

A QUARTER REVIEW:

Familiar themes dominated the US large cap equity market in the second quarter. The S&P500 hit another all-time high and has now posted returns well into the double-digits year-to-date. These returns were again driven by a handful of large cap stocks that have become an increasingly large portion of the market-cap weighted index. The so-called “Magnificent Seven” have returned about 33% year-to-date compared to a return of about 5% for the remainder of the Index. The Technology and Communication Services sectors were the standout performers for the quarter, while other sector returns were closer to flat.

While the bond market was essentially unchanged point-to-point during the second quarter, there was meaningful intra-quarter volatility. Rates rose in early April as the market continued to reassess the odds of rate cuts this year. By May, however, a string of weaker-than-expected economic data pushed rates lower and brought potential Fed easing back into focus. Most notably, the labor market has shown more convincing signs of normalization, with the unemployment rate cresting above 4% for the first time since November 2021. As a result, investment grade credit spreads closed the quarter up 9 basis points from their lows – the first quarterly increase in spreads since Q1 2023. By all accounts, the economy is far from a free fall, but perhaps high rates are starting to leave their mark.

PERFORMANCE SUMMARY:

The Enhanced Index Strategy returned 3.64% during the second quarter, underperforming the S&P 500’s 4.28% return. The primary driver of underperformance during the quarter were returns in the bond portion of the portfolio that failed to keep pace with the embedded cost-of-carry within its equity futures contract positions. While bond returns were positive, cost-of-carry also remains elevated, with the Federal Reserve likely at their peak policy rate for the cycle.

Within the bond portfolio, elevated levels of income pushed performance into positive territory for the quarter. In particular, the strategy’s focus on higher-yielding investment grade corporate bonds was additive to performance. Curve positioning detracted modestly from performance as rates rose and the curve steepened, which pressured prices of the strategy’s three-to-five-year maturities.

PERFORMANCE CONTRIBUTION

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INCOME	1.27%
DURATION	-0.33%
NON-PARALLEL	0.11%
OTHER RATES	-0.06%
SECTOR/QUALITY	-0.03%
SELECTION	-0.01%
FIXED INCOME RETURN	0.96%
S&P 500 FUTURES	2.77%

PERFORMANCE

	QTD	1YR	3YR	5YR	7YR	10YR
JOHNSON (GROSS)	3.73%	23.36%	6.55%	13.08%	12.91%	12.05%
JOHNSON (NET)	3.64%	22.97%	6.22%	12.74%	12.56%	11.71%
S&P 500	4.28%	24.56%	10.01%	15.05%	14.28%	12.86%

MARKET OUTLOOK AND PORTFOLIO POSITIONING:

We continue to adopt a more defensive outlook on the market and the economy. For several quarters, leading economic indicators such as the yield curve and the Conference Board's LEI's have been sending warning signs about a potential slowdown. Recently, labor market data has also shown signs of moderation, suggesting perhaps the Fed's restrictive policy stance is finally starting to cool economic growth. At the same time, credit spreads remain historically tight – further reinforcing more defensive portfolio positioning. As such, we believe a more defensive position is warranted within the bond portion of the Strategy. We continue to emphasize pockets of relative value, such as high-quality regional banks and select short duration BBBs. Additionally, we will continue to maintain an allocation to Agency MBS, which we consider an attractive high-quality corporate alternative. Finally, we have maintained an allocation to three-to-five-year treasuries, which ultimately should benefit from an easing cycle.

OUR ENHANCED INDEX STRATEGY TEAM:



Jason Jackman, CFA
Chief Executive Officer, Principal



Michael Leisring, CFA
Chief Investment Officer - Fixed Income,
Portfolio Manager, Principal



Brandon Zureick, CFA
Managing Director & Portfolio
Manager, Principal



David Theobald, CFA
Senior Portfolio Manager,
Principal



Ryan Martin, CFA
Portfolio Manager, Principal

Our primary objective is to outperform the S&P 500 Index with low tracking error and comparable volatility by replicating the Large Cap Equity market using Index Futures, combined with short duration investment grade Fixed Income securities.

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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