

A QUARTER REVIEW:

SMID Cap stocks bounced back in the third quarter and turned the tables on Large Cap, with the Russell 2500 Index returning 8.75% and outperforming the S&P 500 by 2.86%, the largest margin since the first quarter of 2021. The market experienced a broad rotation, with underperformers turning into leaders: Value outperformed Growth, Small Caps outpaced Large Caps, and International markets rebounded against the U.S.

Within the quarter, market sentiment pivoted from recession anxiety and valuation fatigue early in the quarter to optimism that Federal Reserve interest rates cuts will increase the odds of a “soft landing”. If sustained, lower borrowing rates, contained inflation, and resilient employment growth could all help avoid a recession that has been long anticipated. While economic risk remains a very viable threat, the stock market appreciated the message that a major slowdown is not imminent yet.

PERFORMANCE SUMMARY:

The SMID Cap Core strategy delivered a net return of 10.53%, outperforming the Russell 2500 Index which returned 8.75%. Over longer trailing periods, including since inception, the portfolio continues to provide excess returns over the benchmark.

The broadening of the market was evident in sector performance, with 8 of the 11 market sectors beating the market. Energy was the sole laggard, falling as oil prices dropped 17% on weak demand, dipping below \$70 per barrel during the quarter.

The strategy's outperformance in the third quarter was driven primarily by security selection, with positive attribution across 7 of the 11 sectors. Many of the top performers were “quality cyclical” within the Technology, Industrials, Materials, and Energy sectors. The appeal of these stocks has been an improvement in the outlook for cash flow growth that an economic soft landing would bring, while at the same time having the financial strength and competitive position to navigate ongoing economic uncertainty.

TOP 5 PERFORMERS¹

	WEIGHT	RETURN CONTRIBUTION
HAWKINS INC	1.83%	1.20%
WILLIAMS SONOMA INC	1.33%	0.81%
LEIDOS HOLDINGS INC	1.77%	0.78%
LEMAITRE VASCULAR INC	1.35%	0.77%
AXIS CAP HOLDINGS LTD	1.83%	0.73%

TOP 5 DETRACTORS¹

	WEIGHT	RETURN CONTRIBUTION
DOUBLEVERIFY HOLDINGS INC	0.44%	-0.58%
AMN HEALTHCARE SERVICES INC	0.76%	-0.44%
CHARLES RIVER LABORATORIES INTL INC	1.67%	-0.29%
LKQ CORP	1.32%	-0.24%
COMMUNITY HEALTHCARE TR INC	0.71%	-0.23%

TOP TEN HOLDINGS²

NAME	% OF PORTFOLIO
AXIS CAP HOLDINGS LTD	2.01%
HAWKINS INC	2.00%
APPLIED INDUSTRIAL TECHNOLOGIES INC	1.92%
SMITH A O CORP	1.92%
WINTRUST FINANCIAL CORP	1.91%
DYNATRACE INC	1.80%
UNITIL CORP	1.79%
WORLD KINECT CORPORATION	1.77%
AVERY DENNISON CORP	1.77%
CHEMED CORP	1.75%

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.

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MARKET OUTLOOK AND PORTFOLIO POSITIONING:

The rotation observed in the quarter presents optimism for the SMID Cap space, which continues to trade at a significant discount to Large Cap stocks. The strategy's outperformance amid this shift signals that the portfolio is well-positioned for a soft landing scenario and a continued market broadening.

The start of a Federal Reserve easing cycle has been a nice tailwind to valuation, but sustained returns will likely require an acceleration in earnings growth. That growth has yet to materialize in 2024, with Russell 2500 earnings growth slipping by 1% in the 1st half of the year. Estimate revision trends have been negative, creating a challenge to turn that growth positive in the second half. But next year's growth prospects look brighter with expectations for more than 20% EPS growth in 2025, something an accommodative monetary policy can help support. If SMID Cap earnings growth materializes as expected, it would likely outpace Large Cap's growth, and the space could see extended outperformance.

During the quarter, the team adjusted several positions to stay consistent with the portfolio discipline. Part of the reason why the Russell 2500 is not as concentrated as the large cap indices is due to an annual rebalancing process at Russell that moves stocks out of the Index as they grow into a large cap size. While the SMID Cap Core strategy is comfortable holding stocks that are above the Index's market cap boundary, the team seeks to preserve its SMID Cap focus and, in the quarter, actively reduced positions in a handful of Mid Cap stocks that have become more fully valued and have started to outgrow the range.

Despite the recent market optimism driven by soft landing expectations, the team remains vigilant about the risks of an economic slowdown. Considering this, a few holdings with weakening quality profiles that could face stressed cash flows or balance sheets in a severe downturn were sold in favor of adding weight to higher conviction stocks. Quality is the foundation of our investment discipline, and we are committed to preserving a high-quality profile in the portfolio, regardless of the economic outlook.

	PERFORMANCE					
	QTD	1YR	3YR	5YR	7YR	10YR
JOHNSON (GROSS)	10.80%	29.49%	9.65%	12.81%	10.96%	10.82%
JOHNSON (NET)	10.53%	28.22%	8.56%	11.69%	9.86%	9.72%
RUSSELL 2500	8.75%	26.17%	3.47%	10.43%	9.02%	9.50%

OUR SMID CAP CORE STRATEGY TEAM:



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



Bryan Andress, CFA
Senior Research Analyst,
Principal



Chris Godby, CFA
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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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