

Quarterly Insight

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

Fourth Quarter 2017

Letter from the President



What a year! The stock market certainly had momentum starting 2017, but few predicted that it would continue at such a pace through-

out the year. Bolstered by a growing global economy, sentiment remained high for stocks despite plenty of headline risks. Most other asset classes also exceeded return expectations for the year. In this environment, our diversified, quality-driven approach to investing fared well. Such positive results are always welcome, but navigating the markets is just one aspect of our comprehensive wealth management approach. We are committed to helping people achieve their financial objectives, providing peace of mind in good markets and bad.

Looking ahead, the firm is well-positioned to help more people, which is our ultimate objective. We expanded our physical presence by opening an additional Cincinnati office in Kenwood and our first Cleveland office. These additions demonstrate our desire to be more accessible to our clients in the region and throughout the nation. Our expanding physical presence helps solidify our position as the largest independent Registered Investment Advisor (RIA) in Ohio and one of the nation's top firms. In fact, in 2017 Barron's again ranked our firm among the nation's Top 30 independent advisory firms. This ranking is based upon our size, scale, client service offering, and business performance.

While we are pleased with this national recognition, we are most pleased with the positive feedback and loyalty of our clients. Over the years, our client satisfaction and retention have been well above the industry average, and we have consistently grown as a result of referrals from existing clients. This is a testament to the value of the service and counsel provided by our dedicated team of employees.

As we grow, we are committed to maintaining these high levels of client service, in part by hiring talented employees to deliver on our mission. Last year we added depth and expertise to the Private Client Group, the Trust Company, and the Research Department. We also hired an industry veteran to the key position of Chief Operating Officer to oversee our operational infrastructure. Her main charge is to provide our employees with the tools necessary to effectively serve our clients. As we reinvest in the business, I'm confident that our clients will notice a positive impact.

We are immensely grateful for the trust and loyalty of our clients over many years. We look forward to serving you in the years ahead.

Thank you,

Jason O. Jackman, CFA, President

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TOTAL RETURNS

	4Q2017	2017
S&P 500	6.6%	21.8%
Dow Jones Industrial Average	11.0%	28.1%
NASDAQ	6.6%	29.7%
Russell 2000	3.3%	14.6%
MSCI EAFE (International)	4.3%	25.6%
Barclays Aggregate Bond Index	0.4%	3.5%



▶ Market Update

Record-Setting Year for Stock Markets Worldwide

2017 was a banner year for stock markets worldwide, and several other asset classes also finished with healthy gains. The S&P 500 Index has posted a positive return for 14 straight months, and 2017 was the first year ever in which the index's total return was positive every single month. Each of the major large cap U.S. stock indices steadily advanced throughout the year, reaching new record highs along the way. In addition to the strong returns, 2017 was notable for its lack of volatility. The S&P 500 Index made it through the entire year without a single correction of even 5%, something that typically occurs several times a year on average.



Tech, Emerging Market Stocks Lead the Way

The rally was broad-based. U.S. and developed market international stocks finished roughly in-line, while emerging market stocks were big winners, gaining more than 30%. Large cap stocks outperformed mid and small cap stocks, and stocks with higher earnings growth and higher valuations trounced stocks trading at cheaper valuations. Each of the S&P 500 sectors finished with double-digit returns except energy and telecom, both of which finished down for the year. Tech stocks were the best performers, gaining 39%. About one-quarter of the \$1 trillion increase in U.S. market value was attributed to the five largest companies: Amazon, Alphabet (Google), Microsoft, Apple, and Facebook. Each gained more than 30% thanks to robust growth and bright prospects for future growth. Other sectors performed in-line with the index, but the more defensive utilities and consumer staples sectors lagged with returns in the low-teens.

Economic and Earnings Growth the Key Tailwinds

The key driver for markets in 2017 was double-digit earnings growth supported by coordinated global economic growth. Growth in the U.S. continues at a moderate pace, but Europe and Japan have made nice strides, boosting stock prices in those markets as well as growth in other economies around the world. The Eurozone economy enjoyed its fastest pace of growth in a decade. The decline

in the value of the U.S. dollar and global monetary policy that is still accommodative provided further support.

Tax Reform in Focus All Year

Throughout the year prospects of a significant corporate tax cut as well as individual tax cuts in the U.S. supported stocks. Actual negotiations and passage of a law did not come until the final months of the year, but since the 2016 election expectations for tax reform were top of mind for investors.

The law makes broad changes to both the individual and corporate tax codes. At the heart of the new law is the significant cut to the corporate tax rate from 35% to 21%. While many multi-national companies have paid less than 35% in actuality, the reduced rate and other tweaks to the corporate tax code are likely to provide some benefit to the bottom line. Companies that do most of their business in the U.S. often pay closer to the full rate, and as a result are likely to see substantially lower tax bills.

Changes to the individual tax code will affect most taxpayers. According to the Joint Committee on Taxation, about 48% of households will receive a tax cut of greater than \$500 in 2019. But the impact of the changes depends on each taxpayer's unique circumstances. While the law does reduce tax rates, many of the alterations relate to exemptions, deductions, and credits that impact taxpayers' ultimate tax liability.

Deregulation also Supported Gains

Similarly, potential and actual changes in the regulatory landscape provided a tailwind for the market. In some cases the Trump administration moved quickly to make changes via executive order, while others may not come for some time, if at all. Still, the prospect of reduced regulation in tandem with the potential for lower tax bills going forward boosted optimism in some industries. In some cases this may translate to increased business investment, job growth, and wage increases.

Fed Continues to Normalize Policy

The Fed reacted to the positive developments in the economy by increasing its benchmark interest rate three times during the year, from 0.75% to 1.50%. It has indicated intentions to raise the rate further in 2018 depending on economic data. At times the prospect of Fed rate hikes has spooked some investors who feared it would derail the market rally, but in 2017 the market took each hike in stride.

Interest rates reacted differently depending on their length to maturity. Short-term interest rates rose as the Fed hiked, but long-term bonds held steadier. This dynamic is known as a flattening yield curve. A completely flat (short-term rates equal to long-term rates) or inverted yield curve (short-term rates higher than long-term rates) has sometimes portended recession in the past, but for now the

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curve remains positive. The economy has shown evidence in the past that it has the ability to continue to grow in such an environment even as the curve flattens.



A Look Ahead

Turning to 2018, the focus remains largely in Washington despite the recent passage of the tax reform package. Investors will be watching to see if Trump and Congress are able to score any major legislative accomplishments. While the tax bill is likely to remain the most substantive legislation for this Congress and maybe the President's term, other items on the agenda include the budget,

immigration, and healthcare. Republicans have begun discussions on whether to address entitlements, and Trump is still promoting action to shore up the nation's infrastructure, but agreement on these issues seems unlikely in the short term. The window for action is shortened by the rapidly-approaching campaign season for the November midterm elections.

Trump has also continued to threaten to take action on trade policy, particularly with China. He has also been vocal about the ongoing negotiations surrounding the North America Free Trade Agreement (NAFTA). The outcome of these discussions could make an impact on the global trade environment, so investors will be watching to see if any of the rhetoric translates into concrete action.

The interaction between inflation measures and monetary policy will also be closely monitored. With the economy on solid footing, some international central banks have begun moving to normalize policy as the Fed has, but stimulus is still high relative to normal. There is some concern that this could put upward pressure on inflation measures, which could lead to more aggressive tightening. It's possible such a scenario could choke off the bull market in stocks. Above-average stock valuations in the U.S. exacerbate such concerns. Despite both worries, stocks could still advance if the economic strength and earnings growth remain intact.

▶ JIC News

JIC Research Edge Video Series

The JIC Research Edge video series is designed to give our clients an inside look into the complicated world of investing from a research perspective. In these videos, we leverage our in-house expertise to provide timely insight on key issues involving national and Greater Cincinnati companies, deliver economic updates, and discuss other high-level investment themes. Recently our team has published videos on Procter & Gamble's proxy fight, the iPhone X release, and tax reform. Our Research Edge videos are sent via email and are also available on our YouTube Channel.

The Research Team at Johnson Investment Counsel works behind the scenes to provide investment guidance to our Portfolio Managers. Our team covers all eleven equity sectors, fixed-income, economics, and alternative investments. Having a dedicated in-house Research Team allows JIC to build a deep understanding of our investment universe and gives us strong corporate access. Over the course of the past year, the Team has met with executives from P&G, Kroger, and AT&T, among many others.



Do you have an idea for a JIC Research Edge video? If so, please reach out to your Portfolio Manager. The Research Team is always looking for new ideas!

Welcoming Holli Alexander to the JIC Team

Holli Alexander joined Johnson Investment Counsel as Chief Operating Officer in December 2017. As a member of the firm's Leadership Team, Holli will oversee a variety of functions that will support the firm's continued growth and development. She has more than 20 years of experience in business operations leadership, including strategic planning, execution, relationship management, and systems support.



KMK Law and JIC Women's Initiative

In 2017, JIC started an employee women's initiative dedicated to developing our female employees both personally and professionally. We recently partnered with the women's initiative from KMK Law for the inaugural JIC/KMK Service Day. The two professional development networks chose Sweet Cheeks Diaper Bank as the recipient of support and held separate diaper/monetary donation drives in the fall. At the conclusion of the drives, employees across all departments from both firms came together to wrap diapers for donation to low-income families in the greater Cincinnati area. Together, the groups raised over \$20,000 for Sweet Cheeks, which can provide over 175,000 diapers to those in need. The women's initiatives at both JIC and KMK plan to make the Service Day an annual event going forward.



2017 Patrick Chong Memorial Scholarships

We established the Patrick Chong Memorial Scholarship in remembrance of Patrick Chong, a Portfolio Manager Assistant at JIC, who died of colon cancer in 2002 at the age of 31. JIC annually awards two \$2,500 academic scholarships to children of our employees. This year, we are pleased to honor two outstanding students: Kyle Ackerman and Shaun Grant. Kyle is the son of Client Support Assistant Julie Ackerman. He plans to attend the University of Louisville and major in Exercise Science. Shaun is the son of Client Support Assistant Tina Lowry. He will be attending Eastern Kentucky University with a major in PGA Golf Management.



Pictured on the right:

Top: Julie, Kyle, and Jason; Bottom: Tina, Shaun, and Jason

Promotions

We are pleased to announce that the following individuals have been promoted to the new positions listed below:

- > Bryan Adress
Research Analyst
- > Rick Bryant
IT Infrastructure and Services Manager
- > Ryan Easter, PMP
Director of Information Technology



Adress



Bryant



Easter

About Us

Johnson Investment Counsel, Inc. is Ohio's largest independent wealth management firm, managing over \$9 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.

Divisions

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

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- Stock Portfolios
- Bond Portfolios
- Balanced Portfolios
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- Trust Accounts
- Pension & Profit Sharing Plans
- Individual Retirement Accounts
- 401(k) Plans
- Foundations
- Endowments
- Johnson Mutual Funds
- Johnson Charitable Gift Fund



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