American Century Investments®

U.S. Small Cap Income SMA

Quarterly Commentary

Portfolio Review

U.S. equity markets retreated. Broad U.S. equity markets declined during the quarter, pressured by fears that higher interest rates and persistently rising prices could derail economic expansion and weaken corporate profits. Surging prices prompted the Federal Reserve to raise interest rates by 0.5% in May and again by 0.75% in June. This was the fastest pace of interest rate hikes in decades.

Small-cap and growth stocks lagged. Market declines were broad based. Small-cap stocks underperformed large-cap stocks during the quarter, and growth stocks underperformed value stocks across the market-capitalization spectrum. While all sectors declined, what are often considered defensive sectors generally held up better than cyclical sectors.

Consumer discretionary outperformed on a relative basis. Stock selection in the specialty retail, consumer services and household durables industries drove relative results. We believe this outperformance was noteworthy given the relative weakness in the sector overall, which significantly lagged the broader market.

Materials contributed. Strong stock selection was a key driver of performance in this sector. In the containers and packaging industry, the portfolio benefited from holdings that our research indicated had exposure to the consumer staples sector.

Energy detracted from relative results. This sector performed well relative to the benchmark, driven by oil prices, which approached 10-year highs. Although many small-cap exploration and production companies typically perform well when oil prices are high, we tend to avoid them because, based on our research, most do not meet our quality standards. We believe the portfolio may continue to lag in this sector if oil prices remain elevated.

Increased relative exposure to energy. Rising oil prices resulted in a surge in the energy sector, and our relative exposure increased due to the reconstitution of the benchmark.

Key Contributors

Penske Automotive Group. This leading transportation retailer and logistics provider reported what, in our view, were solid financial results driven by continued strength in profit margins and its ownership stake in Penske Truck Leasing. Our research also indicated that the company's retail inventories remained at historical lows, which resulted in what we believed were extraordinary levels of profitability.

H&R Block. This provider of tax preparation services posted another strong tax season, in our view, as the company gained market share and raised prices. Our research indicated that not only did H&R Block maintain its share of the individual market, but it also grew its presence among small- and medium-sized businesses. Higher prices and more complicated tax filings raised the net average charge received by the company for its services.

Avnet. As a global distributor of technology components, this company reported quarterly earnings that, based on our research, were well above expectations. We believe the company saw broad-based strength as it was able to help its customers navigate supply chain difficulties. In addition, the company lowered its debt and announced a large, accelerated buyback of shares.

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 (%)

Spectrum Brands Holdings Inc	2.85
Popular Inc	2.40
United Bankshares Inc/WV	2.35
Brink's Co/The	2.30
II-VI Inc (conv)	2.27
Timken Co/The	2.26
Home BancShares Inc/AR	2.15
Penske Automotive Group Inc	2.05
Avnet Inc	2.04
Tapestry Inc	2.02

As of 6/30/2022

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

PacWest Bancorp. This holding company for Pacific Western Bank, a California-based lender, underperformed in our opinion due to investor concerns about the company's ability to meet its regulatory financial requirements. We hold a position in the company's preferred stock, which we believed had an attractive risk/reward profile as our research indicated that shares were trading at a sizable discount to peers.

Sculptor Capital Management. This global alternative asset manager underperformed, held back by what we believed were fears about the potential impact of higher interest rates on private company valuations and the company's ability to raise capital and collect performance-based fees. In our view, Sculptor's stock price has not reflected what we believe is the company's true value.

The Carlyle Group. This global asset manager, which offers private equity, real estate and other investments, lagged during the quarter. As was the case with Sculptor, we believe investors avoided Carlyle due to concerns about the potential impact of higher interest rates on private company valuations and the company's ability to raise capital and collect performance-based fees.

Notable Trades

Embecta. We initiated a position in this leading maker of pen needles and syringes used for insulin delivery when the company was spun out of Becton Dickinson and Co. We like the company based on what our research has indicated is its large market share and strong returns, as well as what we think of as the consumable and nondiscretionary nature of its products.

PacWest Bancorp. We initiated a position in the preferred equity of this holding company for Pacific Western Bank, a California-based lender. We liked PacWest's preferred stock because we believed its risk/reward profile was attractive as shares were trading at what we believed was a sizable discount to peers.

CVB Financial. We exited our position in this California-based bank holding company because we believe shares outperformed during the quarter and exceeded what our research indicated was its fair value.

People's United Financial. With M&T Bank's acquisition of People's United, our position in the People's United preferred shares was converted to a similar security under M&T Bank. Given what according to our research was the outsized market capitalization of M&T Bank, we exited the position and allocated capital to opportunities that we believed were more attractive.

Portfolio Positioning

The portfolio seeks to invest in small-cap companies that our research has indicated are higher quality, pay a dividend and trade at a discount to what we believe is their fair value. Our process is based on individual security selection, but broad themes have emerged.

Overweight in financials relative to the benchmark. Our sector overweight relative to the benchmark is concentrated in the capital markets and banking industries. A portion of our overweight consists of issues of both convertible and unconvertible preferred shares, which we believe have the potential to enhance the portfolio's income and lower its volatility relative to the benchmark.

We believe there are attractive valuations in information technology. Our overweight in this sector relative to the benchmark is driven by our conviction in a number of what we believe are unique and attractively valued opportunities. We hold stocks that, according to our research, are trading at attractive valuations due to cyclical reasons, trade war fears, operational miscues and the conflict in Ukraine. In addition to what in our view are compelling valuations, we believe we are invested in attractive businesses, particularly in the electronic equipment, instruments and components industry.

Relative overweight in industrials. In this sector, we favor what we believe are attractive stock-specific opportunities. We continue to own what we think of as a diverse set of higher-quality companies in the machinery, distributors, commercial services and aerospace and defense industries that, according to our research, should be well positioned to weather market and economic volatility and generate what we believe will be attractive risk-adjusted returns through various market cycles.

Underweight health care relative to the benchmark. We continue to underweight this sector as we believe valuations remain high. Some of our relative underweight is driven by our lack of exposure to the biotechnology industry, which now makes up a larger share of the benchmark due to the index's rebalancing late in the quarter. We tend not to own many biotechnology stocks because, based on our research, they frequently do not fit our requirements regarding quality and financial strength, and they generally do not pay dividends.

Few opportunities in real estate. We remain underweight the benchmark in this sector because we believe few stocks represent what our research indicates are 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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