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INVESTOR NEWSLETTER

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Cover story:

2024 CEO outlook

Also in this issue:

Obesity drugs: What are the costs for health plan providers?

Elections 2024: Focus on policy over politics

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Columbia Threadneedle Investor Newsletter is published quarterly online and features timely articles covering economic trends, investment strategies and solutions, and service changes.

2024 CEO outlook

Rates, risks and the fight for market share

WILLIAM F. "TED" TRUSCOTT
Chief Executive Officer

Inflation has come down and the economy has been more resilient than many predicted at the beginning of 2023. Our CEO shares his thoughts on what's in store for markets and asset managers in 2024.

The biggest surprise of the past two years has been a 500-plus basis point increase in interest rates without a recession. While there are pockets of the economy that are not doing well, we've gone from quantitative easing to quantitative tightening without a credit cycle. There's a lot of reasons that hasn't happened — fiscal stimulus and savings accumulated during the pandemic among them — but I think we can also give some credit to the Federal Reserve for calibrating the rate increases successfully.

From an investment perspective, the rate increases have meant that money market rates are attractive once again, but getting investors to consider other asset classes has been a persistent challenge for financial advisors. Cash can be great in the short term, but it's not a long-term investment vehicle, and I think investors will begin to see that as rates come down over the year.

For institutional investors, higher rates have helped many match their liabilities, and not surprisingly they are taking their time with decisions on allocations. Generally, we're seeing them allocate their risk and fee budgets to alternatives and private credit especially. I think private credit will continue to grow because banking regulations have discouraged banks from lending. They don't want to hold loans on their balance sheets, because the capital costs are too high. The private markets are fairly opaque, though, and there could be some accidents, especially if we return to a more historically normal credit cycle.

There's plenty for investors to consider this year. From a technical perspective, I think equity valuations in the U.S. are extended. And pockets of traditional commercial real estate are facing significant uncertainty, particularly older office buildings, which haven't bounced back in terms of occupancy since the global pandemic. There'll be a shakeout in this asset class, and there are going to be some incredible opportunities, but there is pain to get through first.

There's also considerable geopolitical risk, including two wars that could become wider conflicts and the ever-present concerns about China, which wants to dominate the Pacific. Do tensions in the region escalate? Hopefully not, but it's certainly something we can't overlook as a possibility. In the U.S., we are heading into an election year in a particularly polarized political environment. In the long run, politics don't matter to markets as much as some might think. What does matter for the business community — and capital flows — is sensible regulation, endurance of institutions and the rule of law. And if all that stays in place, well then — politics will be politics.

The asset management industry generally remains in flux. I have long said that there are too many traditional asset managers and products and not enough assets to go around. It's a market share fight both in the U.S. and Europe, and I think it's going to lead to more consolidation. Most industry observers think we'll end up with a barbelled industry, with some very large managers that do a lot of things well, and a set of small managers that provide a very focused offering; in the middle, you're probably going to see fewer and fewer players.

Artificial intelligence (AI) is a game-changer for our industry. It's going to get embedded into the operating side of our business. It's going to assist with investment research. It will probably support portfolio management at some point. That said, I think that it's a resource that will supplement a human's work rather than replace it. More broadly, I think that we'll see technology and AI become a bigger part of every industry, but I think there's more to be done to understand all the possibilities and the risks.

Obesity drugs: What are the costs for health plan providers?

As demand soars for GLP-1 obesity drugs, we explain what the drugs are, how they are reshaping health care and why health plan providers need to decide whether to provide coverage.

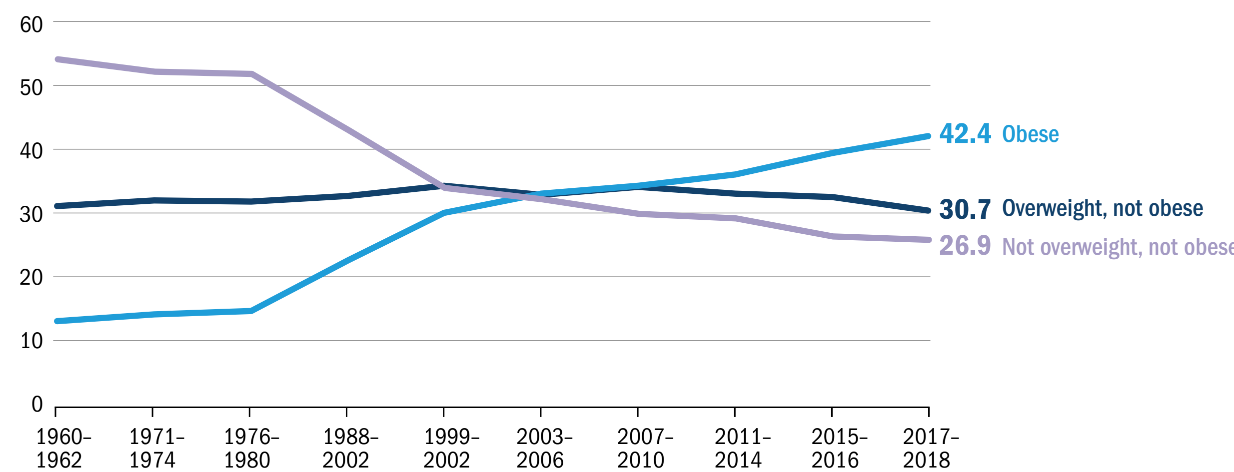
Back to top

KEY POINTS:

- The obesity epidemic costs the economy billions of dollars a year in health care costs, work absences, lost wages and reduced productivity.
- A new class of drugs known as GLP-1 agonists has proved extremely effective at treating obesity, but they come at a high cost.
- Demand for GLP-1s is already robust and is expected to increase significantly, so health plan providers should weigh the costs and benefits of providing coverage.

According to the Centers for Disease Control and Prevention (CDC), more than 100 million American adults (42% of the population) were obese and 80 million (31% of the population) were overweight as of 2018, when the most recent data are available. Globally, the World Obesity Foundation estimates that nearly one billion people are obese.

Prevalence of obese and overweight adults in the U.S. (%)



Source: National Health Examinatin Survey and National Health and Nutrition Examination Surveys.

The obesity epidemic comes at a huge cost, not just to the individuals living with obesity, but also to the larger economy. While many of the adverse health consequences of obesity — such as increased risk for cardiovascular disease, type 2 diabetes and respiratory issues — are well-known, the financial consequences are, perhaps, underappreciated.

The Milken Institute sought to quantify the total cost of the obesity epidemic, and the numbers are eye-opening. According to their research, the direct health care costs attributable to high weight are approximately $500 billion per year. And that figure pales in comparison to the $1.2 trillion in indirect costs related to work absences, lost wages and reduced productivity. Together, the direct and indirect costs, which are borne by governments, employers, insurers and individuals, add up to 9% of U.S. GDP.

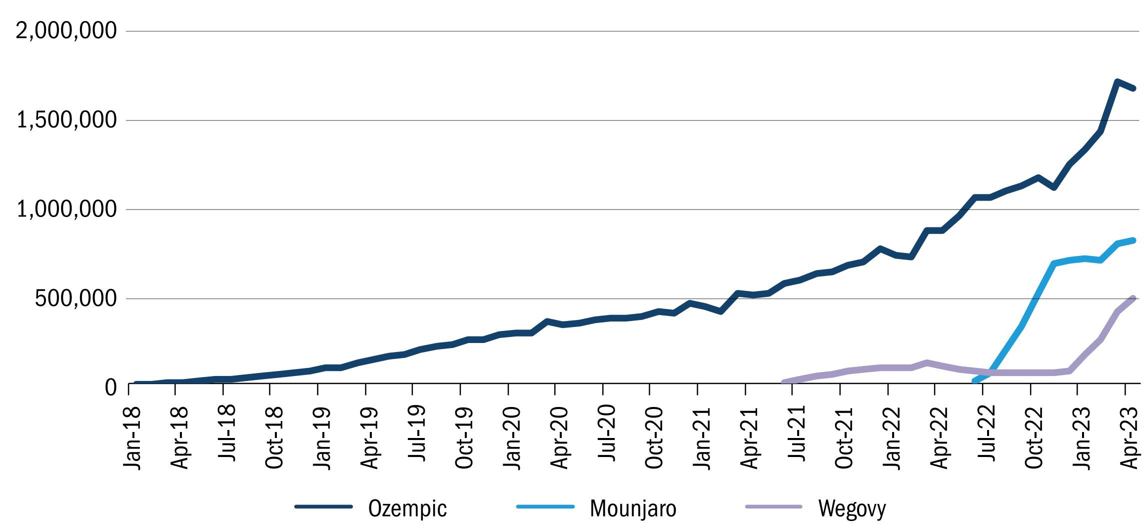
A chance to turn the tide

Given the size and scope of the issue, addressing the obesity epidemic could have positive benefits for individuals, corporations and the overall economy. After decades of increasing obesity rates and no drugs available to effectively treat the problem, we're starting to see options.

The class of drugs dubbed GLP-1 agonists, which were originally developed to treat type 2 diabetes, has recently proved very effective at treating obesity. In yearlong trials conducted by Novo Nordisk and Eli Lilly, diabetic patients taking GLP-1 drugs lost 15%–18% of their body weight. Non-diabetic obesity patients experienced even greater results, losing 16%–26% of their body weight.

Unsurprisingly, demand for these drugs has been soaring. Prescriptions have increased eightfold in three years, and approximately four million Americans are currently taking the latest generation of GLP-1s. Somewhat more surprising is how widely the impact of GLP-1s has spread across multiple sectors of the economy from drugmakers, pharmacies and insurers to food retailers, restaurants and more.

Since launch, GLP-1 agonists have seen strong growth (Monthly prescription counts)



Source: Columbia Threadneedle Investments as of April 2023. Data for Ozempic reflects prescriptions for diabetes; data for Mounjaro reflects diabetes and off-label weight-loss prescriptions; data for Wegovy reflects weight-loss prescriptions.

A strong runway for growth

The meteoric growth of GLP-1s has taken place despite supply constraints and high prices (prescriptions in the U.S. can cost as much as $1,400 per month). As with most drugs, we expect that prices will fall over time as a result of additional competition and increased supply. When prices do come down, demand is likely to increase accordingly.

Consensus expectations forecast that the size of the GLP-1 market will double to $71 billion by 2027, and it appears likely that the market could grow substantially from there. If just 20% of the world's one billion obese people were to pay $100 per month each for a prescription, that would equate to a total addressable market (TAM) of $240 billion, which is nearly 20 times larger than that of the world's current top-selling drug, Humira. While $100 a month is substantially below the current price in the U.S., it is roughly in line with the cost in Europe, and we believe it is a reasonable long-term estimate for the global price.

Back to top

GLP-1 global weightloss TAM sensitivity analysis (TAM = $b)

Table estimates the total addressable market (TAM) in billions based on the number of people on GLP-1s and the price per month. For example, if 20 million people take the drugs and pay $50/month, the TAM would be $12 billion.

Price per month	Number of people on GLP-1s (millions)						
	1	**5**	**20**	**50**	**100**	**200**	**500**
50	1	3	12	30	60	120	300
100	1	6	24	60	120	240	600
250	3	15	60	150	300	600	1,500
500	6	30	120	300	600	1,200	3,000
1,000	12	60	240	600	1,200	2,400	6,000

Source: Columbia Threadneedle Investments as of 10/31/23.

In addition to their proven success in treating obesity, GLP-1s have demonstrated promising results in preventing other serious ailments, including strokes and heart failure, and trials are underway to gauge their effects in treating Alzheimer's, sleep apnea and kidney disease. If GLP-1s are approved in even one of these areas, the market for these drugs will expand and growth could accelerate.

A choice for health plan providers

As the market continues to grow, and more people want access to these life-changing drugs, health plan providers need to decide whether or not to cover the cost for their plan participants. Most insurers are not covering weight-loss drugs unless required to by state law, so there are limited cost risks for commercial insurance.

Currently, GLP-1s are not covered for weight loss by Medicare; for those with access to Medicaid, 10 states require coverage of GLP-1s for weight loss. In a recent survey, 25% of employers indicated that they currently offer coverage of GLP-1s and 40% indicated that they plan to offer coverage in 2024.[1] At up to $1,400 a month per patient, GLP-1s represent a major cost for plans that do cover them, but, as we noted above, that cost should decrease dramatically over time.

Of course, one reason that some companies are willing to cover the drugs despite the high cost is that GLP-1s can bring meaningful benefits, including lower absenteeism, healthier, more productive workers, and potentially reduced spending on other drugs and procedures related to obesity, from diabetes to heart attacks.

As with many choices regarding drug coverage, the costs for health plan sponsors come in the present, but the payoffs take place in the future, and they are hard to quantify at this time. Ultimately, the decision on whether to cover GLP-1s will also include factors that are unique to each organization. Factors include the size, age and health of the workforce, employee turnover rates, the benefits currently offered and the cost of those benefits, as well as the state of the balance sheet.

Given all that is at stake, and how big the market for GLP-1s is forecast to grow, health plan providers should be having conversations today with insurers, pharmacy benefit managers and industry experts about whether it makes sense for them to include coverage for GLP-1s.

[1] ir.accolade.com/news-releases/news-release-details/glp-1-coverage-employer-plans-could-nearly-double-2024

Elections **2024**

Focus on policy over politics

The prospect of a contentious election year might concern investors, but what really matters to markets is policy, not politics. Here are issues investors should follow as the election year unfolds.

Uncertainty can rile markets, especially in an election year. And while history suggests that elections may not dramatically alter the long-term investment landscape, the road to Election Day could involve some uncertainty in the short term, especially as the primaries and the run-up to the general election in November are happening along with the inability of Congress and the White House to reach a final agreement on federal spending, border policy and foreign aid. Here are some areas we are monitoring that could be affected by the election outcome, which could in turn impact investors:

Tax policy changes are in play

Tax policy stands as one of the most immediate areas influenced by election outcomes. The debate surrounding the extension of specific tax-expired provisions from 2023 has pushed this issue to the forefront in 2024. 2025 will bring even more pressure to address tax policy, because most individual tax provisions from the Tax Cuts and Jobs Act expire after 2025. The Congress and president elected in 2024 will need to prioritize and address these tax policies in post election. Should the Democrats secure both the executive and legislative branches, "Build Back Better" will likely return. A Republican-led government would introduce a more nuanced landscape. The necessity for bipartisan consensus still may exist, particularly if the margin of control remains very tight. In addition, Republicans are more likely to defend the Tax Cuts and Jobs Act and are unlikely to pursue sweeping reforms. In the case of divided government, expect a compromise-oriented approach.

Back to **top**

Bipartisan deal on tax extenders is the pregame for 2025

Business tax extenders

Research and development (R&D):
Starting in 2022, the 2017 Tax Cuts and Jobs Act (TCJA) requires companies to amortize the cost of R&D investment over 5 or 15 years, rather than deducting those costs immediately.

Bonus depreciation:
For tax year 2023, companies may only be able to deduct 80% of their investments in short-lived assets immediately, with the remaining 20% spread across the asset's life. This deductible percentage falls to 60% in 2024, 40% in 2025 and effectively phases out completely by 2026.

Business interest expenses:
TCJA limits business deductions for net interest expenses to 30% of EBITDA from 2018–2021 and now limits those deductions to 30% of EBIT after 2021.

Outlook

Provisions included in the Tax Relief for American Families and Workers Act of 2024 would improve the child tax credit, restore the interest deduction for businesses and extend certain business tax provisions including 100% expensing for investment in equipment and R&D through the end of 2025. The House of Representatives voted 357 to 70 on January 31, 2024 to approve the bill. The vote clears a path for Senate consideration, where it has the support of Senate Finance Committee Chairman Senator Ron Wyden (D-OR).

More regulations possible in an incumbent administration

The election outcome often determines the direction and pace of regulatory changes, particularly in an incumbent administration. Drawing parallels from President Obama's 2012 reelection, a win for President Biden could mean a green light for a number of regulatory proposals that failed to make it over the finish line so far. The SEC has already proposed more than 60 rules, with additional proposals from various other federal agencies. Investors should brace for potential shifts in sectors impacted by these regulatory changes, such as finance, health care and technology.

Geopolitical risks remain elevated

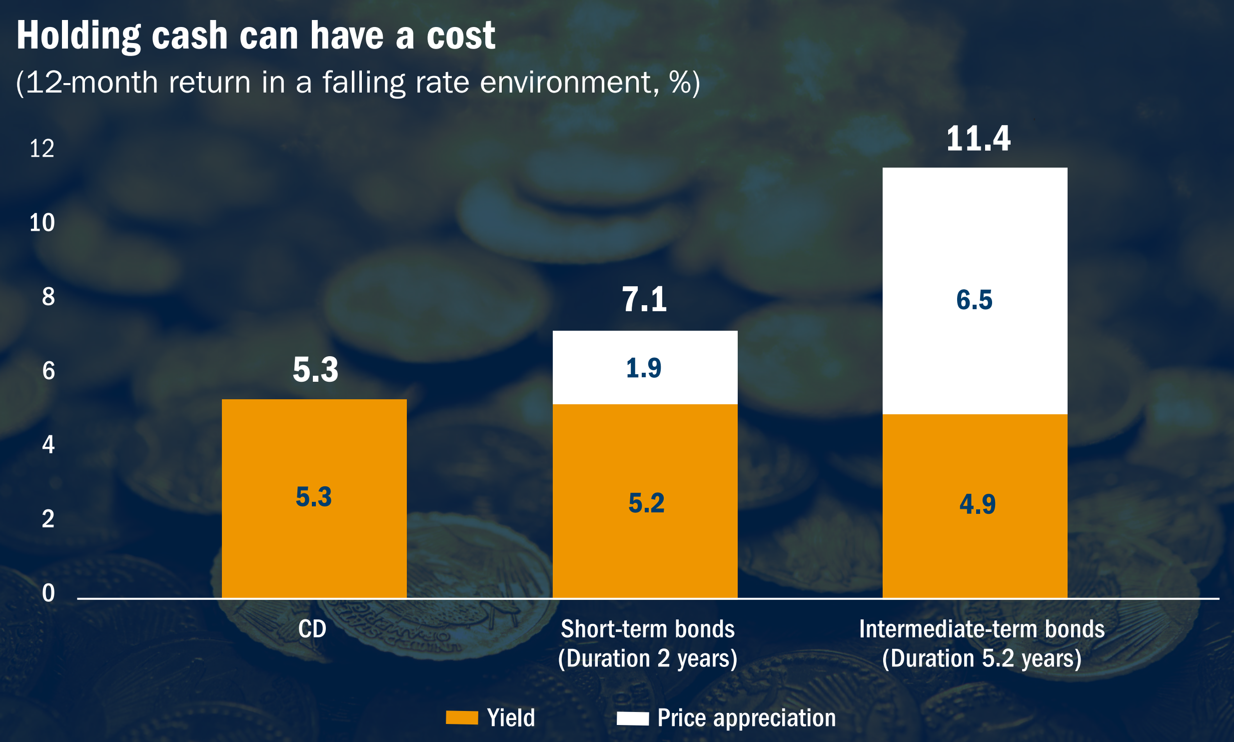
With several ongoing conflicts (Ukraine/Russia, Israel/Hamas, China/Taiwan), geopolitics remains a paramount concern. Despite political differences, a bipartisan consensus appears to converge on a firm stance with China. Both the Trump and Biden administrations maintained a stringent policy vis-à-vis China, signaling continuity in the U.S.'s strategic approach. There are ongoing initiatives to boost U.S. efforts to compete with China from both the executive branch and Congress.

Elections can stir emotions — that's why investing during an election year may appear challenging. But investors should prioritize fundamentals over sentiment. Elections matter, but more because of policy and less because of politics. Investors should stay invested, continue to diversify and keep their eye on specific policies.

Back to top

Chart on the Go

Latest Insights | Fixed income



- Economic uncertainty and high yields have led many investors to keep money on the sidelines. Many have turned to money market funds and CDs. But holding cash can have a cost.
- Consider the return of a high yielding cash investment, short-term bonds and intermediate bonds with starting yields of 5.3%, 5.2% and 4.9%, respectively. Here's what could happen to prices and total returns at the end of 12 months if rates fall by 1%:
    - There would be no change to the cash investment
    - The price of short-term bonds would increase 1.9%, and returns would total 7.1%
    - The price of intermediate-term bonds would increase 6.5%, and returns would total 11.4%
- While cash investments offer stability and capital preservation, bonds can provide meaningful total return potential in a falling rate environment. Consider these trade-offs in determining your investment strategy.

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Source: Columbia Threadneedle Investments. For illustrative purposes only. The above example is intended to illustrate the potential impact of interest rate changes and does not reflect issuer-specific or other factors that could impact bond prices. Assumes a parallel 100 basis point shift across the yield curve and a linear decline of 100 bps over 12-month period. Actual rates and prices will vary, and returns could be higher or lower. Duration is a measure of a bond's sensitivity to interest rate moves; a higher duration indicates greater sensitivity. Short-term bonds are represented by the Bloomberg Aggregate 1–3 Year Bond Index. Intermediate-term bonds are represented by the Bloomberg Aggregate Bond Index.

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* Source: Columbia Threadneedle Investments as of December 31, 2023.

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