CARILLON SCOUT MID CAP FUND

CARILLON FAMILY OF FUNDS

INSIGHT | COMMENTARY

THIRD QUARTER | 2023

Investment Team

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Characteristics

Total Net Assets (billions): $3.27

Number of holdings: 148

Top 10 Holdings

Palantir Technologies

Quanta Services

CBOE Global Markets

CenterPoint Energy

Chart Industries

BioMarin Pharmaceutical

Hubbell

Noble Corp.

Stag Industrial

Pioneer Natural Resources

Market Overview

Major equity indices started the quarter on an up note, but they succumbed to higher interest rates and economic fears as the quarter unfolded. Large caps generally fared better than mid and small caps in a narrow market where just a handful of large tech and media companies dominated the performance of the S&P 500 Index.

The U.S. Federal Reserve (Fed) raised rates again in July, indicating that it would evaluate whether more tightening is necessary. At this juncture, it looks as if one more rate hike in 2023 is possible, perhaps probable. Other central banks around the world generally continued to tighten policies.

Inflation slowed in the third quarter: Commodity prices (except for oil) were generally weak, rent increases decelerated, and housing prices took a breather. This all bodes well for lower inflation, with the possible exception of higher long-term energy prices that are likely to bleed into core inflation eventually as capital spending in the oil industry remains depressed, and energy exports from Saudi Arabia are restrained.

Weak economic growth in China, where the property sector has dragged on overall growth, also has weighed on commodity prices. We don't see any quick fixes for the Chinese economy, so this trend may persist for a while as companies reshore away from China and the country's older demographic trends gradually take hold.

Domestically, the U.S. economy continued to grow: Robust government spending at the federal level continued, and marginal tax rates remain reasonably low to spur activity. Government spending seems thus far to have offset higher interest rates' effects on overall growth. Deficits, however, continue to expand, and the bond market finally noticed, which sent the yield on the 10-year U.S. Treasury bond higher in the third quarter.

Some have dubbed this the return of the "bond vigilantes." The term, coined by Dr. Ed Yardeni in the 1990s, describes more cautious bond investors who demand a higher inflation premium in exchange for the risk of owning long-term bonds. Whether these vigilantes stick around for more than a fleeting moment is an open question, but the answer will depend on the pace of the green energy transition, the trend of budget deficits after the 2024 election cycle, monetary policy, and overall economic growth.

The U.K. has already slowed its energy transition in response to economic pain and its political fallout. We expect this may eventually happen in the United States, but the timing is uncertain.

Portfolio Review

Top securities

The top contributor for the quarter was Splunk, an artificial intelligence (AI) software security company that received an all-cash bid from a market-leading technology company that offered a substantial premium to the market price. Splunk's fundamentals recently improved following the installation of new management that has cut costs and improved marketing.

Second was CBOE Global Markets, the exchange known for hosting S&P 500 Index options, the VIX volatility index, equity trading, and other options and futures. The company benefited from strong volumes in its S&P 500 options business and the growing popularity of daily options. As CBOE is a relatively large position in the portfolio, a strong increase for the stock during the quarter had an outsized positive effect on performance.

Palantir Technologies' stock moved higher on hopes that it could win business from the U.K.'s National Health Services and as customer counts grew rapidly in the latest quarterly report for the company's new Artificial Intelligence Platform (AIP). Palantir also won a significant new contract with the U.S. Army in September, which should last through 2026. The debate on the street is how fast Palantir can monetize its new commercial customers. After the quarter closed, the company announced an enhanced marketing deal with a major auditing and consulting firm.

Noble Corp., an offshore contract driller, benefited from improved sentiment regarding the offshore drilling business as higher day rates, the all-in daily costs of renting a drilling rig, were reported across the industry. The supply and demand for offshore rigs has tightened considerably.

AppLovin's stock moved up sharply as benefits of its new AI-powered advertising platform for mobile apps, Axon 2.0, helped drive a good quarterly report.

Top Securities	Average Weight (%)	Contribution to Return (%)
Splunk	1.11	0.38
CBOE Global Markets	2.35	0.29
Palantir Technologies	4.15	0.24
Noble Corp.	1.35	0.21
AppLovin	0.81	0.21
Bottom Securities		
Edwards Lifesciences	2.03	-0.61
Insulet	0.69	-0.33
Delta Air Lines	1.39	-0.31
Teradata	1.52	-0.27
Quanta Services	4.11	-0.25

As of Sept. 30, 2023. 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, Scout Investments, 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.

Bottom securities

Edwards Lifesciences was the bottom contributor for the quarter. The company's relatively large position in the portfolio hurt performance as the stock slid on fears of negative clinical trial results for low-risk transcatheter aortic valve replacement (TAVR) patients. The company's stock price may have also been affected by concerns about the popularity of glucagon-like peptide 1 (GLP-1) agonists for treating diabetes and weight loss, which may impact the demand for heart valve replacement over the longer term. Only about 1% of the U.S. population takes GLP-1 medication, but it is a rapidly growing trend.

Insulet, the diabetes management device company, was the second largest detractor to portfolio performance. The company was hit by negative sentiment regarding GLP-1 agonists and their potential to reduce the number of type 2 diabetics on insulin therapy. Type 1 diabetes has become increasingly prevalent, which could offset the lower outlook for cases of type 2 diabetes, but the market ignored this development.

The third largest detractor was Delta Air Lines, which pulled back after a sharp rally earlier in the year and as higher oil prices hurt sentiment on airlines overall. While weaker domestic fare prices have weighed on the stock price, stronger demand for international travel has improved the company's profitability.

Enterprise database company Teradata declined after a strong performance earlier in the year. Sentiment on many tech stocks has soured, except for those perceived to have strong AI or security businesses.

Finally, Quanta Services, a leading electrical infrastructure contractor, declined as higher interest rates stoked fears that electric utilities would be slower to ramp up their capital spending.

Outlook

Although there have been several warning signs, such as a steeply inverted yield curve, that historically appear before a recession, the U.S. economy remains resilient. Despite the strong economy and slowing interest rate hikes, mid-cap stocks gave up most of their year-to-date gains during the quarter. Large-cap stocks generally fared better, holding onto much of their gains.

Although the Fed may continue hiking interest rates for the time being, some investors now believe the tightening can be offset by robust government stimulus. Specific programs include:

- The Inflation Reduction Act, which stimulates investment in various alternative energy investments;
- The CHIPS (Creating Helpful Incentives to Produce Semiconductors and Science) Act, which helps reshore semiconductor manufacturing capacity; and
- The Infrastructure Investment and Jobs Act, which modernizes and improves transportation, communications, and power networks.

Remarkably, these cumulative stimulus spending and investment measures, combined with recent liquidity injections into U.S. banks, and reshoring of supply chains (which also requires substantial investment), appear to be offsetting some of the detrimental effects of the Fed's aggressive interest rate hikes, allowing overall growth to maintain a steady pace – even if many consumers suffer from higher interest rate costs on credit cards, loans, and mortgages.

Estimates vary as to the total magnitude of incremental government spending, but we suspect it will be more than $2 trillion over the next decade, depending on how companies and individuals respond to incentives in the laws, interest rates, and the availability of capital. The near-term investment and spending on new facilities and plants appears to be robust, and our suspicion that long-term interest rates might drift higher – communicated in the last quarterly letter – unfortunately proved true: The bond vigilantes showed up in force as concern grew about climbing deficits and higher interest costs on U.S. government debt, which crowded out consumer activity and raised the cost of private sector debt issuance.

As detailed last quarter, we pushed out our expectation for a recession, and we are more seriously considering a possible soft landing, or a no-landing scenario for 2023. Following the inflation surge in 2022, we have seen the U.S. Consumer Price Index (CPI) and core Personal Consumption Expenditures (PCE) Price Index inflation readings on a generally decelerating path. Wage pressures continue, as we are seeing some labor strikes, but they seem to be easing off the boil as inflation decelerates. Monetary indicators such as the growth of M2 money supply have contracted in the United States, which is another good harbinger of lower inflation. These factors should encourage the Fed to slow its aggressive tightening policy.

Overall, the portfolio is positioned slightly defensively, with below-average beta and overweights in information technology, consumer staples, energy, and industrials. Our underweights are in financials, consumer discretionary, communication services, real estate, and healthcare. The utility sector weight is near the benchmark.

In addition to portfolio construction based on our current market outlook and stock-specific factors, we are leaning into long-term themes such as artificial intelligence, renewable energy, infrastructure, reshoring, and conventional energy driven by supply shortages and long-term needs for efficient and reliable energy. In May, a large chipmaker unveiled a blockbuster earnings target that it expected to be fueled by sales to power artificial intelligence programs such as large language models (LLMs). We remain overweight the technology sector, which should benefit from growth in AI and security. Several companies in the industrial sector also seem likely to benefit from power-hungry data centers. We also prefer exposure to stocks that will benefit from the push into renewable energy while avoiding reliance on debt financing, given higher interest rates. Companies that help build out the electrical grid, like Quanta Services, or companies that store and move cleaner fuels should have growth opportunities ahead. We believe select industrial product companies will benefit as companies look to make their supply chains more resilient and look to produce goods closer to the end customer.

Risk considerations: Mid-cap and small-cap stocks may temporarily fall out of favor or perform poorly relative to other types of investments. While stocks of mid-cap companies may be slightly less volatile than those of small-cap companies, they still involve substantial risk.

Real Estate Investment Trusts (REITS) may be affected by economic conditions including credit risk, interest rate risk and other factors that affect property values, rents or occupancies of real estate.

Foreign investments present additional risks due to currency fluctuations, economic and political factors, government regulations, differences in accounting standards and other factors.

Investments in emerging markets involve even greater risks.

Groups of stocks, such as value and growth, go in and out of favor, which may cause certain funds to underperform other equity funds.

The Fund may, at times, experience higher-than-average portfolio turnover, which may generate significant taxable gains and increased trading expenses, which, in turn, may lower the Fund's return.

Investments in the securities of other investment companies, including money market funds and exchangetraded funds ("ETFs") (which may, in turn, invest in equities, bonds, and other financial vehicles), may involve duplication of advisory fees and certain other expenses.

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Definitions:

Beta is a measure of the volatility or systemic risk of a security, group of securities, or portfolio compared with the market as a whole.

"Bond vigilantes" engage in trading activity that signals their disagreement with a bond issuer's monetary or fiscal policies. Bond vigilantes are said to enforce fiscal discipline by selling a government's bonds to increase yields and raise borrowing costs.

The CHIPS (Creating Helpful Incentives to Produce Semiconductors and Science) Act is federal legislation passed in 2022. It aims to increase investments in U.S. semiconductor manufacturing capacity, while also aiming to support the development leading-edge technologies, such as quantum computing, AI, clean energy, and nanotechnology, while also looking to create high-tech hubs that can foster a larger and more inclusive science, technology, engineering, and math (STEM) workforce.

The U.S. Consumer Price Index (CPI) measures the change in prices paid by consumers for goods and services. The U.S. Bureau of Labor Statistics bases the index on prices of food, clothing, shelter, fuels, transportation, doctors' and dentists' services, drugs, and other goods and services that people buy for day-to-day living. Prices are collected each month in 75 urban areas across the country from about 6,000 households and 22,000 retailers.

The Personal Consumption Expenditures (PCE) Price Index, excluding food and energy, known as the core PCE index, is a measure of the prices that people living in the United States, or those buying on their behalf, pay for goods and services. The PCE price index, released monthly by the U.S. Department of Commerce Bureau of Economic Analysis, is known for capturing inflation or deflation across a wide range of consumer expenses and reflecting changes in consumer behavior.

Defensive stocks provide consistent dividends and stable earnings regardless whether the overall stock market is rising or falling. Companies with shares considered to be defensive tend to have a constant demand for their products or services and thus their operations are more stable during different phases of the business cycle.

A futures contract is a legal agreement to buy or sell an asset at a predetermined price at a specified time in the future, which is known as the expiration date. Futures contracts are financial derivatives that allow investors to speculate on the direction of a particular asset and are often used to hedge the price movement of the underlying asset to help prevent losses from undesired price changes.

Glucagon-like peptide 1 (GLP-1) agonists comprise a class of type 2 diabetes drugs that improve blood sugar control and may also lead to weight loss. The drugs mimic the action of a hormone called glucagon-like peptide 1 by stimulating the body to produce more insulin when blood sugar levels start to rise after someone eats. The additional insulin helps lower blood sugar levels, which helps in controlling type 2 diabetes. How GLP-1 agonists lead to weight loss is less clear.

An inflation premium is an investment's additional return to compensate for expected losses of purchasing power due to inflation.

The Infrastructure Investment and Jobs Act, passed by the U.S. Congress in November 2021, provides the funding for new initiatives to rebuild roads and bridges, improve public transit, replace lead pipes and address drinking water contamination, and to also expand access to high-speed internet.

Large language models (LLMs) are arttifical intelligence algorithms that can recognize, summarize, translate, predict, and generate text, as well as respond to questions in a conversational manner, by massively large sets of data. Large language models learn context and meaning by tracking relationships in sequential data, such as words in a sentence.

M2 is a measure of the money supply that includes cash, checking deposits, and easily convertible near money.

Narrow is a term used to describe the relationship between the median and the mean of a market index: When a few data outliers result in a mean that is substantially larger (or smaller) than the median of the full data set, then the performance of the entire index is being driven by a "narrow" selection of companies. An index supported by "broad" market movements is one where the median is closer to the mean.

An option is a financial instrument based on the value of underlying securities such as stocks. An options contract offers its buyers the opportunity to buy or sell — depending on the type of contract they hold — the underlying asset.

Overweight describes a portfolio position in an industry sector or some other category that is greater than the corresponding weight level in a benchmark portfolio.

Reshoring describes the effort to bring manufacturing and other services back to the United States from overseas operations.

A "soft landing" scenario is one where a central bank tightens monetary conditions to slow economic activity without triggering a widespread recession. In a "hard landing" scenario, a central bank has tightened monetary conditions to the point where it triggers a widespread recession.

Tight monetary policy is an action taken by a central bank to slow down overheated economic growth by raising short-term interest rates.

Transcatheter aortic valve replacement (TAVR) is a procedure for replacing a heart's aortic valve when it has narrowed and doesn't open fully. The procedure uses smaller incisions than open-heart valve surgery, and it may be an option for people who are unable to have more invasive heart surgery to replace an underperforming aortic valve.

Underweight describes a portfolio position in an industry sector or some other category that is less than the corresponding weight level in a benchmark portfolio.

The Chicago Board Options Exchange (CBOE) Volatility Index, or VIX, is a real-time market index that represents the market's expectation of 30-day forward-looking volatility. Derived from the price inputs of the S&P 500 index options, it provides a measure of market risk and investors' sentiments.

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Indices

The Russell Midcap® Index, the Fund's benchmark, measures the performance of the mid-cap segment of the U.S. equity universe. The stocks are also members of the Russell 1000 Index.

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 80% of the investable U.S. equity market.

Investors cannot invest directly in an index and unmanaged index returns do not reflect any fees, expenses or sales charges.

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