Quarterly Insight

Johnson Private Client Group | Johnson Trust Company | Johnson Institutional Management

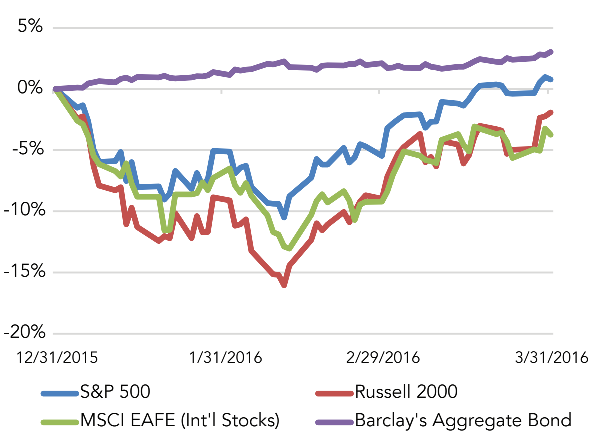
First Quarter 2016

Market Update

On March 9th, the bull market in stocks reached its seventh anniversary. Over the seven years, the S&P 500 Index gained more than 240%, an annualized return of more than 19%! Much has happened during that time, but despite a few corrections along the way the bull market has remained intact. The market weathered various storms, including the European debt crisis, the "flash crash," the U.S. debt downgrade, a handful of economic growth scares, surprise currency devaluations, the Arab Spring, and the U.S. government shutdown. None of these events derailed the bull market. Looking ahead, investors are confronting a number of questions, and we address several of them in this article.

Q. The market got off to a bad start this year. Even though it has recovered, it has remained volatile. What do you expect from the market for the rest of this year?

A Volatile Quarter



Source: Bloomberg

A. Seven years into the bull market, stocks are trading close to record highs. At the same time, a number of headwinds have gained attention, creating doubts about the market's ability to go higher. This is a recipe for volatility because markets are quick to react to disappointing news or economic data. In addition, central banks are very active and markets are sensitive to any hint of change in policy. On top of that, 2016 is an election year in the U.S. (political shifts are happening abroad also). All of these factors are likely to lead to more volatility throughout the year. In order to advance from these levels, stocks likely need the support of solid economic data and improved corporate earnings. Stocks could also benefit from the "cooperation" of politicians and central banks around the world.

Q. Will the economy slip into a recession?

A. The odds of a recession occurring in the near-term are low. While manufacturing has suffered from lower energy prices, the rest of the economy has held up relatively well. The U.S. has enjoyed the best back-to-back years of job growth since the 1990s at the same time consumer spending got a boost from lower gas prices. Markets have been volatile despite the solid fundamentals, which some have

Featuring

TOTAL RETURNS

Quarter ending March 31, 2016

S&P 500	1.3%
Dow Jones Industrial Average	2.2%
NASDAQ	-2.4%
Russell 2000	-1.5%
MSCI EAFE (International)	-2.9%
Barclays Aggregate Bond Index	3.0%

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taken as a sign of coming economic distress. But markets are unreliable in this regard, having "predicted" many more recessions than have actually occurred.

Q. How will the election impact investors?

A. Election season is in full swing, and clients often ask what impact the outcomes will have on the economy and markets. There is much to say on this topic, and we address it separately on page three. The short answer is that it depends, and no one knows! However, a few lessons can be learned based on historical experience.

Q. Many foreign economies seem to be struggling – why would I own international stocks?

A. Investors tend to focus on markets in their home country more than those of foreign countries. This is especially true of U.S. investors due to the relative size and importance of the U.S. market. However, investing abroad can be an attractive way to diversify a portfolio. U.S. stocks are still some of the highest-quality investments in the world, but it is foolish to think attractive opportunities don't exist elsewhere. U.S. stocks have outperformed most international indices during this bull market, but that hasn't always been the case. And investing internationally offers exposure to economies with stronger growth and more attractive valuations in a time when large, developed economies in the West are growing at a slower pace. In addition, there are plenty of attractive companies in foreign countries worth including in a diversified portfolio. International stocks can also boost the dividend yield of a stock portfolio, as many are offering higher (and growing) dividend yields compared to U.S. stocks. As with any investment, it is important to consider the unique risks. Evaluating the economic, political, and demographic aspects of international stocks is a key part of the investment decision. Still, in a constantly-changing world, ignoring an entire set of investments abroad could prove to be a missed opportunity.

Q. What's going on in China and how will it impact our economy and markets?

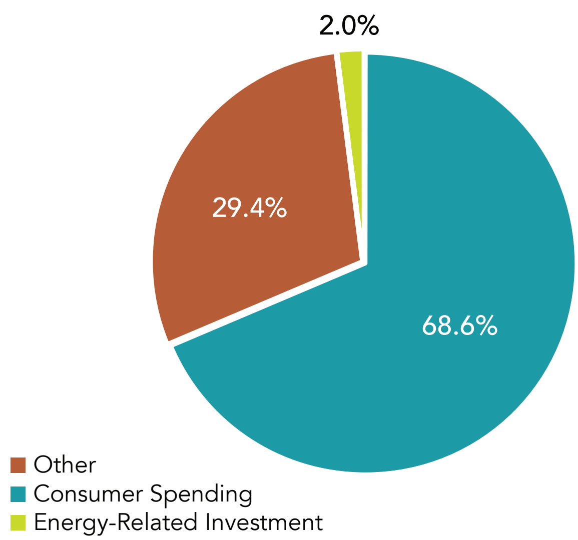
A. China is undergoing a major transition. For decades it has been an engine of global growth, mainly because of rapid investment in new infrastructure. As their economy began to mature it became increasingly difficult to produce such impressive growth. The Chinese government completed large but uneconomical projects simply to meet GDP growth targets. The government has shifted its focus from simply building more buildings to developing a consumer-based economy like that of the U.S. This transition is a wise move, but it has weighed on international economies and markets, particularly commodity exporters who have heavily relied on Chinese demand. The effect on the U.S. has been less damaging thanks to our relatively small dependence on the Chinese economy.

Q. Is the drop in oil prices bad for the economy and investors?

A. The drop in oil prices has obviously hurt companies tied directly to energy production. But these companies represent a very small piece of the U.S. economic pie. In fact, energy-related investment accounts for just 2% of U.S. GDP. Consumer spending represents the overwhelming majority of the U.S. economy – about 67% of GDP. So while a small sliver of our economy suffers as a result of falling oil prices, nearly two-thirds stands to benefit. Historically, upward spikes in oil prices have been more detrimental to the economy, as higher energy prices squeeze consumer budgets and reduce spending.

Consumer Spending vs. Energy-Related Investment

Composition of U.S. GDP



Source: Bureau of Economic Analysis

Q. Will the Federal Reserve raise interest rates further this year?

A. The Fed is likely to raise interest rates, but at a historically-slow pace. The Fed has been in a holding pattern since the first hike in December because of its desire to proceed with caution. But the Fed will ultimately react to broader economic fundamentals, which are healthy enough to justify more hikes this year given Fed guidance. Most importantly, labor markets are the healthiest they have been in a decade. At the same time, inflation is moving gradually higher. Inflation is a key indicator for the Fed, and one particular inflation measure is above the Fed's long-run target. However, the Fed has emphasized that the rate-hike process will be data dependent, allowing for some flexibility to stop and start as needed.

Election Year Myths

It's time once again for voters to choose the next President of the United States, and as always there is heated debate between and among the political parties and candidates. Candidates, commentators, and citizens alike do their best to persuade others that their way is the right way on many issues, especially the economy. Unfortunately, misconceptions and myths abound. In this article we specifically address a handful of these myths.

Myth 1: The Fed doesn't want to be viewed as political and is biased against changing monetary policy during a presidential election year.

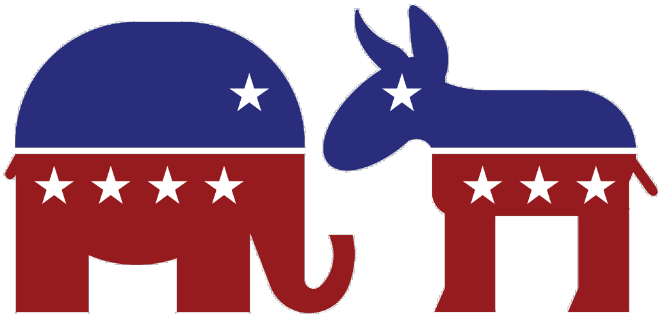
False. Since 1928 there have been 22 presidential election years. The Fed has adjusted interest rate policy in 16 of those years (73% of the time), and has raised interest rates more frequently than it has lowered them. The month with the highest number of Fed policy rate changes is August – right in the heat of the campaign and the party conventions. It's impossible to judge the motives of each individual Fed official over the last century. However, it is clear that Fed policy changes have been in-line with the economic realities of the times, regardless of which way the political winds may be blowing.

Myth 2: The stock market goes on hold ahead of a presidential election until investors are confident about who the winner will be.

False. Within a four-year presidential cycle, the year of the election is the second best for the stock market, rising approximately 75% of the time. Since 1900, returns have been more modest in the first two years of a presidential term. Returns have been stronger in the final two years. Even including the financial crisis election year of 2008, stocks have averaged a return of more than 10% during election years. On average, the third year has been the best year for the stock market, and the second (mid-term) year has been the worst. Some have theorized about these patterns, but the reality is that markets are more concerned with the economy and corporate earnings than the presidential cycle.

Myth 3: The stock market performs better with a Republican in office.

False. Since 1900 there have been 60 years with a Republican in the White House and 55 years with a Democrat. The average market return during Democratic presidential terms has been nearly twice that of Republican administrations. Excluding the severe bear markets that occurred during the George W. Bush and Hoover administrations, the returns are roughly equal between each party. Before reading too much into these averages, it's important to realize the larger point. The reality is that the market generally advances under both Democrat and Republican leadership. In fact, history suggests that the best returns have



actually come during times of split government, when one party is in the White House and the other has control of Congress.

The 2016 election cycle is extremely contentious. Candidates from both parties are making bold claims. While this year seems particularly egregious, campaigns are always guilty of inflated language. Eventually the votes are counted and investors gain clarity on the nominees from each party, and then the ultimate winner. At that point, the rhetoric typically calms and becomes less inflammatory. The reality is markets are influenced more by the health of the economy and corporations than what any of the candidates are saying. Throughout our nation's history people have attempted to cast the opponent as a disaster for the economy and the stock market. And although the President is very powerful, the office only has limited direct influence on the American economy, not to mention the global economy. Investors who keep that in mind will be better prepared to stay focused on the long term.

"...the reality is that markets are more concerned with the economy and corporate earnings than the presidential cycle."

New Additions to the Team

At Johnson Investment Counsel, we continue to invest in our service infrastructure, which includes hiring the right people to join our team. As our firm grows, this expansion is critical to maintain our objective of providing the highest level of client service. We are pleased to announce that the following individuals have joined our team over the last quarter.

> Chris Tschieder
Portfolio Manager

> Michelle Lind
Trust Administrative Assistant

Chris Tschieder

Michelle Lind

C-Change Leadership Program

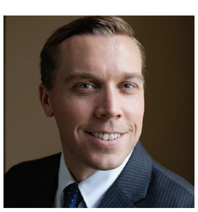
We would like to congratulate Jamie Winburn for her recent selection to C-Change Class 11. Jamie is the Marketing Manager at JIC and joined the company in 2010. C-Change is a program managed by the Cincinnati USA Regional Chamber which focuses on leadership development. It provides emerging leaders with the opportunity to enhance their leadership skills and connects them with professionals and other established leaders in the community.

Jamie Winburn

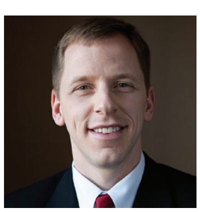
JIC In the News Spotlight

WVXU Cincinnati, Cincinnati Edition, March 18, 2016

Portfolio Managers Chad Maggard and Scott Wyckoff were guests on the Cincinnati Edition, WVXU Cincinnati on March 18, 2016 with host Chris DeSimio. The group discussed how to boost retirement savings and provided advice about how to live comfortably through the retirement years.



Chad
Maggard, CFA



Scott
Wyckoff, CFA

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About Us

Johnson Investment Counsel, Inc. is Greater Cincinnati's largest independent wealth management firm, managing over $8 billion in assets. Johnson Investment Counsel is an employee-owned firm, offering a full range of fee-based, integrated wealth management services, including: investment portfolios, education and retirement planning, cash management, estate planning, trust services, charitable giving, mutual funds, 401(k) plans, IRAs and more. Johnson Investment Counsel has built strong, long-term relationships with individuals and families, charitable organizations, foundations and corporations through three divisions: Johnson Private Client Group, Johnson Trust Company, and Johnson Institutional Management.

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