# Quarterly Update
SECOND QUARTER 2021

JOHNSON ASSET MANAGEMENT

## QUARTER END MARKET STATISTICS

| June 30, 2021 | Q2 | YTD | 1 Year | 3 Year | 5 Year | 7 Year | 10 Year |
|---|---|---|---|---|---|---|---|
| Core Fixed Income (Gross) | 2.30% | -1.57% | -0.40% | 6.07% | 3.76% | 4.01% | 4.17% |
| Core Fixed Income (Net) | 2.24% | -1.70% | -0.65% | 5.81% | 3.50% | 3.75% | 3.91% |
| Barclays Aggregate Index | 1.83% | -1.60% | -0.33% | 5.34% | 3.03% | 3.28% | 3.39% |
| | | | | | | | |
| Intermediate Fixed (Gross) | 1.37% | -0.95% | 0.26% | 5.24% | 3.39% | 3.39% | 3.54% |
| Intermediate Fixed (Net) | 1.31% | -1.07% | 0.01% | 4.98% | 3.13% | 3.13% | 3.29% |
| Barclays Intermediate G/C Index | 0.98% | -0.90% | 0.19% | 4.70% | 2.63% | 2.73% | 2.76% |
| | | | | | | | |
| Short Duration (Gross) | 0.26% | -0.24% | 0.59% | 3.34% | 2.33% | 2.12% | 2.10% |
| Short Duration (Net) | 0.20% | -0.36% | 0.34% | 3.08% | 2.08% | 1.87% | 1.85% |
| ICE BofAML U.S. Corp & Gov't 1-3 Year Index | 0.06% | 0.04% | 0.54% | 2.99% | 1.90% | 1.71% | 1.53% |
| | | | | | | | |
| Enhanced Index (Gross) | 8.61% | 14.62% | 40.47% | 19.72% | 17.87% | 14.49% | 15.40% |
| Enhanced Index (Net) | 8.53% | 14.45% | 40.05% | 19.36% | 17.50% | 14.15% | 15.07% |
| S&P 500 Index | 8.55% | 15.25% | 40.79% | 18.67% | 17.65% | 14.10% | 14.84% |
| | | | | | | | |
| SMID Cap Core Equity (Gross) | 6.19% | 18.92% | 49.55% | 12.49% | 14.55% | 10.77% | - |
| SMID Cap Core Equity (Net) | 5.93% | 18.34% | 48.11% | 11.38% | 13.43% | 9.67% | - |
| Russell 2500 Index | 5.44% | 16.97% | 57.79% | 15.23% | 16.35% | 11.74% | - |

**Dear Friends & Investors:**

It is hard to believe that 2021 is already halfway over, time flies when you are not in quarantine! While 2020 was an especially challenging year, 2021 has so far been characterized by pervasive optimism. Broadening vaccinations, widespread economic reopening, and ongoing stimulus have combined to ignite a boom in economic activity. As a result, most major equity indices have continued to forge new, all-time highs. Despite the economic and market optimism, the speed with which the economy has recovered has caused some to worry about possible consequences. Namely, investors have grown concerned that the economy may overheat, sparking fears of sustainably higher inflation. In turn, bond yields rose sharply throughout the early part of the year but have since stabilized. The recent moderation in bond yields is likely a reflection that the intensity of the "triple tailwinds" – vaccines, reopening, and stimulus – will begin to fade as we look forward to the second half of this year.

As always, we remain committed to our quality investment discipline and strive to provide consistency in our results through all market environments. If you have any additional questions, please feel free to reach out to any member of the Johnson Asset Management Team.

Sincerely,

Johnson Asset Management Team

SECOND QUARTER MARKET COMMENTARY

## FIXED INCOME

2021 has been a tale of two quarters for bond investors. The first quarter was all about inflation. Broadening vaccinations and economic reopening provided hope that the economy was on the path toward a self-sustained recovery. At the same time, policy makers agreed to deploy $1.9 trillion of additional economic stimulus. For investors, this combination fueled fear that the economy may be in jeopardy of overheating and, by the end of the first quarter, the chorus calling for faster inflation had reached a deafening pitch. As a result, bond yields rose sharply during the first quarter. So sharply, in fact, that the Bloomberg Barclays Aggregate Bond Index posted its worst quarterly return since the 1980s – a decline of 3.37%.

The good news for bond investors, however, is that many of the themes that dominated markets during the first quarter reversed during the second. At the heart of this reversal was a softening of investors' inflation fears. While official measures of inflation did confirm a bump in consumer prices, the underlying details of these reports were enough to convince investors that the rise in inflation may indeed prove temporary. As a result, market-based inflation expectations plateaued which put downward pressure on longer-dated bond yields. Commodity prices generally followed suit, including the highly publicized price of lumber which tumbled over 50% from its early May peak. In June, the FOMC further reinforced the "peak inflation" narrative by delivering a somewhat hawkish surprise to investors. The Fed's economic forecast, also referred to as the "dot plot", revealed two possible rate hikes in 2023 versus the previous forecast for just one the following year. As a result, longer-dated bond yields retraced about half of their first quarter increase and helped bond portfolios recuperate a meaningful amount of their first quarter losses.

While interest rates were volatile throughout the first half of this year, corporate bond spreads were not fazed. Spreads on the Bloomberg Barclays Corporate Bond Index tightened 11 basis points during the second quarter and now sit at their tightest level since 2005. First quarter corporate excess returns were driven by low-quality, cyclical, long duration sectors – all areas that our quality investment discipline seeks to avoid. While this was a modest headwind for relative performance during the first quarter, these areas no longer offer relative value versus their high-quality peers. As a result, spread tightening was more evenly distributed during the second quarter and was beneficial to relative performance. Additionally, we remain underweight Agency MBS relative to the benchmark, which was beneficial to performance during the second quarter. Agency MBS underperformed duration-matched Treasuries by 50 basis points, as investors grappled with the prospect of Fed Tapering which could lead to increased net mortgage supply. We continue to reiterate our tilt toward high-quality investment grade corporate bonds as a way to enhance the yield of portfolios, but do not expect meaningful spread tightening going forward. As always, we remain committed to our Quality Yield investment discipline, and seek to maximize portfolio yield, while never sacrificing our pledge to deliver a reliable hedge against risk asset volatility.

## ENHANCED EQUITY

Another quarter, another new all-time high for the S&P 500 as the index posted five straight monthly gains to close out the first half of the year. US large cap equities pushed +8.5% higher during the second quarter of 2021, bringing YTD performance for the S&P 500 index up to over +15.2% through the end of June. Performance by sector was broadly positive, with Real Estate and Technology leading the way, and only the Utilities sector generating negative returns.

The Enhanced Index strategy finished slightly ahead of its benchmark for the second quarter. While longer-term interest rates moderated as inflation fears subsided, short-dated (i.e. two-to-three year) interest rates jumped in June as the Fed's hawkish rate guidance pulled forward market expectations for the timing of the first interest rate hike. While this upward move in short-term rates was a headwind for the portfolio's bond performance, its impact was minimal and was more than offset by the income generated by the portfolio as well as tightening spreads on the portfolio's corporate bond positions. Futures contracts' cost-of-carry remains low, and an upward-sloping treasury and credit curve offers attractive total return potential for the portfolio's bond positions in the near-term.

## SMID CAP CORE EQUITY

Small and mid-cap companies have benefited greatly from economic reopening, vaccine administration, and fiscal stimulus. As a result, the Russell 2500 returned 5.4% in the second quarter, with YTD performance up 17.0% and 1-year performance ending 6/30 up a whopping 57.8%. SMID cap companies have outperformed their large-cap counterparts on a YTD and 1-year basis, giving up some ground in the 2Q as sentiment shifted. Our SMID Cap Core strategy outperformed the Russell 2500 by 0.5% net of fees during the second quarter.

Early in the quarter, inflation pressures continued to drive outperformance in many of the cyclical, value-oriented stocks. Inflation-linked asset classes performed well with both commodities and REITs outperforming the broader market. However, we saw a reversal of that mid-quarter as the Federal Reserve tilted more hawkish as the reflation trade cooled. This led to growth and technology outperforming in the second half of the quarter – similar to the 2020 market environment.

Our underweight to energy created a small headwind for our strategy, however our security selection proved to be additive in seven of ten allocated sectors. As 2020 saw the biggest returns for unprofitable, low-quality companies, 2021 sentiment has shifted toward a focus on rewarding strong company fundamentals – which is a landscape in which our high-quality strategy should outperform.

As the economy slows and normalizes from the unprecedented COVID shutdown and subsequent reopening environment, we believe that our Quality, Valuation, and Momentum approach to stock analysis will prove to outperform over the long-run and protect against downside risks. With uncertainty evident in the global economy as the Delta variant gains traction, vaccine administration is slowing, and fiscal and monetary stimulus potentially causing a fiscal cliff, we believe downside risk is an important consideration to be made in portfolios.

*†Beginning January 1. 2010, the firm was redefined as Johnson Institutional Management which only includes institutional client assets with a single asset mandate. In 2019, Johnson Institutional Management was renamed Johnson Asset Management (JAM).*

*Johnson Asset Management is a division of Johnson Investment Counsel, Inc. ("JIC"), an independent and privately owned Midwestern based investment advisory firm registered with the Securities and Exchange Commission. Johnson Asset Management manages institutional separate account portfolios for a wide variety of for-profit and nonprofit organizations, public agencies, public and private retirement plans, and personal trusts of all sizes. It may also serve as sub-adviser for mutual funds. JIC's fees are available upon request and may be found in our Form ADV Part 2A. Performance data quoted herein represents past performance. Past performance does not guarantee or indicate future results. All data is current as of June 30, 2021, unless otherwise noted. Returns and net asset value will fluctuate. To determine if this strategy is appropriate for you, carefully consider the investment objectives, risk factors, and expenses before investing. Individual account management and construction will vary depending on each client's investment needs and objectives. Investments employing JIC's strategies are NOT insured by the FDIC or by any other Federal Government Agency, are NOT Bank deposits, are NOT guaranteed by any Bank or any Bank affiliate, and MAY lose value, including possible loss of principal.*

*Johnson Asset Management claims compliance with the Global Investment Performance Standards.*

*The Institutional Core composite includes all fee paying, fully discretionary, actively managed institutional fixed income portfolios with a minimum value of $500,000 and an investment objective of broad investment grade, taxable fixed income, benchmarked against the Barclay's Capital Aggregate Index. The Barclays US Aggregate Bond Index is a broad-based flagship benchmark that measures the investment grade, US dollar-denominated, fixed-rate taxable bond market.*

*The Institutional Intermediate Fixed Income composite includes all fee paying, fully discretionary, actively managed institutional fixed income portfolios with a minimum value of $500,000 and an investment objective of broad investment grade, taxable fixed income securities with an intermediate average duration, benchmarked against the Barclay's Capital Intermediate G/C Index. The Barclays Capital U.S. Intermediate Government/Credit Index measures the performance of U.S. Dollar denominated U.S. Treasuries, government-related and investment grade U.S. corporate securities that have a remaining maturity of greater than one year and less than ten years.*

*The Short Duration Fixed Income composite includes all fee paying, fully discretionary, actively managed institutional fixed income portfolios with a minimum value of $500,000 and an investment objective of short duration, investment grade taxable fixed income. The benchmark for this composite is the Merrill Lynch 1-3 Year G/C Index. The Merrill Lynch 1-3 Year Corporate/Government Bond Index includes publicly issued U.S. Treasury debt, U.S. government agency debt, taxable debt issued by U.S. states and territories and their political subdivisions, debt issued by U.S. and non-U.S. corporations, non-U.S. government debt and supranational debt.*

*The Enhanced Index Composite is comprised of all discretionary equity portfolios with a portfolio value greater than $1 million and an investment objective of replicating the S&P 500 Index utilizing equity futures contracts and short duration fixed income securities. The benchmark for this composite is the S&P 500 Index, a broadly diversified large cap equity universe of U.S. companies.*

*JAM's policies for valuing portfolios, calculating performance and preparing compliant presentations, as well as a complete list of composite descriptions are available upon request. Please contact our office at 513.389.2770 or 3777 West Fork Road, Cincinnati, OH 45247.*

*All returns reflect the reinvestment of investment income (dividends and/or interest) and capital gains. Valuations and returns are stated in U.S. dollars. Trade date accounting is used. Portfolio returns are calculated using time weighed return methodology on a monthly basis. Net returns shown reflect gross performance less the highest fee schedule for this strategy.*

*Actual client returns would also be reduced by brokerage commissions, custodial fees, and other client paid expenses detailed in JIC's Form ADV Part 2A..*