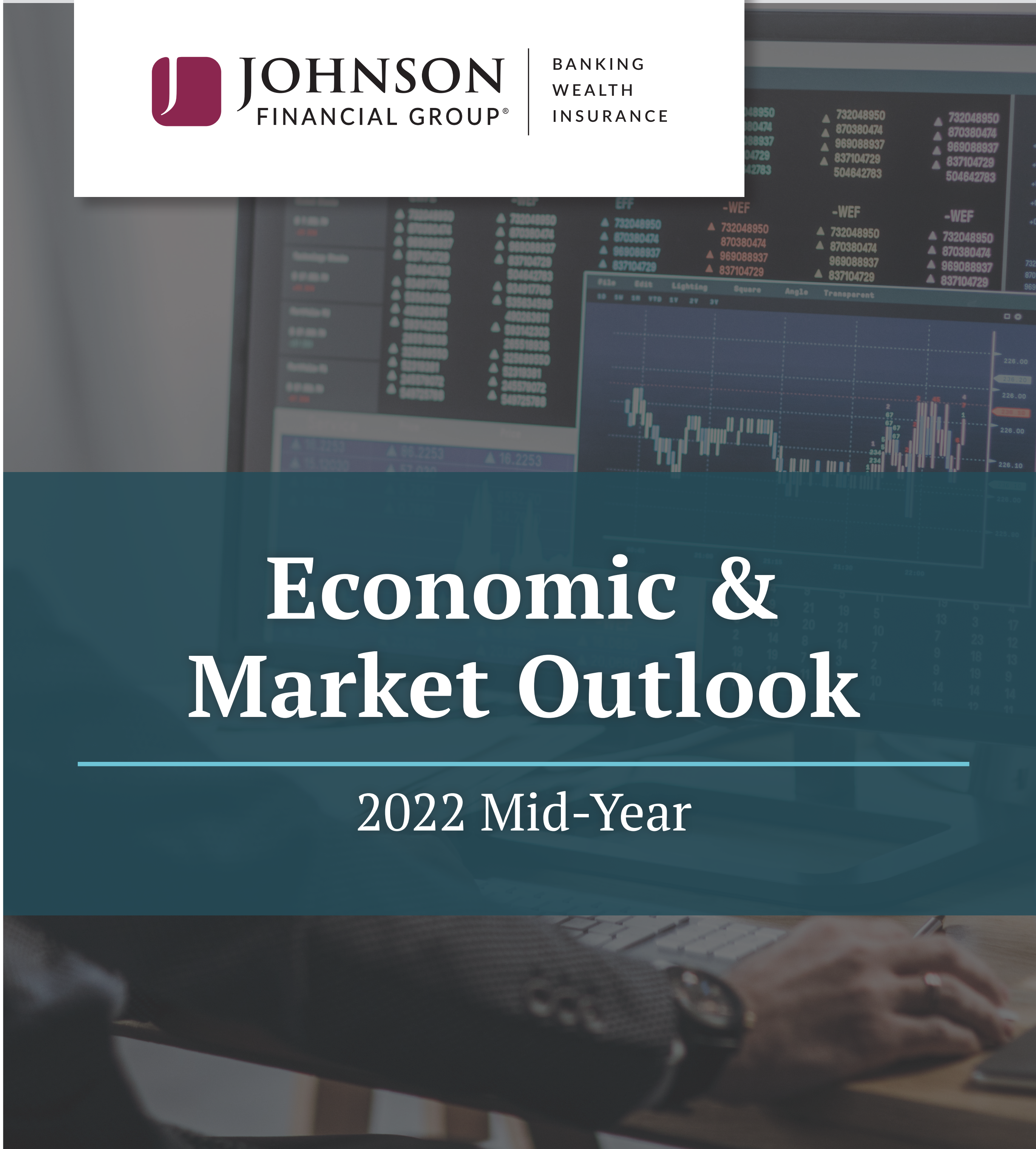

JOHNSON FINANCIAL GROUP®
BANKING
WEALTH
INSURANCE

Economic & Market Outlook

2022 Mid-Year

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Executive Summary

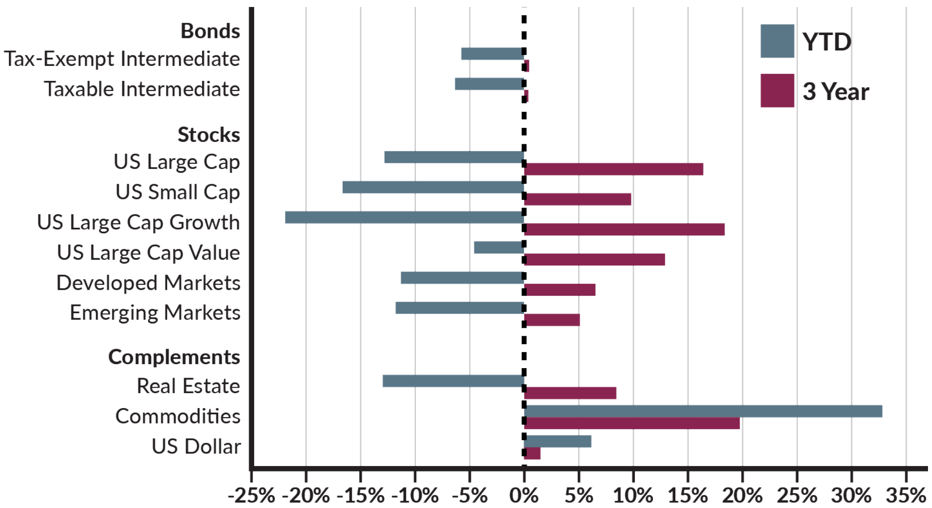
With hindsight we should be unsurprised we'd have a different sort of recovery given the circumstances surrounding the pandemic. The sharp decline in economic activity when parts of the economy were shut down was followed by a tidal wave of demand as the economy reopened. Supply chains were unprepared for the surge in demand bolstered by unprecedented monetary and fiscal policy support. Add a war in a region that supplies food and energy to much of the world and you have a recipe for high inflation.

The consequences of high inflation led to high volatility in financial markets as investors reprice assets for the new environment **[Figure 1]**. Bond prices have declined at one of the fastest rates in history, because interest rates are rising from such a low level. Interest rates are moving higher after reaching historic low levels during the pandemic. Stock prices are adjusting from a Goldilocks period a year ago with ample demand and low interest rates to a period of high uncertainty surrounding earnings given slowing economic growth and high inflation.

Figure 1

Three Year vs. Current Year Performance

As of May 31, 2022



Source: Morningstar Direct

While volatility will be with us for the foreseeable future, we are confident the economy, companies and markets will adjust to the new environment as they have in the past.

The Economy

- Economic growth is slowing after the post-pandemic reopening boom. While recession risks are rising, economists expect real gross domestic product (GDP) growth of 2.6% in 2022 after the 5.7% boom in 2021. Note this is similar to the long-term average before the pandemic began.
- Inflation appears to be in the process of peaking. We expect the rate of inflation to gradually decline over the next year, although the level may remain above the Fed's 2% target for years.

Fixed Income

- The increase in interest rates over the past year has led to large paper losses in the bond market. The decline reverses the large gains that took place in 2019 and 2020, leading to a flat three-year return. However, investors can also now benefit from much higher yields.
- Markets expect the Fed, in its fight against inflation, to raise the Fed Funds rate above 3% by the end of the year.
- Higher interest rates provide an opportunity to invest in bonds; our focus is on Treasuries and high-quality corporate bonds.

Equity Markets

- Many stock market indices are in bear market territory after an early June swoon in reaction to a hot inflation report and faster than expected pace of Fed rate hikes.
- The impact from higher interest rates and the war in Ukraine appear to be largely "priced in" to stocks. Uncertainty remains about the impact on earnings, which will be the linchpin for the remainder of the year.
- Our base case is for volatility to continue until the outlook for growth and inflation is clarified. Upside potential lies in the potential for resilient earnings, inflation rolling over and a resolution in Ukraine. Downside risk focuses on continued slowing economic and earnings growth from persistent inflation and rising interest rates.

Portfolio Positioning

- The market decline has led us to add to stocks after the recent sell-off. Earlier changes to the stock portfolio included a reduction to small cap stocks due to greater economic sensitivity and to international stocks based on the uncertain long-term impact from the war in Ukraine on Europe.
- We are underweight bonds based on an outlook for rising interest rates. Recent changes include extending the duration of the portfolio to take advantage of high interest rates and increasing the quality of the portfolio by reducing corporate bonds in favor of Treasuries.
- Where appropriate, we have used complementary asset classes to add diversification and alternative sources of income. The portfolio has exposure to private debt, real assets, real estate and hedge funds.

While volatility will be with us for the foreseeable future, we are confident the economy, companies and markets will adjust to the new environment as they have in the past.

Economic Outlook

Oh, what a difference a year makes! Looking back at the first quarter of 2021, the US economy was coming out of the pandemic and growth was surging. Year over year GDP was up over 12%. The massive fiscal stimulus package boosted disposable personal income by 17% year over year. With limited travel options, consumers were using this boost in their pocketbooks to buy a lot of "stuff." Furniture, electronics, household consumer goods, kitchen appliances, online spending…etc.…all experienced significantly increased sales early in 2021. The fiscal stimulus "injection" was driving robust growth.

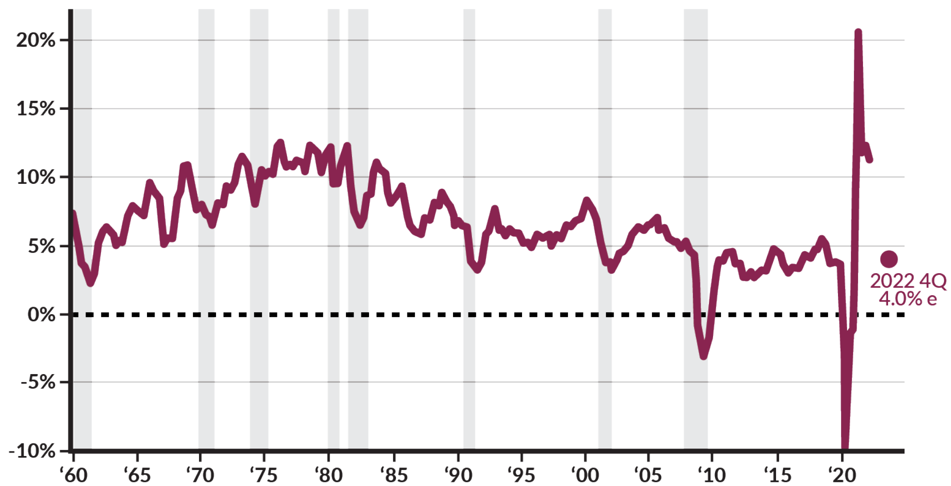
Moving the clock forward to today, we have experienced some significant changes. First, the fiscal stimulus tailwind that helped boost personal income and spending has started to fade. The 17% increase in personal income that we experienced last year has morphed into a 6% relative decline during the first quarter of 2022 **[Figure 2]**. In addition, real consumer spending has been under pressure due to significant inflation. These consumer pressures have translated to corporate earnings as several major retailers across a variety of sectors have announced inventories are too high and consumer behavior may be changing.

The impact of the slowing demand and cost pressures on earnings is starting to show in employment data as well. While the overall labor market is still quite strong, initial unemployment claims were recently reported at the highest level in approximately 20 weeks, and the softening market is starting to impact wages as average hourly earnings growth has been slowing consistently in 2022.

Figure 2

U.S. Nominal Consumer Spending

Y/Y% 2022:1Q:11.2%e



Source: Piper Sandler

Clearly the economy is slowing, but the key question from an investment perspective is "how slow do we go"? Our base case is that economic growth continues to slow yet we avoid falling into a recession in 2022 **[Figure 3]**. However, risks to the base case are skewed to the downside. Consumer and business confidence is falling sharply, and the snowball effect could lead to a sharper downturn than we currently expect. As always, exogenous impacts from events such as the war in Ukraine, Covid changes, or an unexpected pivot by the Federal Reserve could have a material impact on the outlook.

Inflation continues to be a major concern and is currently running at rates not experienced in the United States since the early 1980s. There are wide ranging opinions about whether inflation is peaking and how long it might take for inflation levels to return to normal.

The overall consumer price index (CPI) is broadly grouped into six components including: Food, Energy, Commodities (excluding food and energy), Shelter, Medical Services and Transportation Services **[Figure 4]**. To frame the inflation outlook, let's look more closely at three of the major components that make up the CPI.

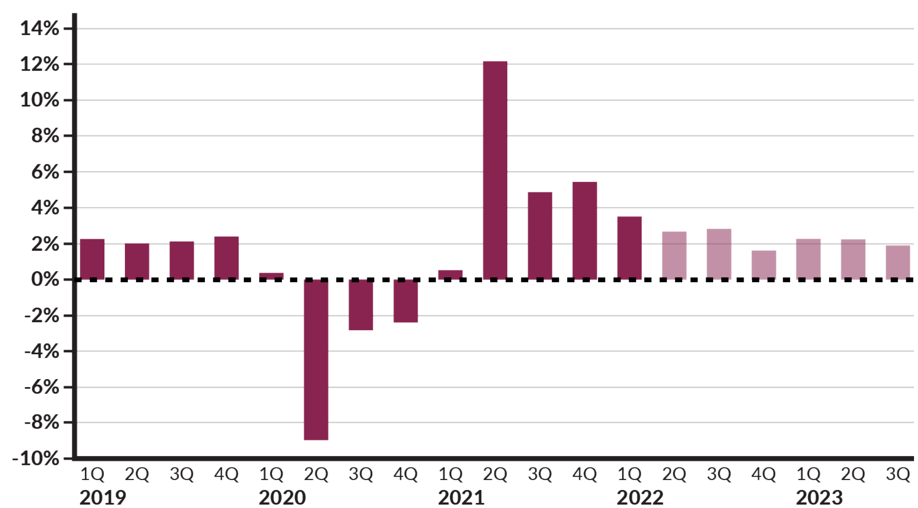
- Shelter (32% of CPI): Significant price increases coupled with higher mortgage rates have resulted in housing affordability metrics at their lowest level since 2006. We anticipate home prices will stabilize, and possibly decline, which will be a headwind for inflation.
- Commodities less Food and Energy (22% of CPI): Auto prices have sharply escalated due to chip shortages and consequent manufacturing slowdowns. The chip shortage is beginning to subside, and manufacturing output is returning to pre-crisis levels, which should result in downward pressure on inflation.
- Energy (8% of CPI): There is no immediate relief in sight for energy prices, and this should continue to drive higher inflation. However, higher consumer spending on energy reduces discretionary spending on other items, partially offsetting the inflationary impact.

Given the expected slowdown in these major components of the CPI, we believe inflation is in the process of peaking. Although it will take time, these changes should reduce prices levels over the coming months, and we expect the rate of inflation to gradually decline over the next year.

Figure 3

Real GDP Year/Year Change

Quarterly, SAAR

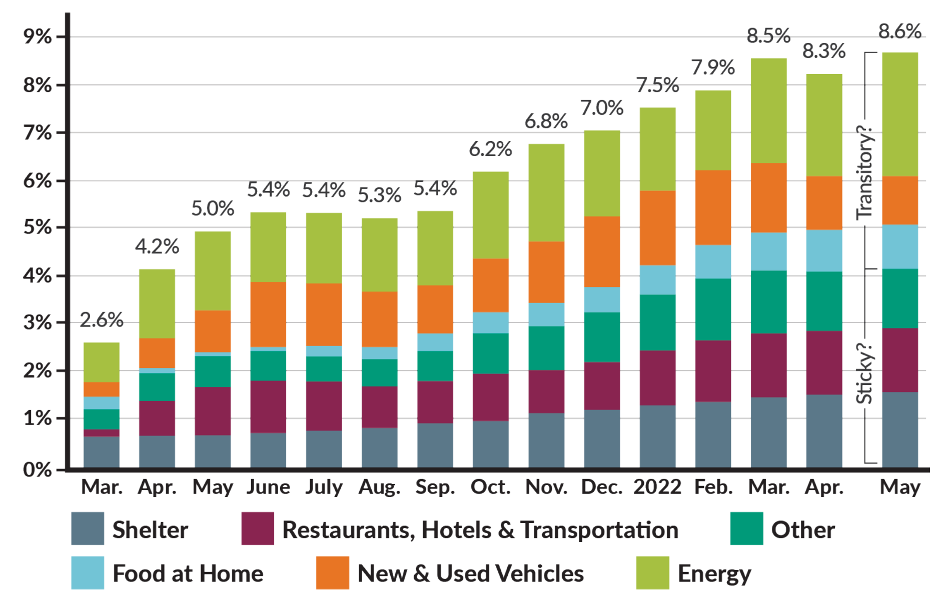


Source: Bloomberg

Figure 4

Contributions to Year/Year Change in CPI

March 2021 to May 2022



Source: U.S. Bureau of Labor Statistics, J.P. Morgan Asset Management

Fixed Income

Preparing not Predicting

High inflation is something most economies haven't experienced in decades, which raises the question of whether persistent high inflation is going to force the Federal Reserve to raise interest rates so high that it induces a recession. This is sometimes referred to as a "policy mistake." But the evidence is increasingly clear that the Fed already made a mistake by maintaining accommodative monetary policy far too long, even as asset prices and inflation soared.

With a Fed determined to slow demand to quash inflation, long-term inflation expectations have been declining.

We can criticize the Fed with the benefit of hindsight, but answering the recession question remains difficult. History tells us that recession risks are rising as financial conditions tighten—but that a contraction is not guaranteed. The Fed avoided a decline into recession after raising rates in 1984 and 1994. Today we have seen a slowdown in rate-sensitive areas of the economy such as housing, but rising rates' impact on corporate profits has yet to play out.

We may not be able to predict a hard or soft landing during this cycle, but we can prepare. Within fixed income, that means moving up in quality and stepping a bit farther out the curve as bond yields reach multi-year highs and forward returns look increasingly attractive.

Are Yields Peaking?

The consumer price index increased 8.6% in May, a higher-than-expected increase that raised concerns inflation may still not have peaked. Treasury yields shot up in response, with two, five, and 10-year yields all moving above 3% **[Figure 5]**. That represents an extraordinary 2.25 percentage point increase in the two-year yield just since the beginning of the year, while the five-year Treasury yield reached its highest level since 2008.

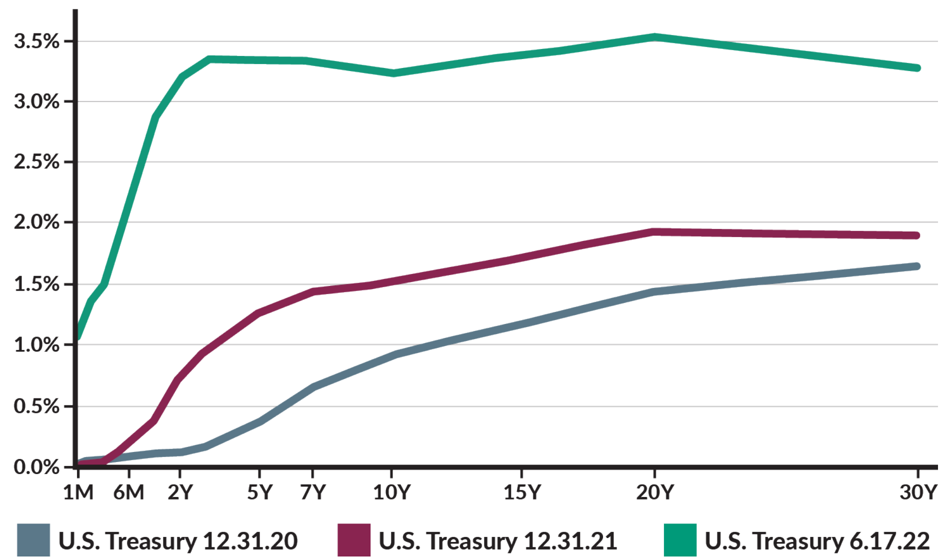
Short-term rates typically rise faster than long-term rates during hiking cycles because the former reflect current Fed policy while the latter reflect the long-term consequences of that policy. We expect that trend to continue and result in a flatter yield curve over the course of the year.

With a Fed determined to slow demand to quash inflation, long-term inflation expectations have been declining from peak levels seen earlier in the year. The 10-year TIPS (Treasury Inflation Protected Securities) breakeven level is now about 2.6%, significantly lower

Figure 5

Treasury Yield Curves

December 2020, December 2021, & June 2022



Source: Bloomberg

than the two-year breakeven rate of 3.9%. While both levels exceed the Fed's 2% inflation target, investors continue to expect today's extraordinary price pressure to abate as restrictive monetary policy begins to take hold.

Fed funds futures, which represent market expectations of where the federal funds rate will be in the future, provide another way to analyze the path of interest rates. **[Figure 6]** Markets are betting that a hawkish Fed will raise the fed funds rate to over 3% by year-end, about 2% higher than the current rate. Markets expect this key short-term rate to peak near 3.5% in 2023 before falling in 2024. This means that investors anticipate the Fed to begin cutting rates again within the next two years.

In another sign yields may be peaking, real, or inflation-adjusted yields, have turned positive for the first time since 2019. Over the past decade, 10-year real yields have ranged between 1% and -1% **[Figure 7]**. Real yields were negative in 2020 and 2021 with anticipated inflation exceeding Treasury yields. Now, the 10-year Treasury yield exceeds long-term inflation expectations by about 0.63%.

With the Fed laser focused on fighting inflation and economic growth forecasts declining in response, we believe it's time to start buying bonds a bit farther out on the yield curve. Yields could rise a bit more, but starting yields are highly correlated with future returns, and today's yields of 3%-4% provide a cushion of income to offset further price declines.

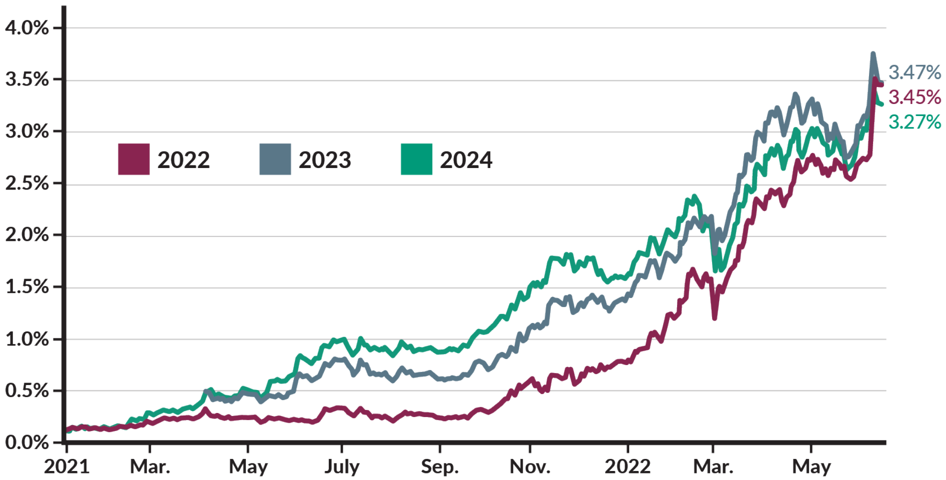
Better Returns Likely Ahead

The word "unprecedented" has been invoked endlessly over the past two years as policymakers injected massive amounts of liquidity into the financial system. Now they are tasked with removing that stimulus amid uncomfortably high inflation. As Fed Chairman Jay Powell noted, "the process of getting inflation down to two percent will… include some pain."

Figure 6

Implied Fed Funds Rate

December futures

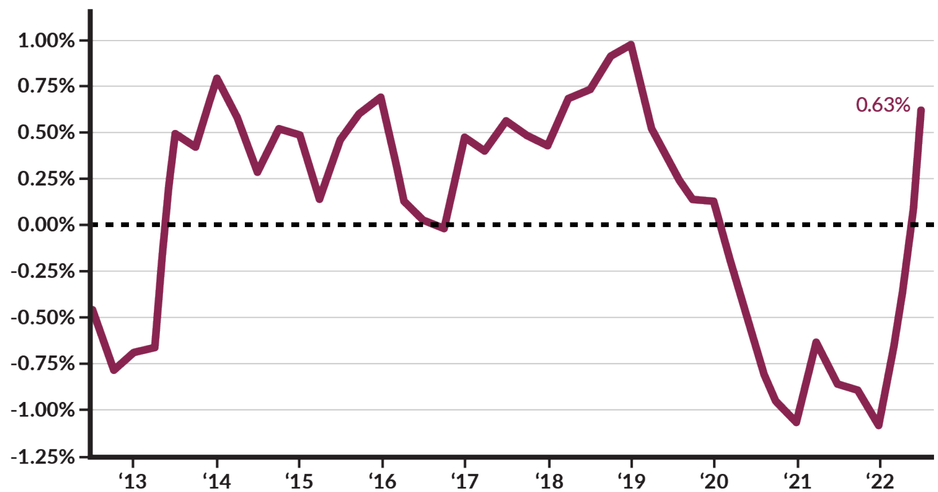


Source: Bloomberg

Figure 7

10 Year U.S. Treasury Real Yield

June 10, 2012 to June 10, 2022



Source: Bloomberg

So far investors have been the ones feeling the pain as stock and bond prices fall in concert. We believe that most of the pain for bond investors is behind us and that we could be in for better returns as investors begin to focus on risks to economic growth and corporate profits. As growth slows, safe cash flows become more attractive to investors concerned about preserving principal.

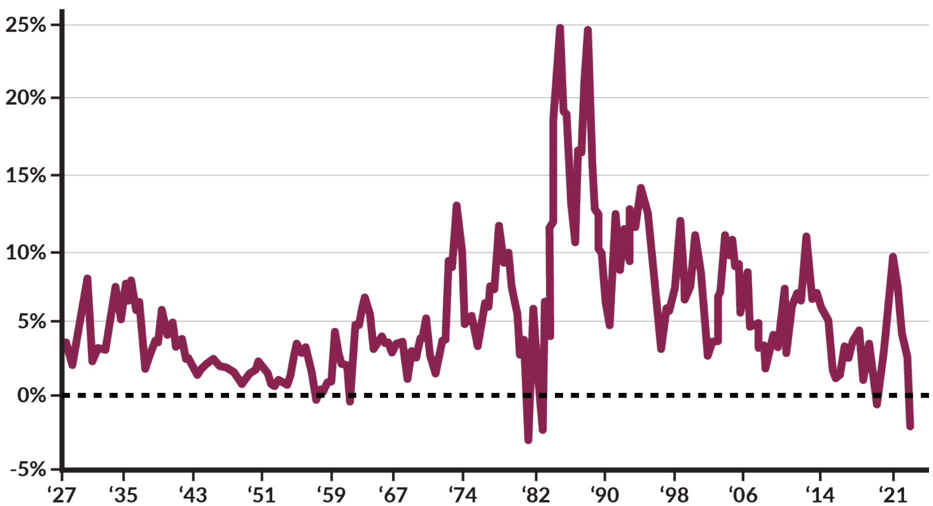
Consecutive years of negative returns are rare in the bond market and forward returns after such periods can be strong **[Figures 8 and 9]**. We want to be invested in high-quality fixed income instruments when this reversal takes place. That means trimming exposure to below investment-grade issuers while modestly extending the average maturity of our holdings to take advantage of higher yields farther out the curve.

Three years ago, 30% of global bond yields were negative. Two years ago, 10-year Treasuries paid less than 1%. Bond investors have been waiting years for a better opportunity. We recommend taking advantage of today's opportunity set in quality fixed income. It may not last.

Figure 8

Two Year Rolling Returns for U.S. Bonds

Average annual two year returns



Source: BlackRock Student of the Market April 2022, Morningstar and Gallup as of 3.31.2022

Equity Markets

Stocks Volatile Amidst Uncertainty

The stock market is off to a poor start this year due to the impact of high inflation, rising interest rates and geopolitical events. Like the changes in the bond market, expectations have been changing quickly. Stock market volatility has followed suit. Through the first five months of the year, the S&P 500 Index has experienced 33 daily moves up or down at least 1%, which equates to a 1% move once every five days. We expect volatility to remain high until the outlook for growth and inflation is clarified.

There has been nowhere to hide, with all major stock market indices and all but the energy sector declining through mid June. As of the end of May, U.S. stocks were down 13% year-to-date with international stocks faring slightly better down 11% despite the impact of the war in Ukraine. A hot inflation report, however, triggered a sell-off that has taken most indices into bear market territory.

Figure 9

Worst Two Year Peroids for U.S. Bonds

MONTH	U.S. BONDS	NEXT 2 YEARS
March 1980	-3.1%	11.4%
August 1981	-2.7%	23.0%
March 2022	**-1.8%**	**?**
August 1956	-0.8%	3.1%
December 1959	-0.8%	6.7%
July 2018	-0.8%	9.1%

Source: BlackRock Student of the Market April 2022, Morningstar and Gallup as of 3.31.2022

From a style perspective, value-oriented strategies have held up better than growth-oriented strategies, reversing a trend that has been in place for most of the past decade. The return differential between value and growth tends to come down to sector composition. Value strategies have more exposure to the financial, healthcare and energy sectors, which have been more resilient in the current environment of rising interest rates and higher oil prices. Growth strategies, on the other hand, have more exposure to technology and consumer discretionary sectors, which have suffered as expectations reset for many of the pandemic winners. **[Figure 10]**

Figure 10

MAJOR MARKET INDICIES		LAST 3 YEARS	CY 2021	YTD
S&P 500		16.4%	28.7%	-12.8%
Russell 1000 Growth		18.3%	27.6%	-21.9%
Russell 1000 Value		12.8%	25.2%	-4.5%
Russell 2000 (small-cap)		9.7%	14.8%	-16.6%
MSCI ACWI Ex USA		6.5%	7.8%	-10.7%
MSCI EM		5.0%	-2.5%	-11.8%
S&P 500 SECTORS	**WEIGHT**			
Energy	**4.8%**	20.6%	54.6%	58.5%
Utilities	**3.0%**	12.1%	17.7%	4.7%
Consumer Staples	**6.5%**	13.7%	18.6%	-3.2%
Materials	**2.8%**	20.2%	27.3%	-4.7%
Health Care	**14.4%**	17.1%	26.1%	-5.8%
Financials	**11.2%**	13.4%	35.0%	-8.8%
Industrials	**7.8%**	11.6%	21.1%	-10.1%
Real Estate	**2.8%**	10.2%	46.2%	-14.1%
Technology	**27.1%**	26.3%	34.5%	-19.4%
Communications	**8.8%**	9.7%	21.6%	-24.4%
Consumer Discretionary	**10.9%**	12.2%	24.4%	-24.7%

Source: Morningstar Direct as of 5.31.2022.

What's Priced into Stock Prices?

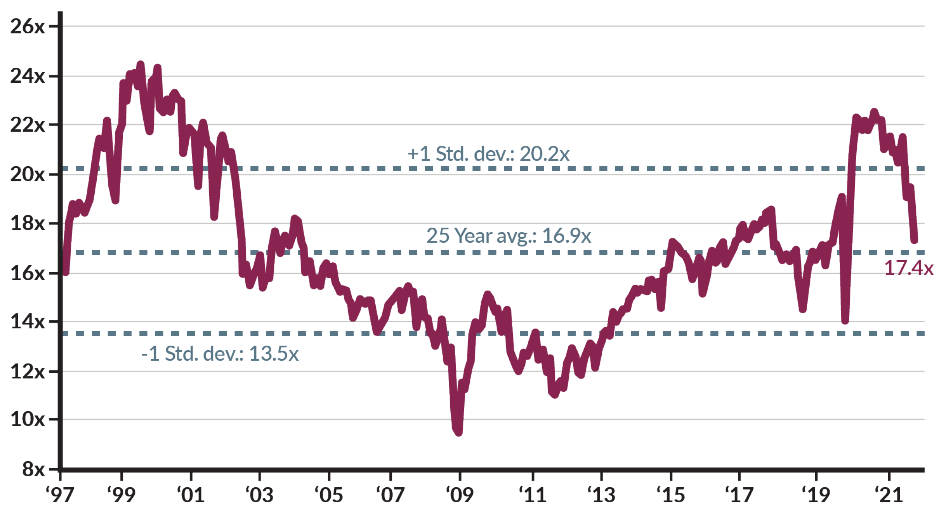
One question we routinely hear from our clients is the degree to which the risks are "priced in" to stock prices. For starters it is important to consider that it can take up to six months for new risks like a change in the Fed's interest rate policy or a geopolitical event to be "priced in" to market prices. We do believe that the year-to-date decline in the S&P 500 Index largely incorporates the increase in interest rates to 3% and the immediate impact of the war in Ukraine.

One way to visualize the positive sentiment that had been embedded in the stock market coming into the year—versus the level of bearishness in place today—is a chart of price to earnings (P/E) ratios for the S&P 500 Index **[Figure 11]**. Since the beginning of the year, the P/E ratio of the S&P 500 Index has declined from about 21.5x to 17.3x at the end of May and closer to 16x earnings after the June swoon, demonstrating that investors require a higher expected return (lower valuation) to invest in stocks based on the uncertainty being faced.

Figure 11

S&P 500 Index: Forward P/E Ratio

As of May 31, 2022



Source: FactSet, Refinitiv Datastream, Standard & Poor's Thomson Reuters, J.P. Morgan Asset Management

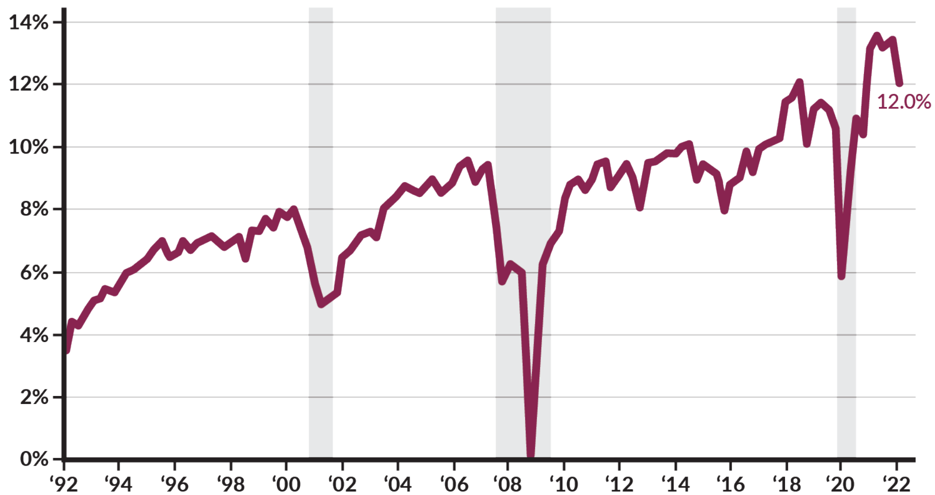
The decline in valuations is largely due to a change in prices, as earnings expectations have been fairly stable. We believe the risk from current levels relates to earnings expectations. We will be listening to companies for signs of weakness in demand (sales) and profitability (margins) due to high inflation and normalization of economic activity.

[Figure 12] Illustrates the surge in profitability in recent quarters and the normalization that is beginning. A recent example includes an update from Amazon indicating that it grew their distribution network too aggressively in the past year. In similar fashion, Walmart and Target miscalculated consumer trends and reported that inventory is too high, which is bad for future profits even if it is good for those in need of a grill or patio furniture! If demand (sales) and profit margins normalize, we may be in for a period of slow earnings growth or even a mild recession, albeit from elevated levels of economic activity.

Figure 12

S&P 500 Profit Margins

Quarterly operating earnings & sales



Source: BEA, Compustat, FactSet, Standard & Poor's, J.P. Morgan Asset Management as of 5.31.2022

While the downside case is gloomy, it is important for investors to keep a few points in mind.

1. The year-to-date decline is following a period of ***above average returns*** for the stock market. Even including this decline, the S&P 500 has averaged a return over 14% per year over the past 10 years.

2. If the recession is on the mild side, the resulting bear market would likely be in the group of historical bear markets that declined ***less than 40%***. The average recovery time for these bear markets is 31 months, and if the 1946-1949 Post-War bear market is removed, the average recovery time ***drops to 24 months***. This means that we may be making new highs by early 2024.

3. ***It is important to be humble with respect to market timing.*** Even if we experience a mild recession, investors may look past what may be a short-term earnings impact. This means that the low in stocks may already be behind us or could be anytime in the next few quarters.

4. Furthermore, it is important to remember that ***volatility is very high in the period around a bear market low.*** Stocks often fall precipitously to the ultimate low and then rally strongly in the early days and weeks after the low. Therefore, the market timing risk is ***high for long-term investors*** as it is a challenge to identify the right time to buy back into the market.

5. Finally, from a long-term perspective, an investment in stocks should have ***at least a five-year investment horizon***. For most investors, the amount invested in stocks should ***not be needed for 10 years*** or maybe never. This is one of the many intersections between your investment portfolio and your financial plan.

Figure 13

Bear Markets & Recovery

Sorted by decling percent

PEAK	TROUGH	DECLINE	RECOVERY	MONTHS	EVENT
9.1929	6.1932	**86.2%**	3.1937	**78**	Crash of 1929, 1st pt. Great Depression
3.1937	4.1942	**60.0%**	5.1946	**76**	2nd pt. Great Depression, WWII
10.2007	3.2009	**56.8%**	2.2020	**148**	Global financial crisis
6.1911	12.1920	**51.0%**	12.1924	**161**	WWI, Post-war auto bubble burst
3.2000	10.2002	**49.1%**	10.2007	**89**	Dot-com bubble burst
1.1973	10.1974	**48.2%**	8.1987	**163**	Inflationary bear market, Vietnam, Watergate
11.1968	5.1970	**36.1%**	1.1973	**50**	Start of inflationary bear market
1.1906	10.1907	**34.2%**	8.1908	**31**	Panic of 1907
2.2020	3.2020	**33.9%**	3.2020	**2**	COVID-19 crash
8.1987	10.1987	**33.2%**	7.1990	**35**	Black Monday
4.1899	6.1900	**60.4%**	3.1901	**12**	Cornering of Northern Pacific Shock
5.1946	6.1949	**29.6%**	8.1956	**123**	Post-war bear market
12.1961	6.1962	**28.0%**	2.1966	**51**	Height of Cold War, Cuban Missle Crisis
10.1892	7.1893	**27.3%**	3.1894	**17**	Silver agitation
11.1886	3.1888	**22.0%**	5.1898	**19**	Depression, railroad strikes
4.1903	9.1903	**21.7%**	11.1904	**19**	Rich Man's Panic
8.1897	3.1898	**21.1%**	8.1898	**12**	Outbreak of Boer War
9.1909	7.1910	**20.6%**	2.1911	**17**	Enforcement of the Sherman Anti-Trust Act
5.1890	7.1891	**20.1%**	1.1892	**20**	Barings Brothers Crisis
	59 MONTHS	AVERAGE ALL PEROIDS			
	31 MONTHS	*AVERAGE BEAR MARKETS LESS THAN 40%			
	119 MONTHS	AVERAGE BEAR MARKETS GREATER THAN 40%			

*24 months excluding 123 month recovery period in the Post-war Bear Market in 1946-1956

Source: Bank of America Global Investment Strategy, Ibbotson, SBBI Yearbook, Bloomberg

How Bad Could It Get?

This leads to the question on most of our minds: how far might stocks fall if earnings disappoint? Using Target as an example, the stock declined over 30% in the days after the announcement. Amazon and Walmart also declined significantly after providing their own version of disappointing guidance.

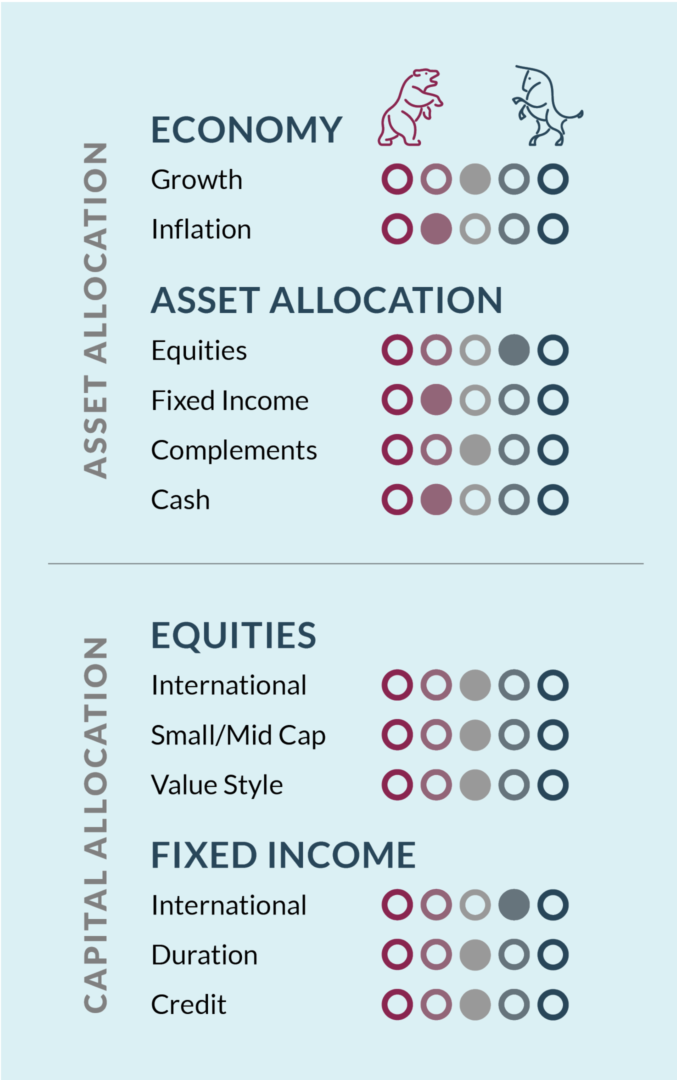
While it is difficult to put specific numbers to upside and downside potential, below is an attempt to frame our base case, upside case and downside case over the balance of the year.

- **Base case:** Stocks trade in a wide trading range as fundamentals (earnings) catch up to prices. In this scenario stocks would not trade significantly lower than the -20-25% year-to-date decline nor would we make new highs this year.
- **Upside case:** Inflation slows in line with current consensus forecasts, which would give the Fed flexibility to slow the pace of rate hikes if growth concerns emerge. A satisfactory to markets conclusion of the war in Ukraine would also be a positive surprise. In this scenario, stocks may recoup a large portion of year-to-date losses in the next few quarters.
- **Downside case:** Inflation remains high and the Fed is forced to keep raising interest rates to fight inflation, which may lead to a shallow recession by mid-2023. In this scenario, earnings estimates would likely be revised lower and investors may further discount the P/E ratio they are willing to pay during a lengthened period of uncertainty. In this scenario, stock prices may track the typical recessionary peak-to-trough bear market declines in the 25-40% range, which would mean we're about halfway through the pain **[Figure 13]**.

Portfolio Positioning & Summary

Whether you get your news from the internet, television news channels or old-school newspaper, we are inundated daily with massive amounts of information. While the news creates the daily fluctuation in markets, it is important to separate what is part of a short-term cycle and what might have a long-term impact to your portfolio and financial future.

As we have discussed, the most critical topic right now is inflation and the war in Ukraine that has exacerbated price levels and could have long lasting geopolitical implications. These issues have impacted all aspects of the economy, and the very real costs have been experienced by all of us. Inflation is running well above average with May hitting a new high of 8.6%. To fight inflation, the Federal Reserve has taken an aggressive stance



by raising interest rates, which has put pressure on bond prices. Our approach has been to underweight fixed income not only because we believe equities will ultimately present more opportunity but also to protect against higher interest rates.

The Russia-Ukraine war is impacting the volatility of global equity markets. Our strategy has been to tilt our portfolios to equities vs. fixed income; however, within that equity sleeve we have repositioned based on changes to our outlook. We have reduced small company exposure given small company stocks' tendency to underperform as the economy slows. We also reduced international equity exposure given the unknown geopolitical risks that can develop from war.

The allocation to complements is designed to provide an alternative source of income in a period of low interest rates and diversification to traditional stocks and bonds. While traditional stock and bond markets have experienced large declines, our complements sleeve is, on the whole, down only in the low single digits. That's largely because the complements are less sensitive to inflation. In fact, inflation beneficiaries such as real assets and investments resilient to rising rates such as floating rate bonds and certain hedge funds have benefited the portfolio.

Finally, in periods of high volatility portfolios have historically benefited from a more active rebalancing policy. This triggers trims of stock after large rallies and adding exposure after large declines. This process is based on market history and helps us to limit the mistakes that are often made when emotions are running high.

While volatility in the stock and bond markets is likely to remain high in the coming months, economic growth has been strong in the first half of 2022, and our base case assumption is for continued growth in the second half of the year, although at a slower pace.

Let's start a conversation

Your Johnson Financial Group team is here to help you understand this complex and ever-changing economic landscape. We aim to position your portfolio with the flexibility to navigate this volatility while also meeting your financial goals. We understand these times can be very stressful but hope you take comfort in having an experienced and dedicated financial team working specifically for you. **Thank you for your partnership and trust in Johnson Financial Group.**