JOHNSON ASSET MANAGEMENT

STRATEGY COMMENTARY
Johnson SMID Cap Core Equity
AS OF 03.31.2023

A QUARTER REVIEW:

Stocks were resilient in the first quarter despite uncertainties that emerged from the banking industry. Investors seemed inclined to leave 2022 in the rear-view mirror, and the turn of the calendar year came with sharp reversals in the market's performance themes. SMID Cap stocks delivered positive returns, and growth stocks beat value stocks by the widest margin since 3Q2020. Last year's top performing sector, Energy, cooled as inflation began to moderate and the Technology sector returned as the market leader. While stocks began the quarter showing typical "January Effect" behavior, it was really a surprising bank run on deposits at a few select regional banks in March that drove a big shift in style performance.

Banking can be a fragile business that requires customers to feel that their deposits are safe. A major crisis in that confidence rapidly emerged in March at Silicon Valley Bank, leading to overwhelming deposit withdrawals for the California lender with heavy exposure to private equity. Attention quickly turned to other banks with a high proportion of large customers well above the FDIC insurance limit, and Signature Bank, one of the SMID Cap Core strategy holdings, matched that profile. Unfortunately, this bank also suffered a similar devastating run on deposits and was taken over by regulators within just a few days' time, leaving its shares nearly worthless. The lasting effects seem likely to bring higher costs to banks and tighter lending conditions, which pose a broader economic risk.

PERFORMANCE SUMMARY:

For the quarter, the SMID Cap Core strategy slightly lagged the Russell 2500 with a net total return of 2.94% vs. 3.39% for the index.

Despite the impact on performance from the Signature Bank position causing more than 100 bps of negative contribution, the portfolio delivered positive overall returns. All of the negative relative performance drag on the portfolio occurred in January when an emphasis on high quality companies and valuation was out of favor as the market reversed the 2022 themes. The portfolio was able to offset the headwinds of January as the market fled to high quality companies in February and March.

Outside of Signature Bank, security selection led to positive excess return. The portfolio was underexposed to highly leveraged companies and speculative, capital-needy industries such as biotech, which are more at risk if lending standards continue to

TOP 5 PERFORMERS[1]

	WEIGHT	RETURN CONTRIBUTION
SMITH A O CORP	1.78%	0.38%
WATSCO INC	1.39%	0.37%
ON SEMICONDUCTOR CORP	0.44%	0.35%
CATALENT INC	1.04%	0.34%
FLOOR & DECOR HOLDINGS INC CL A	1.01%	0.34%

TOP 5 DETRACTORS[1]

	WEIGHT	RETURN CONTRIBUTION
SIGNATURE BANK NEW YORK NY	1.05%	-1.17%
GLOBUS MED INC CL A	1.12%	-0.42%
ARROW FINANCIAL CORP	1.38%	-0.40%
AMN HEALTHCARE SERVICES INC	1.68%	-0.36%
WINTRUST FINANCIAL COPR	1.72%	-0.24%

TOP TEN HOLDINGS[2]

NAME	% OF PORTFOLIO
APPLIED INDUSTRIAL TECHNOLOGIES, INC	2.05%
NVENT ELECTRIC PLC	1.98%
EVEREST REINSURANCE GROUP LTD	1.98%
TYLER TECHNOLOGIES INC	1.96%
LKQ CORP	1.93%
CHEMED CORP	1.92%
BJS WHSL CLUB HOLDINGS INC	1.86%
SMITH A O CORP	1.82%
AVERY DENNISON CORP	1.76%
NORDSON CORP	1.76%

1) Past performance is not indicative of future results, and there is a risk of loss of all or part of your investment. The above does not represent all holdings in the Strategy. Holdings listed might not have been held for the full period. To obtain a copy of Johnson Asset Management's calculation methodology and a list of all holdings with contribution analysis, please contact your service team. The data provided is supplemental. Please see important disclosures at the end of this document.

2) Holdings are subject to change. Past performance is not indicative of future results, and there is risk of loss of all or part of your investment. The data provided is supplemental. Please see disclosures at the end of this document.

tighten and credit becomes more expensive. Top portfolio contributors included many cyclical industry stocks with a stronger financial position that benefitted from better than feared economic data and a slower pace of interest rate hikes from the Federal Reserve. Half of the bottom ten negative contributors in the quarter were banks and financial services stocks. Fortunately, the strategy has been underweight this weakened sector. A positive overall sector allocation effect also included an Energy underweight and an overweight to the outperforming Industrials and Technology sectors.

MARKET OUTLOOK AND PORTFOLIO POSITIONING:

As desirable as the profitability profile of the Signature deposit customer was, the risk of a concentrated deposit base is certainly a lesson learned. These events in March were reaffirming of the strategy's discipline, which values diversification. The portfolio was able to maintain the characteristics of a quality stock portfolio that does well in times of higher uncertainty. Through a portfolio construction process that considers risk management as well as return opportunity, there were enough favorable positions in the portfolio to offset a bad outcome in a single stock.

The economic outlook remains uncertain and risky. Earnings estimates have been falling as interest rates have risen which has raised the risk of recession. Earnings growth expectations remain positive with 2023 estimates for the Russell 2500 projecting 10% growth in 2023. However, the first quarter is likely to be the third straight quarter of negative year over year growth and much of this year's growth is dependent on a sizeable second half lift, which seems unlikely. Considering these risks, the team took advantage of January's rally to sell cyclical stocks in Technology. While some valuation opportunities have emerged on the heels of last year's bear market, quality evaluation remains front of mind for the team as companies are likely to continue to see a tougher operating environment before the cycle pivots higher again.

PERFORMANCE

	QTD	1YR	3YR	5YR	7YR	10YR
JOHNSON (GROSS)	3.19%	-1.36%	21.51%	8.36%	10.57%	10.48%
JOHNSON (NET)	2.94%	-2.34%	20.32%	7.29%	9.48%	9.38%
RUSSELL 2500	3.39%	-10.39%	19.42%	6.65%	9.46%	9.07%

OUR SMID CAP CORE STRATEGY TEAM:

Brian Kute, CFA
Managing Director of Research, Senior Portfolio Manager, Principal

Bryan Andress, CFA
Senior Research Analyst

Chris Godby, CFA
Senior Research Analyst

1965
ESTABLISHED

$4.9B
INSTITUTIONAL ASSETS UNDER MANAGEMENT
(As of 03.31.23)

The Johnson SMID Cap Core Equity strategy seeks to consistently outperform the Russell 2500 Index over a full market cycle with less volatility. The strategy seeks to identify stocks that are making smart allocation decisions, with a favorable combination of quality, valuation, and momentum characteristics.

For more information on our products and services, please contact a member of the our Sales & Client Service Team at **513.389.2770** or **info@johnsonasset.com**.

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