

A QUARTER REVIEW:

It's official! On September 18th, the Fed cut rates for the first time since the onset of the pandemic. Citing progress on inflation and concern over the outlook for the labor market, the Fed elected to lower rates by 50 basis points. As a result, bond yields rallied meaningfully throughout the quarter and the yield curve steepened. In fact, the two-year Treasury yield fell 111 basis points, compared to just 44 basis points on the long end. Despite the Fed's concerns about recent labor market softness, credit spreads tightened by 5 basis points during the quarter—an indication that the market remains confident in the Fed's ability to act swiftly and effectively to engineer a soft landing.

PERFORMANCE SUMMARY:

The Enhanced Index strategy returned 7.37% during the second quarter, outperforming the S&P 500's 5.89% return. The primary driver of outperformance during the quarter were returns in the bond portion of the portfolio that well exceeded the embedded cost-of-carry within its equity futures contract positions. Cost-of-carry remained elevated with the Federal Reserve still in restrictive territory, but gradually moved lower toward the end of the quarter as the Fed began reducing its short-term policy rate.

Within the bond portfolio, declines in yields boosted price returns well into positive territory and were a positive contributor to total return. In addition, the strategy's focus on higher-yielding investment grade corporate bonds was additive to performance. Curve positioning detracted modestly from performance, as the curve steepened in advance of the Fed's first cut to its policy rate.

PERFORMANCE CONTRIBUTION

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INCOME	1.25%
DURATION	1.15%
NON-PARALLEL	0.83%
OTHER RATES	-0.04%
SECTOR/QUALITY	0.05%
SELECTION	0.02%
FIXED INCOME RETURN	7.46%
S&P 500 FUTURES	4.21%

PERFORMANCE

	QTD	1YR	3YR	5YR	7YR	10YR
JOHNSON (GROSS)	7.46%	38.15%	8.96%	14.27%	13.36%	12.74%
JOHNSON (NET)	7.37%	37.71%	8.61%	13.91%	13.01%	12.40%
S&P 500	5.89%	36.35%	11.91%	15.98%	14.50%	13.38%

MARKET OUTLOOK AND PORTFOLIO POSITIONING:

We maintain a more cautious outlook on the economy than what is currently reflected in risk asset markets. While it's not immediately clear that a recession is imminent, current credit spread valuations appear disconnected from macroeconomic fundamentals. For instance, the latest ISM Manufacturing reading of 47.2, while not at recessionary lows, signals continued contraction. Historically, investment-grade spreads tend to exceed 150 basis points during periods when ISM Manufacturing consistently falls below 50. For context, there has only been one reading above 50 since October 2022.

In light of this, we continue to take a conservative stance in portfolios. We are reducing overall exposure to credit and shortening spread duration to limit the strategy's sensitivity to potential spread widening. At the same time, we have gradually increased the duration of our government bond holdings and have actively repositioned the strategy's key rate duration toward the belly of the yield curve. Even in a soft-landing scenario, we expect the Fed to lower rates to a less restrictive level, benefiting the short and intermediate segments of the yield curve and also reducing the cost-of-carry embedded in our futures contract positions.

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
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Senior Portfolio Manager,
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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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