising fertilizer prices.

McKesson (MCK) distributes pharmaceuticals, medical- surgical supplies, and health and beauty care products. The company agreed to proceed with a comprehensive agreement to settle the vast majority of the opioid lawsuits filed by state and local governmental entities.

Bristol-Myers Squibb (BMY), the biopharmaceutical company, entered into accelerated share repurchase agreements.

Meta Platforms (FB), the social media company formerly known as Facebook, missed forecasts amid stagnating user growth and increasing competition.

Microsoft (MSFT) reported positive results driven by personal computing strength, but analysts were especially positive on its growth outlook for its Azure cloud-computing services.

Home Depot (HD), the home improvement retailer, reported quarterly results that beat consensus on the top line, but noted uncertainty from ongoing inflation and supply chain constraints, dampening the outlook.

EPAM Systems (EPAM) offers information technology services. The company struggled amid geopolitical instability given its 14,000 employees in Ukraine and associated operational, relocation, and travel costs. The Fund sold the stock.

Teradyne (TER) develops and sells self-automatic test systems. The company gave a weak outlook as a major customer slowed its 3-nanometer technology transition. The Fund sold the stock.

Outlook

The realities in Ukraine are horrific, making investing seem trivial. However, focusing on how it affects markets, the war also is a concern for global growth and a source of volatility as the highly uncertain situation evolves. Russia is a major exporter of oil and natural gas, particularly to Europe, and a removal of that supply from the system (formally through sanctions and/or informally through private curtailment) would put further upward pressure on energy prices and inflation. Perversely, the situation could favor U.S. stocks, as they are more insulated than their European counterparts from energy price spikes and the direct impacts of the war and its economic ramifications.

Growth-oriented stocks were at the epicenter of the pain amid fears of rising rates and a slowing economy. Growth stocks are considered long- duration assets because their cash flows are realized further into the future. Higher rates drag on the present value of these future cash flows. Value stocks, meanwhile, are shorter duration with cash flows that are front-end loaded. The period of extremely low interest rates was very good for growth stocks and very challenging for value investors. From here, the question is how much of this is reflected in stock prices.

One commonly cited benefit of investing across the globe (instead of just in your local market) is the diversification benefit given low correlations across countries and regions. While much of the last decade has seen an increase in the globalization of markets, one potential impact of the pandemic is the reversal of this trend as companies and also countries seek to become less subject to external shocks. Less globalization could translate to less global competition, fewer productivity gains, more inflationary pressure, and lower global growth.

The very rapid run-up in energy and food prices could impact the emerging market countries in Africa and Asia that are highly dependent on energy and food imports. China's economy was already under pressure from the real estate downturn and weak credit growth. Even before Russia's invasion, the World Bank warned that some emerging market economies were at risk of a hard economic landing on the basis of increased indebtedness built up as a result of the COVID pandemic. Over the past decade, emerging markets have proved to be a major engine for world economic growth, and any major setback would constitute a meaningful headwind for the world economic recovery.

ClariVest's investment philosophy is built around the idea that due to behavioral biases, investors tend to anchor to the long-term trend and incorrectly dismiss short-term changes. This is reflected in our signature portfolio characteristics of long-term earnings growth that is typically in line with the benchmark, but recent earnings growth that is higher than the benchmark. That distinct pattern, combined with discounted fundamentals, is what we refer to as "underappreciated growth." Over the last 12 months many investors anchored to the long-term growth trends while discounting value's recent strength, and more importantly the reasons behind it. This gives us considerable confidence in our positioning for the remainder of 2022 and beyond.

FOOTNOTES

[1] *Source: Reuters*

[2] *Source: Reuters*

[3] *Source: Bloomberg*

Original Post

Editor's Note: The summary bullets for this article were chosen by Seeking Alpha editors.

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Additional disclosure: As with all equity investing, there is the risk that an unexpected change in the market or within the company itself may have an adverse effect on its stock. The biggest risk of equity investing is that returns can fluctuate and investors can lose money.

Growth companies are expected to increase their earnings at a certain rate. When these expectations are not met, investors may punish the stocks excessively, even if earnings showed an absolute increase. Growth company stocks also typically lack the dividend yield that can cushion stock prices in market downturns.

Investments in mid-cap and small-cap companies generally involve greater risks than investing in larger capitalization companies. Mid-cap companies often have narrower commercial markets, more limited managerial and financial resources, and more volatile trading than larger, more established companies.

Quantitative risk involves the dependence on proprietary quantitative tools for security selection which may not be predictive of a security's value.

Securities in the Carillon Clarivest Capital Appreciation Fund are typically selected from investment universes consisting of U.S. Large Cap and U.S. Mid Cap companies, but may invest in the stocks of U.S. companies of any size without regard to market capitalization. The fund does not invest in securities traded in markets outside of the U.S.

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A yield curve is a line that plots yields (interest rates) of bonds having equal credit quality but differing maturity dates. The slope of the yield curve gives an idea of future interest rate changes and economic activity. Investors and market analysts watch certain yield curves for signs of inversion, when yields for longer-term debt instruments fall below yields on short- term debt with the same credit quality. Inversions are watched as potential signs of a weakening economy and in certain cases, a harbinger of recessions.

Growth investing is a stock-buying strategy that focuses on companies expected to grow at an above-average rate compared to their industry or the market.

Value investing is an investment strategy that involves picking stocks that appear to be trading for less than their intrinsic or book value.

Equity duration is the cash-flow weighted average time at which investors can expect to receive the cash flows from their investment in a company’s stock. Long-duration stocks include fast-growing technology companies, including those that may not pay any dividends in their early years, while short-duration stocks tend to be more mature companies with higher ratios to dividend to price.

Indices

The Russell 1000® Growth Index, the Fund's benchmark, mea sures a growth-oriented subset of the Russell 1000 Index, which tracks approximately 1,000 of the large-sized capitalization companies in the United States equities market.

The S&P 500 Index measures change in stock market conditions based on the average performance of 500 widely held common stocks. It is a market-weighted index calculated on a total return basis with dividend reinvested. The S&P 500 represents approximately 75% of the investable U.S. equity market. Indices are unmanaged, and one cannot invest directly in an index.

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