

A QUARTER REVIEW:

The fourth quarter brought a welcome rally for SMID Cap stocks, which had been stuck in a three-quarter losing streak. It was not enough to reverse a historically challenging year for capital markets. Part of the relief in the fourth quarter was driven by optimism that high inflation might finally be starting to slow its pace, giving hope for some moderation in the tight monetary policy that has been depressing financial markets.

While inflation has helped many companies increase profits coming out of the pandemic, earnings expectations turned lower in the second half of 2022. It is likely that SMID Cap earnings will continue to decline sequentially for the second straight quarter when fourth quarter results are released. Energy and other commodity-driven companies have had positive estimate revision trends, but more economically sensitive sectors are starting to feel margin pressures.

PERFORMANCE SUMMARY:

During the fourth quarter, the SMID Cap Core strategy outperformed the Russell 2500 Index by 190 bps net of fees. As we reach the 10-year anniversary of our strategy, the high quality discipline of the strategy has led to outperformance net of fees versus the index over the 1, 3, 5, and now 10 year time period.

Our emphasis on higher quality companies continued to provide favorable positioning, as these companies tend to exhibit greater earnings resilience amid falling market expectations and cleaner balance sheets as credit continues to tighten. An overweight toward sturdier midcap stocks was also beneficial to the strategy's positioning.

Energy was a top performing sector throughout 2022. The portfolio is underweight energy as most companies within this sector do not meet our quality standards. Our underweight to energy caused a slight drag on our performance. However, this was offset by the excess returns generated by security selection, where the portfolio was able to provide relative outperformance in 8 out of 11 sectors.

TOP 5 PERFORMERS¹

	WEIGHT	RETURN CONTRIBUTION
UNIVERSAL HEALTH SERVICES INC CL B	1.36%	0.64%
FAIR ISAAC CORP	1.38%	0.64%
COLLEGIUM PHARMACEUTICAL INC	1.41%	0.53%
EVEREST REINSURANCE GROUP LTD	1.95%	0.53%
APPLIED INDUSTRIAL TECHNOLOGIES INC	2.13%	0.46%

TOP 5 DETRACTORS¹

	WEIGHT	RETURN CONTRIBUTION
SIGNATURE BANK NEW YORK NY	1.40%	-0.37%
PAYLOCITY HOLDING CORP	1.29%	-0.31%
LUMENTUM HOLDINGS INC	0.79%	-0.22%
CATALENT INC	0.67%	-0.19%
FIVE9 INC	0.17%	-0.16%

TOP TEN HOLDINGS²

NAME	% OF PORTFOLIO
APPLIED INDUSTRIAL TECHNOLOGIES INC	2.13%
NORDSON CORP	1.92%
WINTRUST FINANCIAL CORP	1.89%
EVEREST REINSURANCE GROUP LTD	1.86%
CHEMED CORP	1.86%
LKQ CORP	1.86%
NVENT ELECTRIC PLC	1.82%
AVERY DENNISON CORP	1.82%
SMITH A O CORP	1.80%
LEIDOS HOLDINGS INC	1.80%

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.

MARKET OUTLOOK AND PORTFOLIO POSITIONING:

We are taking a cautious approach to forecasting how company performance might unfold in 2023. Consensus expectations for 2023 still optimistically show double-digit EPS growth for SMID Cap companies. However, the falling revisions indicate that an earnings recession is not out of the question in 2023 if the economy slows too much. Encouragingly, the market is priced to doubt the rosy growth outlook as the Russell 2500 forward P/E is trading at approximately a 15% discount to its own 20-year average, and an even steeper discount of nearly 25% when compared to the large-cap S&P 500 P/E.

Recent portfolio positioning reflects preparing for an environment of slowing economic activity and a more difficult earnings environment. During the fourth quarter we sold several companies where conviction in management strategy was declining. We also sold more expensive stocks with valuations that no longer properly accounted for their cyclical risk. New, higher confidence holdings added included an eclectic mix of bottom-up ideas: a defense industry contractor, a specialty software company that serves the insurance industry, a midstream natural gas company, and a wood products manufacturer.

Back-to-back negative return years are rare – it hasn't happened in twenty years -- and the market is aware of the risk of an economic slowdown in 2023. Valuation is more reasonable now after the multiple compression, yet emphasis on earnings consistency is still a high priority for the team in what is likely to become a more difficult operating environment for companies.

PERFORMANCE					
	QTD	1YR	3YR	5YR	SINCE INCEPTION 1/1/2013
JOHNSON (GROSS)	9.60%	-11.60%	8.43%	7.50%	10.59%
JOHNSON (NET)	9.33%	-12.49%	7.35%	6.44%	9.50%
RUSSELL 2500	7.43%	-18.37%	5.00%	5.89%	9.00%

OUR SMID CAP CORE STRATEGY TEAM:

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



Bryan Andress, CFA
Senior Research Analyst



Chris Godby, CFA
Senior Research Analyst

1965
ESTABLISHED

\$4.6B
INSTITUTIONAL
ASSETS UNDER
MANAGEMENT
(As of 12.31.22)

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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