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Neuberger Berman Bolton Group All Cap Core Portfolio

PORTFOLIO MANAGERS: Bolton Group

Performance Highlights

The Neuberger Berman Bolton Group All Cap Core Portfolio posted a negative return in the second quarter of 2023, but outperformed its benchmark, the S&P 500 Index.

Market Context

Following a strong first-half rebound, the U.S. stock market experienced its worst quarter in over a year, as rapidly rising long-term interest rates undermined investors' confidence in a soft landing for the U.S. economy. The closely watched 10-year Treasury Bond Yield, which had traded in a narrow range of 3.50% to 4.00% since mid-November 2022, rose relentlessly throughout September, reaching 4.69% by September 28. The causes for this sudden increase in long-term interest rates have been vigorously debated. Economists have cited the persistence of strong demand for labor and the accompanying upward pressure on wages and, more ominously, the huge increase in bond issuance by the U.S. Treasury required to finance the federal budget deficit. The latter explanation is particularly worrisome because it cannot be rectified by the Federal Reserve's ("the Fed") monetary policy. Only reduced federal spending and/or higher taxes can address it. The higher long-term interest rates adversely affect the stock market both by reducing the present value of future corporate earnings and by increasing the risk of a recession. By the end of the third quarter, the S&P 500 Index ("S&P 500") had lost 3.3% despite being propped up by a handful of giant technology stocks (e.g., Apple, Google, Meta, Microsoft, Amazon, and Nvidia) seen as benefiting from advances in artificial intelligence. A more representative measure of the typical stock's performance, the S&P 500 Equal Weighted Index (which equally weights all stocks in the index) fell 8.6% in August and September and 5.3% for the entire quarter.

In July, the Fed raised the federal funds rate for the eleventh time since March 2022, bringing the fed funds rate to 5.25%–5.50%. Subsequently, at the September meeting, the Fed left rates unchanged but warned that rates set by the Fed are likely to stay "higher for longer." The warning caused investors to infer that reducing inflation from the recent level of 3.5%%–4.0% to the Fed's stated target of 2% could require additional rate hikes and that no rate cuts were likely for a long time. The Fed's message was a disconcerting reminder that the Fed remains willing to risk inducing a recession if that's what it takes to achieve its inflation target. Investors' hopes for a soft landing for the economy remain highly dependent on inflation declining steadily in the coming months and the Fed's ability to reduce rates soon enough to avoid a recession—but without permitting inflation to snap right back as it did in the late 1960s and throughout the 1970s.

Portfolio Review

The Neuberger Berman Bolton Group All Cap Core Portfolio posted a negative return for the third quarter of 2023 but outperformed the return on the S&P 500 Index during the same period. Information Technology (IT) Financials and Health Care are the most heavily weighted sectors in our portfolio. During the quarter we reduced weightings in Financials and Energy and our cash holding and used the proceeds to increase our weight in Health Care.

Compared with the benchmark, the portfolio's relative performance in the third quarter was positively impacted by both sector weighting and stock selection—led by stock selection in Health Care, Financials, and IT, while stock selection in Industrials and Utilities negatively impacted performance. Cash was approximately 3.1% of portfolio at the end of the quarter.

Market Outlook

Consumers, who have been a growth engine for the U.S. economy throughout the recovery from the COVID-19 pandemic, are beginning to feel pressured. Consumer confidence surveys reveal that expectations about the near-term future are quite depressed. Mortgage rates approaching 8% are at levels not seen since 2000, and rates are similarly elevated for home equity, auto, and credit card loans, a concern that is compounded by tighter lending standards. Consumers are feeling additional pressure from the depletion of savings that accumulated from reduced spending in the initial phase of the pandemic and generous government stimulus payments to mitigate the pandemic's effects. Deferment of student loan payments ended on October 1, which economists estimate could cost consumers as much as $100 billion annually. The 20% increase in the oil price during the third quarter, a result of Saudi Arabia's successful efforts so far to restrict OPEC production, has been an additional headwind for households and businesses.

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As we have written in earlier letters this year, our portfolio strategy has been to invest in high-quality growth companies with strong balance sheets that we believe can deliver reasonably good returns in either a soft landing or a recession. We believe recent market trends have vindicated this strategy so far this year and will continue to do so in the months ahead. The second quarter earnings results reported this summer boosted our confidence in the stable and growing earnings power of our portfolio companies. We are pleased with the way our portfolios performed this past quarter in a very difficult environment. In this challenging period, we are deeply appreciative of your continued confidence in us.

Bolton Group Team Update

The Bolton Group is delighted to announce that, effective January 1, 2024, we will combine with The Kamen Group, a highly regarded NB Private Wealth team with an investment process very similar to our own. The Kamen Group includes nine talented and dedicated individuals who bring to our combined team their expertise in equities and fixed income investments, as well as excellence in client relationships and financial planning.

Stuart Pollak will join David Pedowitz, who has led the Bolton Group for over a decade since our founder Jeff Bolton retired, as Co-Senior Portfolio Manager of the combined group. We have enjoyed a close working relationship with Stu, who has been instrumental in all aspects of the Kamen Group's investment approach and has been highly valued by Kamen Group founder and leader Michael Kamen as "a true partner and peer." As Michael steps back from day-to-day client, portfolio, and team management responsibilities, he notes that Stuart's "excellent investment skills, thoughtfulness, and keen intuition give me the utmost confidence in his leadership abilities." Michael is a truly outstanding investor, and we feel deeply fortunate that he has agreed to continue to advise Stu, his "trusted partner and successor." David and Stu look forward to co-leading the combined team for years to come.

Finally, in the context of the combination, we will adopt a new group name—BKS Select Investment Group—to reflect more of "what we do" in addition to "who we are." When Jeff Bolton retired in 2013, he graciously honored our request to continue operating under the Bolton Group name. At that time, Jeff reminded us that "Bolton" is our brand; and asked us to treat it with care by maintaining the highest standards in all aspects of the business. We are beyond grateful to Jeff for the amazing business he built and his generosity in allowing us to continue operating for the last ten years under his name.

Similar to our team, Neuberger Berman itself has never been stronger. Our firm has outstanding senior leadership and a vibrant investment culture that prioritizes the client experience above all else. Our upcoming combination with the Kamen Group provides additional expertise and talent and ensures continuity of leadership for decades to come. We highly value your trust and confidence in us. We see a bright future ahead and are excited to continue along this journey with you and your family.

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The S&P 500 Index consists of 500 stocks chosen for market size, liquidity, and industry group representation. It is a market value weighted index (stock price times number of shares outstanding), with each stock's weight in the Index proportionate to its market value. The "500" is one of the most widely used benchmarks of U.S. equity performance. As of September 16, 2005, S&P switched to a float-adjusted format, which weighs only those shares that are available to investors, not all of a company's outstanding shares. The value of the index now reflects the value available in the public markets.

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