JOHNSON FINANCIAL GROUP®

BANKING WEALTH INSURANCE

ECONOMIC & MARKET OUTLOOK

2019 MID-YEAR REVIEW

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EXECUTIVE SUMMARY

The first half of 2019 included continued economic growth and strong returns from most asset classes. The abrupt change in Federal Reserve policy toward an easing bias helped fuel both equity and bond market gains. We expect U.S. economic growth to continue in line with the average growth rate for this expansion. Equity returns will depend on the expected pace of earnings growth in 2020 and current estimates may be overly optimistic. Fixed income returns should benefit from expected Fed easing.

Economic Outlook

- At the end of June, U.S. economic growth matched the longest economic recovery on record and has begun a new record for the longest expansion.
- Our expectations for real GDP growth in 2019 remain largely unchanged at 2.0%-2.5%, moving the pace of growth back toward the average growth rate for this expansion.
- Our growth estimates assume a favorable resolution to the trade war, without any further escalation.

U.S. Equity Outlook

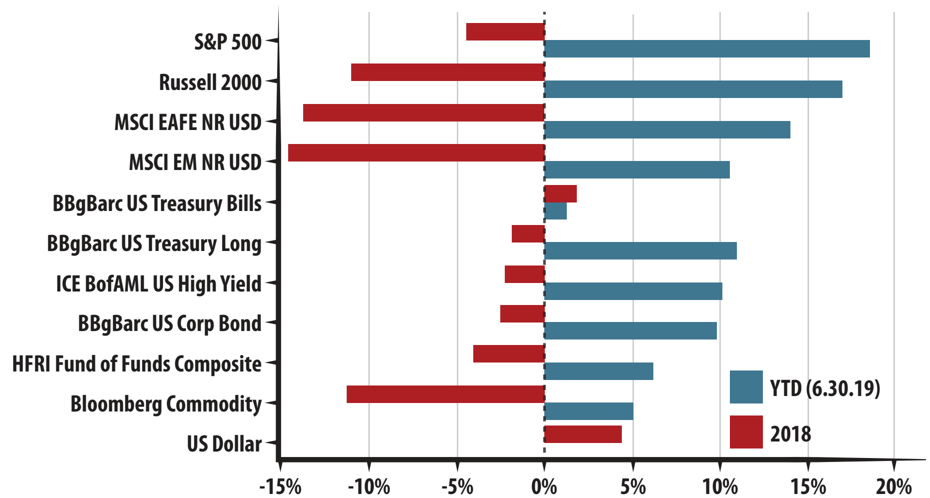
- While not at extreme levels, investor optimism has turned decidedly bullish, pushing equity returns for the S&P 500 Index up 18.5% during the first half of the year, the highest return since 1997. [Exhibit 1]
- The key to equity returns for the second half will be the expected pace of earnings growth in 2020. After increasing 23% in 2018, earnings are expected to increase 3% in 2019 and 12% in 2020. Based on recent economic data, the earnings outlook may prove overly optimistic with an earnings decline possible after second or third quarter earnings are reported.
- Priced at 17 times expected forward earnings, we consider equities to be in the range of fair value. As a result, we trimmed exposure to lock in some of the year-to-date gains. Lower interest rates and the likelihood of an "insurance cut" from the Fed lend support to equity valuations.

U.S. Fixed Income Outlook

- The Fed pivot from a tightening bias to an easing bias is complete. A July rate cut is likely while the market anticipates further easing later in the year. We expect that one to two federal funds rate cuts in the second half of 2019 will result in a modest additional decline in short term bond yields, with rates already having declined in anticipation of the cuts.
- Returns across fixed income markets have been strong as interest rates have declined. Investment grade (IG) corporate bonds and mortgage-backed securities (MBS) are more attractive than high yield (HY) bonds based on current valuations and our economic outlook.
- We expect interest rates to remain historically low due to low inflation, and economic growth to slow but remain near the average for this expansion. Our outlook is for the 10-year U.S. Treasury yield to remain in a 1.8% to 2.3% range, although a shock could widen this range materially.
- The shape of the Treasury yield curve, with short rates close to long rates, is not a sign of an impending recession. We continue to see a low risk of recession over the next 12 to 18 months.

Exhibit 1

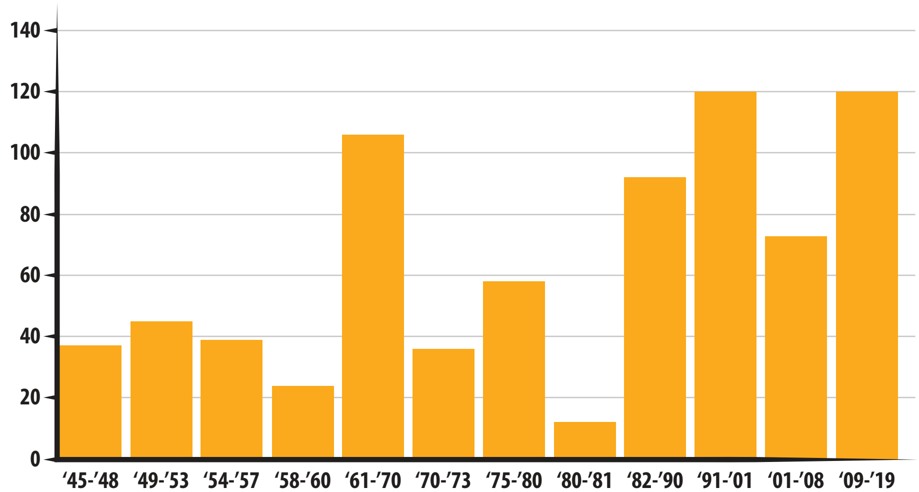
2018 & YTD PERFORMANCE



Source: Morningstar Direct

Exhibit 2

U.S. ECONOMIC EXPANSIONS
Duration in Months

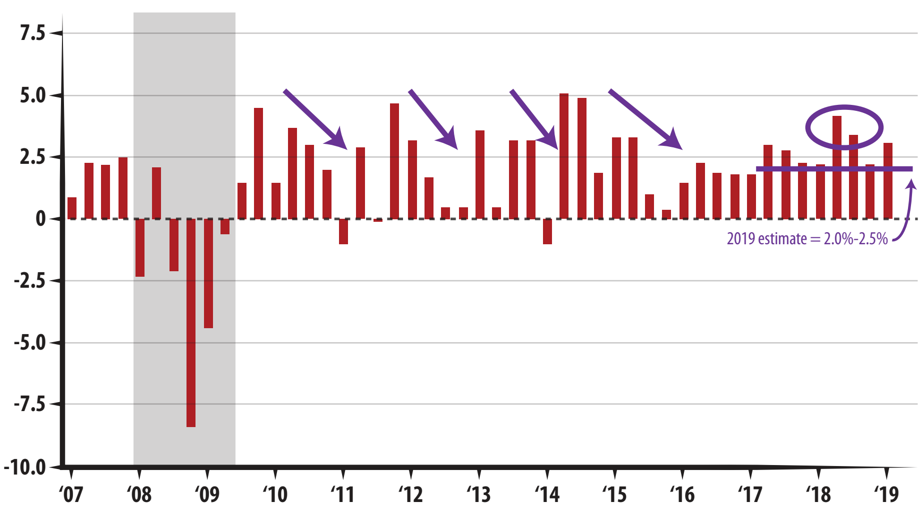


The current U.S. economic expansion is now tied for the longest in post-war history, 120 months.

Source: FactSet

Exhibit 3

REAL GROSS DOMESTIC PRODUCT
Percent Change from Preceding Period, Seasonally Adjusted Annual Rate



Source: U.S. Bureau of Economic Analysis

ECONOMIC OUTLOOK

Real GDP

Happy 10-year anniversary to the economic expansion! According to the National Bureau of Economic Research, from the bottom in June 2009 following the Global Financial Crisis, the U.S. economic recovery hit the 10-year milestone at the end of June 2019. This tied the duration of the recovery with the 1990s expansion, which had held the prior record at 120 months [Exhibit 2]. In July, the current expansion begins its 11th year, making it the longest on record.

One can observe that four of the last five longest expansions in history have been the most recent four expansions. This is the result of structural changes that have mitigated some of the factors leading to past recessions. Better inventory and supply chain management, as well as a shrinking share of cyclical and industrial businesses in the U.S., have contributed to this phenomenon. In addition, the decline of U.S. energy dependency has reduced the sensitivity of the U.S. economy to spikes in oil prices. Energy usage as a percentage of GDP has declined over the past few decades, and significant increases in U.S. energy production has made our economy less reliant on imported oil.

While long in duration, the current expansion has had several 'growth scares' at various points with periods of decelerating growth, and even a few isolated quarters of negative real GDP [Exhibit 3]. In 2011, growth slowed as peripheral European economies were in crisis. In 2013, the economy suffered a temporary setback due to the government shutdown while 2014 posted a weak quarter due to extreme weather across much of the U.S. The 2015 slowdown was precipitated by a significant slowdown in China, the world's second largest economy—this has dampened growth recently as well. Despite these setbacks, the U.S. economy has been resilient enough to withstand a recession.

U.S. economic growth in 2018 was boosted following the passage of the Tax Cuts and Jobs Act. As the benefits from fiscal stimulus faded, economic growth was expected to moderate. Our expectations for Real GDP growth in 2019 remain largely unchanged at 2.0%-2.5%, moving the pace of growth back toward the average growth rate for this expansion.

Tariffs

Our growth estimates assume a favorable resolution to the trade war, without any further escalation. With the trade war well into its second year, the economic impact thus far has not been problematic. The ongoing risk—in addition to a possible escalation -- is whether trade tensions will impact corporate and consumer confidence, and ultimately behavior. Trade-related uncertainties have already caused some measures of confidence to waver. The Conference Board's Expectations Index has moved sideways as trade rhetoric intensified, even though the Present Situation Index has remained robust [Exhibit 4]. The Total Index is currently at its lowest level since September 2017.

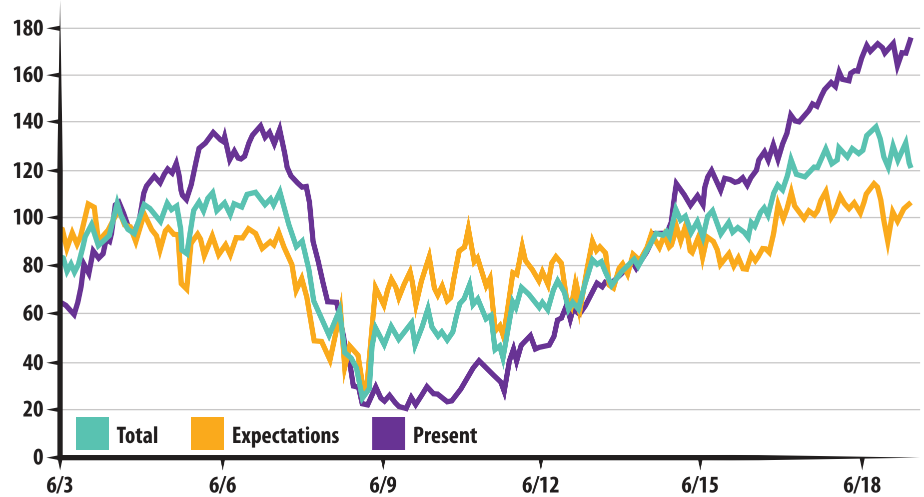
While tariffs are effectively a tax on consumers, tariff income can potentially be redistributed. However, the inefficiencies or 'deadweight loss' from tariffs can be more costly than the tariffs themselves. According to a study recently posted by Liberty Street Economics, which features analysis from Federal Reserve Bank of New York economists, the projected cost of the recent increase in tariffs on $200 billion of Chinese goods from 10% to 25% will result in a per household annual cost to consumers of $831 in 2019 [Exhibit 5]. These additional tariffs were levied beginning May 10, 2019 after a breakdown in trade negotiations with China. While the annual cost to consumers of these additional tariffs amounts to $211 per household on an annual basis, the deadweight loss, or efficiency loss, could amount to $620 per household on an annual basis. This is the result of sourcing shifts and reorganization of the supply chain.

The good news is that it appears that progress is being made in the negotiations. If common ground can be made on key issues such as intellectual property and forced technology transfers, then that would be good for U.S. businesses over the long run. Discussions have been continuing at the June G-20 meeting and current indications are that we are closer to a deal. Both sides have incentives to reach a deal soon.

Tariff concerns notwithstanding, investors have been contemplating whether the current slowdown is the start of an economic deterioration that will lead to an imminent recession. We don't think so. Some have pointed to the recent inversion of the yield curve—i.e., short-term interest rates that are higher than long-term interest rates—as signaling an impending recession. It is important to remember that while an inverted yield curve has historically been one precursor, numerous other past precursors to recessions are not flashing warnings. Even the yield curve inversion has had a mixed track record and the time between an inverted yield curve and subsequent recession has been very inconsistent—sometimes lasting years. While a number of interest rate models are showing an elevated risk of recession, models based on economic measures are not forecasting the same level of caution.

Exhibit 4

CONSUMER CONFIDENCE



Source: Conference Board, 6.25.19

Exhibit 5

THE U.S. TARIFFS' COSTS

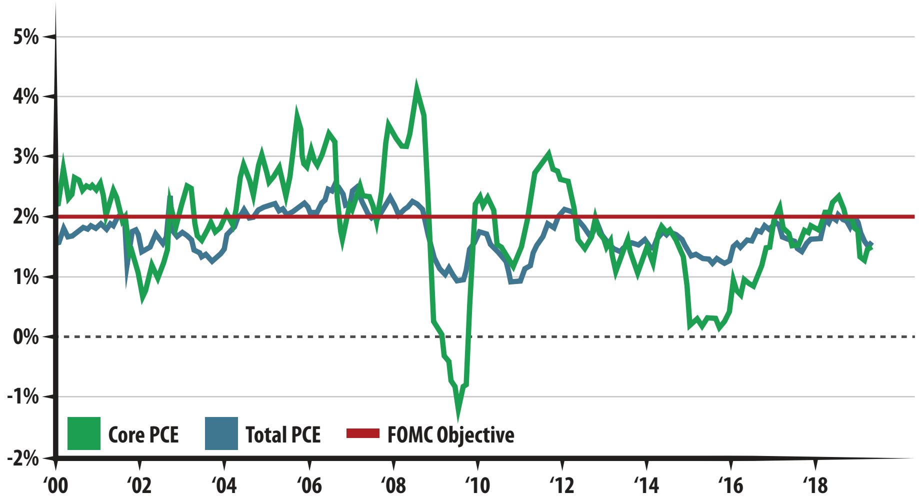
Estimated Cost to Consumers

2018 Tariffs	Tax Payments	Deadweight Loss	Total Cost to Consumers
Monthly Cost	$3.0 billion	$1.4 billion	$4.4 billion
Annual Cost	$36.0 billion	$16.8 billion	$52.8 billion
Per Household Annual Cost	$282	$132	$414
Additional 15% Tariffs on $200 Billion			
Monthly Cost	$2.245 billion	$6.594 billion	$8.84 billion
Annual Cost	$26.942 billion	$79.132 billion	$106.074 billion
Per Household Annual Cost	$211	$620	$831

Per houshold numbers are calculated based on 127.6 million households in the U.S. in 2018. The lower panel is forecast based on the elasticities in the study. Source: Amiti, Redding & Weinstein

Exhibit 6

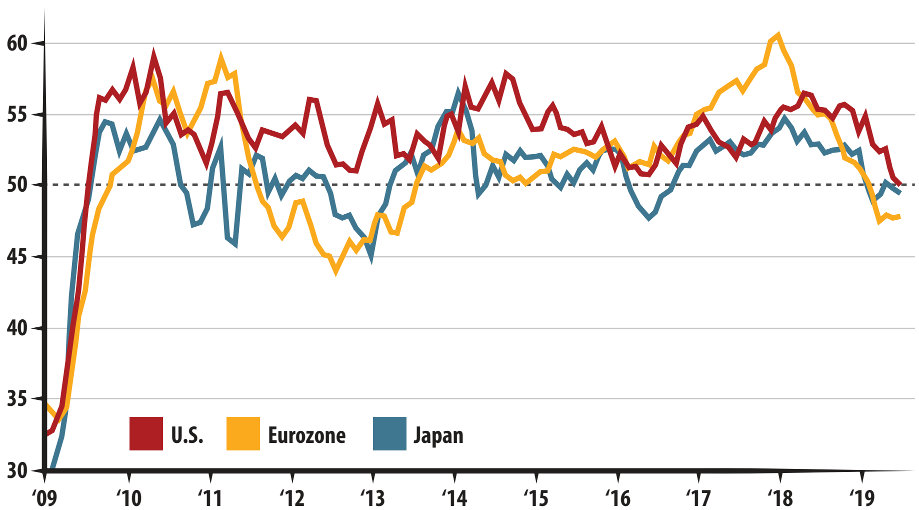
PCE DEFLATOR
12-Month Percent Change



Source: Bureau of Economic Analysis via Haver Analytics

Exhibit 7

IHS MARKIT MANUFACTURING PMI
Flash Estimates for June 2019



50 = no change on prior month.
Source: IHS Markit

Central Bank Policy

The Fed also seems to have offered reassurance to the financial markets that they would come to the rescue if the economy slowed as a result of a trade-related slowdown. At the June Federal Open Markets Committee (FOMC) meeting, the Fed abandoned the long-standing use of "patience" when describing interest rate moves and instead stated that they "will act as appropriate to sustain the expansion." Given that inflation has persistently remained below the Fed's target rate and economic risks are to the downside, we expect an interest rate cut in July.

The objective of the Federal Reserve is to use monetary policy to foster economic conditions that achieve both price stability and maximum sustainable employment, often referred to as the Fed's dual mandate. Even with the unemployment rate at a 50-year low, inflation has consistently remained below the Fed's 2% target rate. This has been somewhat unexpected since wage inflation has historically escalated when labor markets are tight. The Core PCE (Personal Consumption Expenditure) Deflator is the Fed's preferred gauge of inflation and it remains below the Fed's long run goal [Exhibit 6]. Market-based measures of inflation compensation have also declined.

The benign inflation environment gives the Fed more latitude to lower interest rates preemptively, as 'insurance' to help extend the current economic cycle. Economic risks are currently to the downside—few are concerned about an overheating economy.

The deceleration in growth has not been unique to the U.S. In fact, growth outside the U.S. has been challenged for some time. The International Monetary Fund (IMF) recently reduced its global growth outlook for the third time in six months, currently expecting 2019 global growth to come in at 3.3%. The organization cited weaker Eurozone growth as a concern driven by uncertainties such as Brexit, the Italian banking crisis, the French protests, and trade. The Eurozone economies are more cyclical as compared to the U.S. and rely more heavily on trade, so the recent slowdown in world trade has negatively impacted growth. Purchasing Manager Index (PMI) surveys published by IHS Markit show a continued deterioration in trends for the manufacturing sector on a global basis [Exhibit 7]. Thus far, there has not been a significant deterioration in service sector trends.

> "The benign inflation environment gives the Fed more latitude to lower interest rates preemptively, as 'insurance' to help extend the current economic cycle."

In response to slow growth, Central Banks across the globe have transitioned from a tightening cycle toward looser monetary policies, which should ease financial conditions and provide the backdrop for a modest recovery. The European Central Bank (ECB) has added another round of targeted longer-term refinancing operations (TLTRO), an inexpensive loan program for stressed European Banks. On a positive note, there have been some signs of green shoots in China's economy after numerous rounds of stimulus measures. Given the importance of China's economy to global growth, this is a welcome improvement.

Productivity

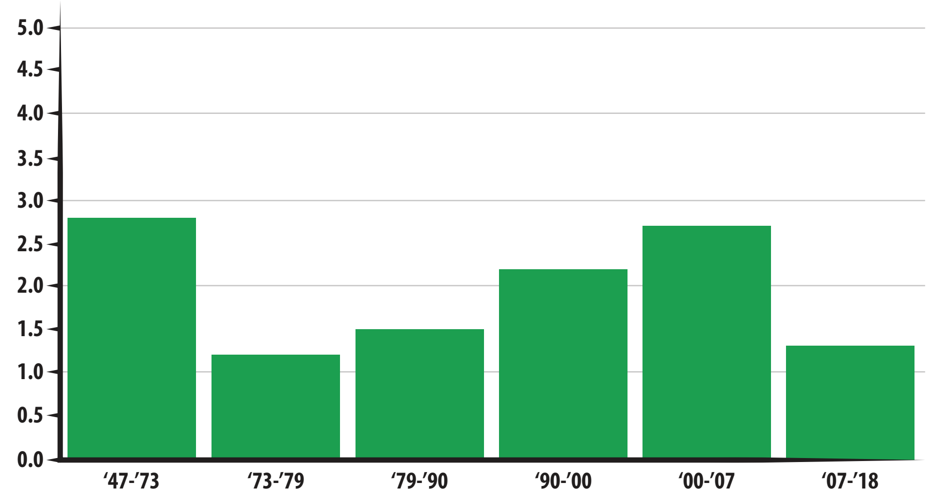
The potential for growth in the U.S. economy is driven by the combination of growth in workers (i.e., labor force growth) plus the growth in real output per worker, also known as productivity. Growth in the work force is expected to slow moving forward as the growth in our native born population and immigration both slow.

Productivity growth has slowed markedly over the past several years, as shown in [Exhibit 8], but could be key to sustaining the current expansion. One of our research partners, Cornerstone Macro, has called the new stronger productivity trend "The Story of the Decade" given its potential to drive faster growth while keeping unit labor costs low and dampening core inflation. According to the Bureau of Labor Statistics, nonfarm business sector productivity increased 3.4% during the first quarter of 2019, bringing the four-quarter increase in productivity to 2.4%-- its largest gain in almost 9 years.

Exhibit 8

PRODUCTIVITY CHANGE IN THE NONFARM BUSINESS SECTOR

Average Annual Percent Change

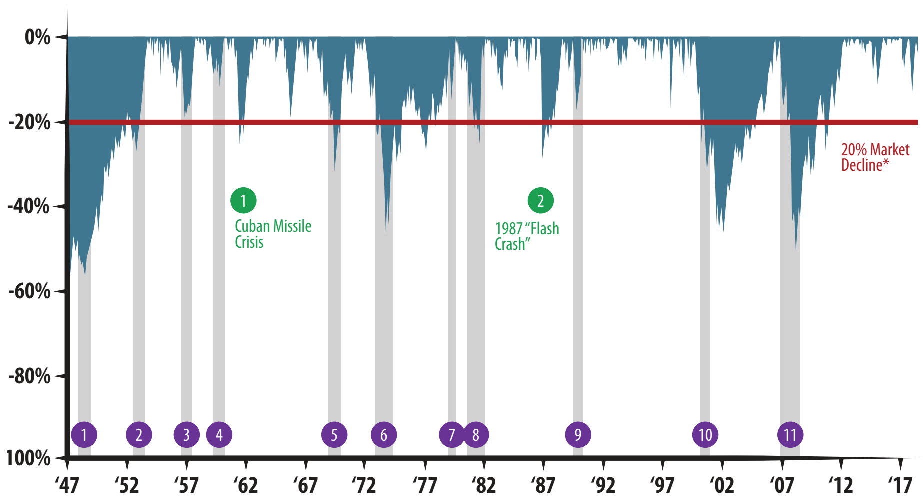


Source: U.S. Bureau of Labor Statistics

> "One of our research partners, Cornerstone Macro, has called the new stronger productivity trend "The Story of the Decade" given its potential to drive faster growth while keeping unit labor costs low and dampening core inflation."

Exhibit 9

U.S. RECESSION AND S&P 500 COMPOSITE DECLINES FROM ALL-TIME HIGHS



CHARACTERISTICS OF RECESSIONS & RELATED STOCK MARKET DECLINES

Recession	Recession: Peak Qtr	Recession: Trough Qtr	Recession: % Decline	Related Market Sell-off: Peak Date	Related Market Sell-off: Trough Date	Related Market Sell-off: % Decline	Macro Envornment: Comm. Spike	Macro Envornment: Agg. Fed	Macro Envornment: Extreme Value
1 Recession of 1949	4Q48	4Q49	-1.5%	6/15/48	6/13/49	-21%			●
2 Recession of 1953	2Q53	2Q54	-2.4%	1/5/53	9/14/53	-15%			
3 Recession of 1958	3Q57	2Q58	-3.0%	8/2/56	10/22/57	-22%			●
4 Recession of 1960-61	2Q60	1Q61	-0.1%	8/3/59	10/25/60	-14%			●
5 Recession of 1969-70	4Q69	4Q70	-0.2%	11/29/68	5/26/70	-36%		●	
6 Recession of 1973-75	4Q73	1Q75	-3.1%	1/11/73	10/3/74	-48%	●		
7 Recession of 1980	1Q80	3Q80	-2.2%	2/13/80	3/27/80	-17%	●	●	
8 Recession of 1981-82	3Q81	4Q82	-2.5%	11/28/80	8/12/82	-27%		●	
9 Early 1990s Recession	3Q90	1Q91	-1.4%	7/16/90	10/11/90	-20%	●	●	
10 Early 2000s Recession	1Q01	4Q01	-0.4%	3/24/00	10/9/02	-49%	●		●
11 Great Recession	4Q07	2Q09	-4.0%	10/9/07	3/9/09	-57%	●	●	
Non-Recession Bear Markets									
1 1962 Flash Crash, Cuban Missile Crisis	-	-	-	12/12/61	6/26/62	-28%			●
2 1987 Flash Crash, Program Trading, Overheating Markets	-	-	-	8/25/87	12/4/87	-34%			●
Average	-	-	**-1.9%**	-	-	**-30%**			

Source: FactSet, NBER, Robert Shiller, Standard & Poor's, J.P. Morgan Asset Management

Risk Factors

Most bear markets, defined as a 20% or more decline from the previous market high, are associated with recessions—which is why financial market participants monitor the economy so closely. This chart shows the history of recessions and related stock market declines. The peak-to-trough drawdown during the 13 bear markets that the S&P 500 has endured over the past 75 years has averaged -30% [Exhibit 9]. It is worth noting that all of these market declines have been associated with either a commodity spike, aggressive Fed, or extreme valuations. None of those factors are presently a concern.

Geopolitical risks can also weigh on financial markets, but those are notoriously difficult to forecast. Recently, there has been an escalation in tensions between the U.S. and Iran which has the potential to deteriorate into a military conflict. If a conflict were to occur, the Strait of Hormuz could close. Over 20% of global oil production travels through this strait and oil prices could spike as a result. We have been monitoring this and other potential conditions that may impact the financial markets.

> **"As we look forward, returns are almost certain to be more modest than the first half as renewed optimism needs to be confirmed with data in the coming quarters."**

U.S. EQUITY MARKET

YTD Recap

U.S. equities posted strong returns again this quarter with the S&P 500 up 4.3%, bringing the return for the first half to 18.5% [Exhibit 10]. This is the highest return for the S&P 500 Index for the first six months of a year since 1997. International stocks posted strong returns as well, increasing 3.0% in the quarter and 13.0% for the first half as measured by the MSCI All Country World - ex U.S. Index.

While the gains in the first quarter occurred with limited downside volatility, second quarter returns were nearly spoiled by a large decline in May triggered by an escalation in the U.S. trade war with China. Specifically, tariffs on $325 billion of Chinese goods were increased from 10% to 25% after negotiations broke down. There were also threats of a 25% tariff on goods imported from Mexico, but this threat diminished relatively quickly after Mexico agreed to work with the administration on its immigration objectives. News that President Trump and President Xi were to meet at the G-20 meeting at the end of June buoyed markets as well and justifiably so as their meeting resulted in an agreement to resume negotiations. Another significant support for equities in June was further confirmation from the Federal Reserve and later the European Central Bank that easier monetary policy may be forthcoming.

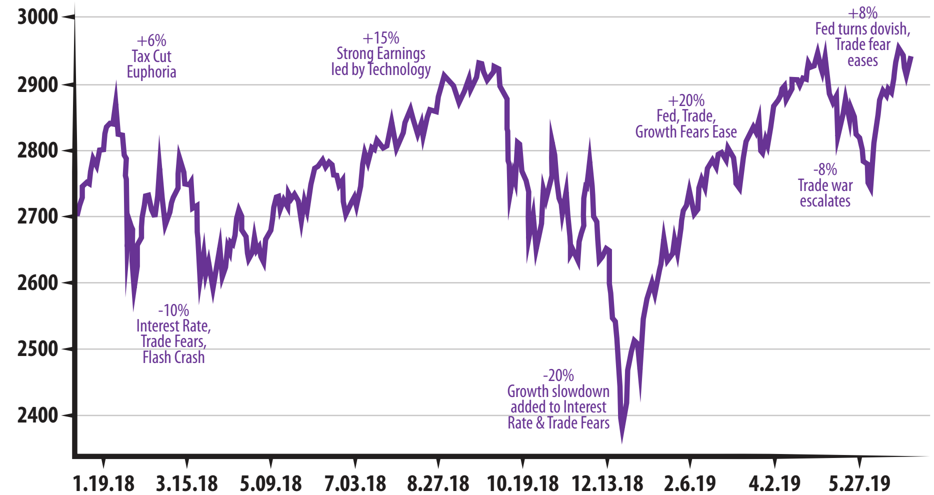
Second Half Outlook

2019 began with negative investor sentiment as stocks experienced a peak to trough decline of nearly 20% for the S&P 500 Index during the fourth quarter of 2018. However, fears of recession have eased throughout 2019 and stocks are near their highs for the year. [Exhibit 11] reveals the change in investor sentiment since late 2018 with the ratio of bullish investors to bearish investors now at nearly three to one. As we look forward, returns are almost certain to be more modest than the first half as renewed optimism needs to be confirmed with data in the coming quarters. Our equity check list for the second half includes:

- The Federal Reserve delivering on the rate cuts that they have signaled.
- The U.S./China trade truce remaining in place, and a deal ultimately being made.
- Global economic growth stabilizing and demonstrating signs of reacceleration in 2020.

Exhibit 10

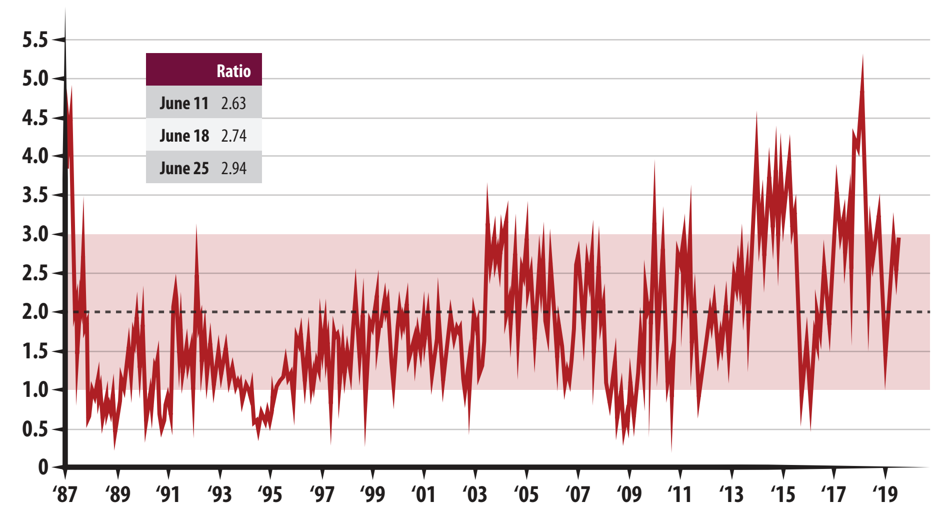
S&P 500 INDEX
1.1.18 to 6.30.19



Source: Thomson ONE

Exhibit 11

INVESTORS INTELLIGENCE BULLS & BEARS

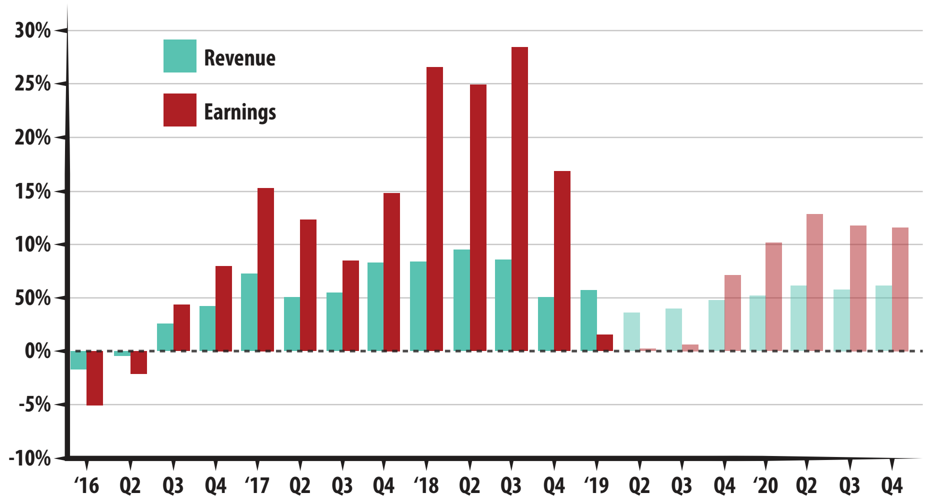


A higher ratio indicates a higher level of bullish investors.
Source: Investors Intelligence, Yardeni Research

Exhibit 12

S&P 500 REVENUE AND EARNINGS

Year-over-year growth rates

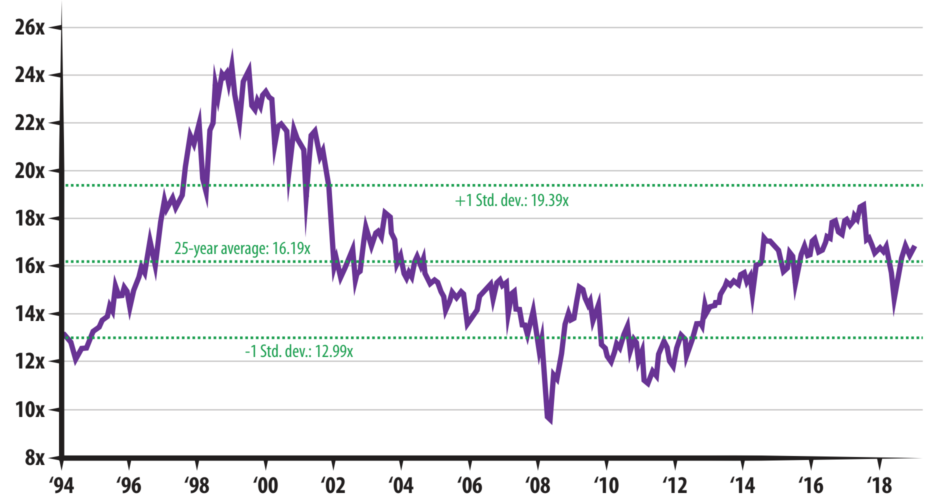


Source: I/B/E/S data from Refinitiv as of June 28, 2019

Exhibit 13

S&P 500 INDEX

Forward P/E Ratio



Source: FactSet, Thomson Reuters, Standard & Poor's, JP Morgan Asset Management

> "After 23% growth in 2018, S&P 500 earnings are expected to increase in the low single digits in 2019."

If this check list is achieved, equity returns are likely to outpace other asset classes over the balance of the year. However, if investors are too optimistic, then equities may have downside in the second half of the year. Given our view that the economic expansion will continue but risks are heightened in the near term, we have rebalanced client portfolios following strong year-to-date equity returns and are managing near long-term target allocations.

Earnings Growth and Valuations

Earnings growth has slowed to a crawl during the first half of the year with expectations for an improvement in this trend by the end of the year [Exhibit 12]. After 23% growth in 2018, S&P 500 earnings are expected to increase in the low single digits in 2019. The primary headwind to earnings growth is a slower global economy with higher costs, a stronger dollar and difficult comparisons versus a year ago as contributing factors.

If we are correct that we are experiencing another mid-cycle slowdown and not a recession, then earnings will reaccelerate next year and support stock prices. However, we expect another quarter or two of challenging growth, which may lead to continued volatility given that valuations are 16.7 times consensus forward earnings estimates, near the high point of this cycle. [Exhibit 13].

Equity Market Focus: The Impact of Technology on Relative Returns

A look under the hood of equity returns reveals the varied return experienced by equity investors within different categories [Exhibit 14]. The style that stands above the rest is the 18.07% average annual return for U.S. Large Cap Growth stocks over the past three years. The disruption and market share gains from technology companies like Amazon, Microsoft and Alphabet (Google) is in stark contrast to the below average growth generated by the global economy during this expansion. As a result, growth stocks have outperformed value stocks and large companies have outperformed small companies.

The strength of the technology sector has also been a major contributor to the outperformance of U.S. stocks compared to international stocks. With a technology sector weighting of 32% in the U.S. compared to 12% for the EAFE index (large developed market international stocks), it is no wonder that international equity market returns have been subpar compared to the U.S. [Exhibit 15]

U.S. FIXED INCOME MARKETS

YTD Recap

In October of 2018, Federal Reserve Chairman Jerome Powell said in an interview that the short-term policy rate set by the Fed was "a long way from neutral," implying room for several more interest rate hikes. Shortly thereafter, the 10-year Treasury yield jumped to 3.25%. The committee followed through on Powell's October message by hiking the fed funds rate 0.25% in December to its current range of 2.25%-2.50%. As we now know, risk assets, including stocks and corporate bonds, greeted that decision poorly.

Exhibit 14

EQUITY MARKET ANNUALIZED RETURNS BY CATEGORY

	1-Month Returns			1-Year Returns			3-Year Returns		
	Value	Core	Growth	Value	Core	Growth	Value	Core	Growth
U.S. Large Cap	7.18	7.02	6.87	8.46	10.02	11.56	10.19	14.15	18.07
U.S. Mid Cap	6.75	6.87	7.02	3.68	7.83	13.94	8.95	12.16	16.49
U.S. Small Cap	6.37	7.07	7.70	-6.24	-3.31	-0.49	9.81	12.30	14.69

	1-Month Returns	1-Year Returns	3-Year Returns
Global	6.55	5.74	11.62
U.S.	7.05	10.42	14.19
Internat.	5.93	1.08	9.11
EM	6.24	1.21	10.66

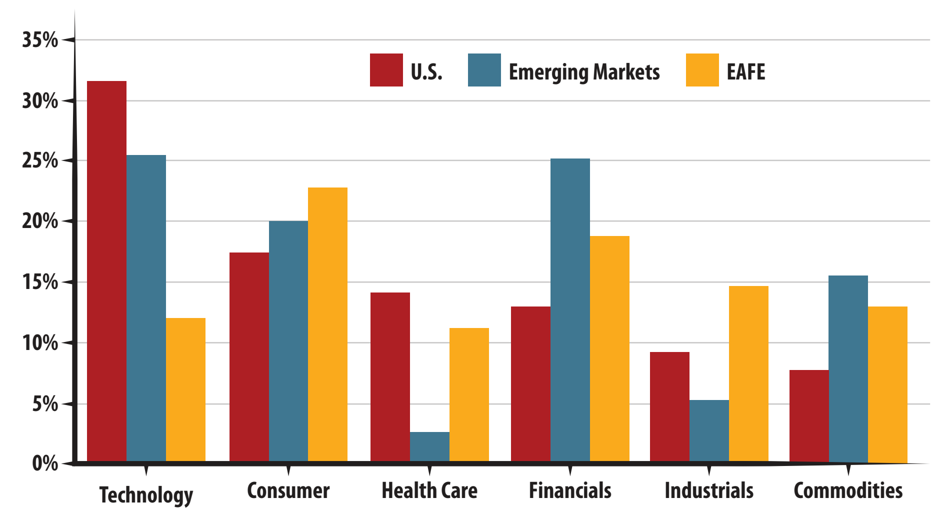
-10 to 0
0 to 10
10 to 20

Internat. = International, EM = Emerging Markets
Source: Eaton Vance Monthly Market Monitor

Exhibit 15

GLOBAL EQUITIES BY SECTOR

Percent of Index Market Capitalization

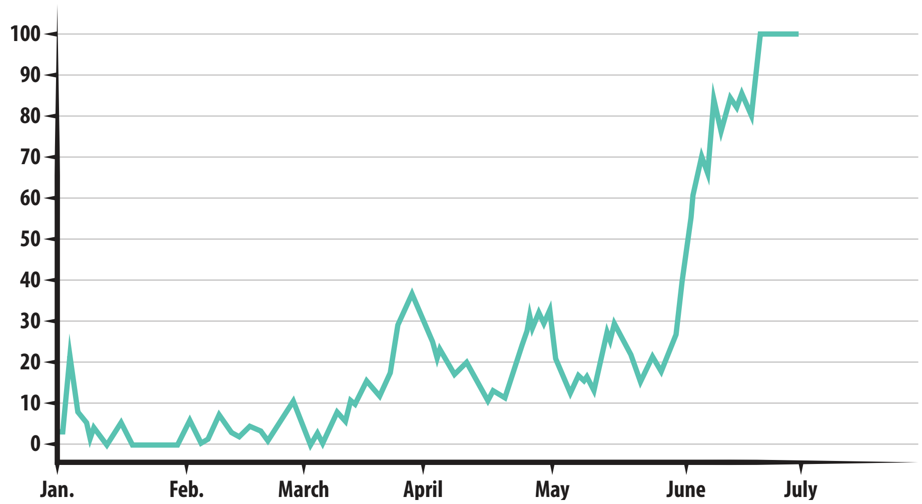


Sector breakdown includes the following aggregates: Technology (communication services and technology), Consumer (consumer discretionary and staples), and Commodities (energy and materials). Source: Standard & Poor's, MSCI, JP Morgan Asset Management

Exhibit 16

ODDS OF FED FUNDS RATE CUT IN JULY

Investors Pricing in 100% Chance of Cut at July 31st FOMC Meeting

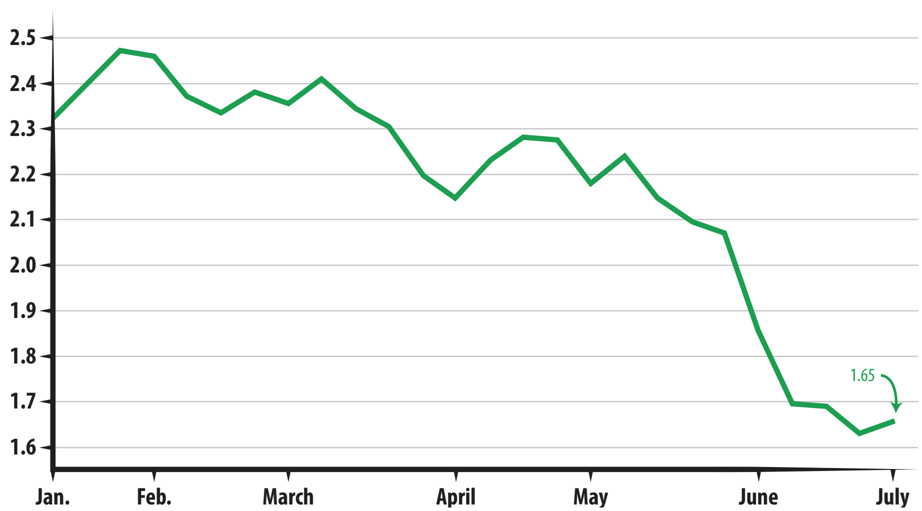


Source: Bloomberg Finance L.P.

Exhibit 17

DECEMBER 2020 FEDERAL FUNDS FUTURES

Investors are Pricing in 3 Cuts by January 2020



Source: 2019 Bloomberg Finance L.P.

While the Fed maintains that it is data, not market, dependent, investors' angst in response to less accommodative policy in late 2018 clearly influenced the about face we have seen this year. The 2019 FOMC has moved to calm markets and support a slowing economy first by insisting that it would be "patient" with further policy moves, and more recently by removing the word patient from its official statement altogether. In his post-meeting press conference on June 19, Powell went further, indicating an easing bias by stating that "an ounce of prevention is worth a pound of cure," and that the committee "will act as appropriate to sustain the expansion."

Fed funds futures, which reflect the market's expectations for future rate cuts, are now pricing in a 100% chance of a rate cut in July and a total of 3 rate cuts by January of 2020. Risk markets have cheered the Fed's turn toward preventative medicine by sending stocks to all-time highs and the 10-year Treasury yield to its lowest level since November 2016. Lower yields translate into higher prices for bond investors, and YTD returns have been strong across the risk spectrum from Treasuries and Agency MBS to corporate bonds and Emerging Market Debt. Longer term bonds have outperformed short-term bonds.

Second Half Outlook

We believe an insurance cut at the Fed's July meeting to retract what is widely perceived as December's policy error is all but certain [Exhibit 16]. In our view, a 25 basis point (0.25%) cut is most likely given that this is intended to act as a precaution against further weakness, and to extend the expansion. The Fed cut rates in slowing but non-recessionary times in 1984, 1987, 1995 and 1998. After those cuts, economic expansions continued for a few more years.

A rate cut would acknowledge global growth concerns and align the Fed closer to global central banks who are already easing or expected to cut policy rates this year. Most recently, ECB President Mario Draghi cited uncertainty driven by trade tensions and downside risks to growth and inflation as reasons for additional stimulus. Powell himself has lamented inflation persistently below the Fed's 2% target and suggested that we should not view low rates and central bank asset purchases as unconventional policy tools.

Investors are pricing in three rate cuts by January 2020 [Exhibit 17].

We expect that one to two fed funds rate cuts in the second half of 2019 will result in a modest additional decline in short term bond yields, with rates already having declined in anticipation of the cuts [Exhibit 18].

Whether easier monetary policy will further benefit credit markets is less certain. The incremental yield of corporate bonds over Treasury bonds has declined due to investor demand for income even as corporate leverage has increased in recent years. Nevertheless, we expect corporations to continue to generate adequate profit margins and interest coverage to service their debt. As such, we believe corporate bonds continue to have a place in investor portfolios alongside government bonds. At current valuations, we continue to favor investment grade corporate and mortgage-backed securities over high yield bonds [Exhibit 19].

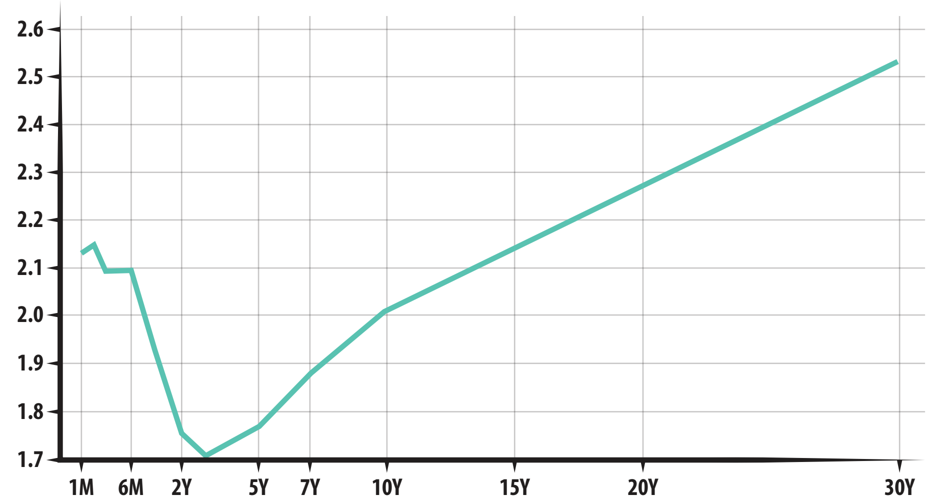
Emerging Market (EM) bond yields are high relative to other fixed income sectors, but our neutral positioning reflects near-term volatility due to growth, trade, and political pressures, along with a strong U.S. Dollar. Over the longer-term, EM's stronger growth potential, lower debt levels, and favorable demographics remain a compelling secular theme. We are also neutral with respect to our view on Treasury Inflation Protected Securities (TIPS). We forecast inflation to remain near the Fed's 2% target, suggesting TIPS are fairly valued. Although wage growth has begun to increase and unemployment is low, productivity gains, spurred in part by increased business investment and decreased regulation, have kept unit labor costs and inflation in check.

> **"Corporate bonds continue to have a place in investor portfolios alongside government bonds. At current valuations, we continue to favor investment grade corporate and mortgage-backed securities over high yield bonds."**

Exhibit 18

U.S. TREASURY CURVE

Short Rates Likely to Decline Further if Fed Cuts as Expected



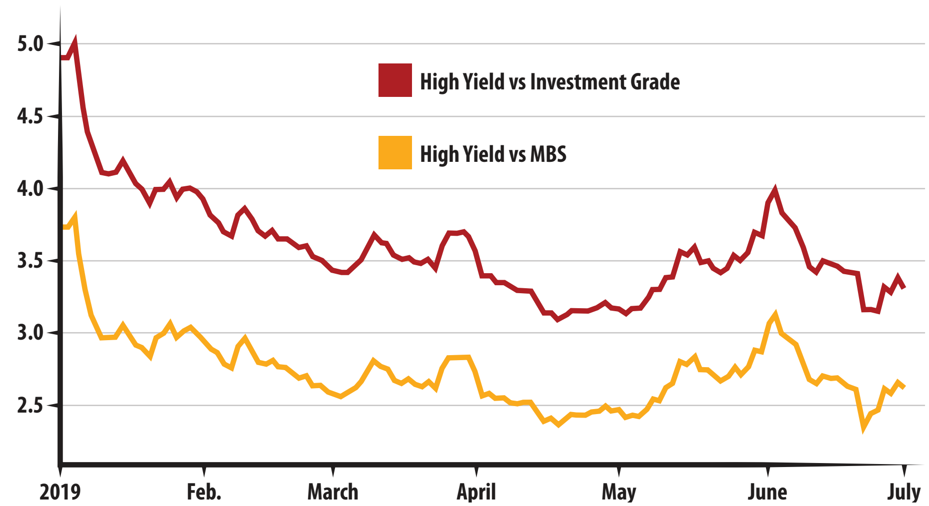
U.S. Treasury Act Last Mid YTM.

Source: 2019 Bloomberg Finance L.P.

Exhibit 19

HIGH QUALITY BONDS ARE ATTRACTIVE

Incremental Yield of High Yield over IG and MBS Has Declined

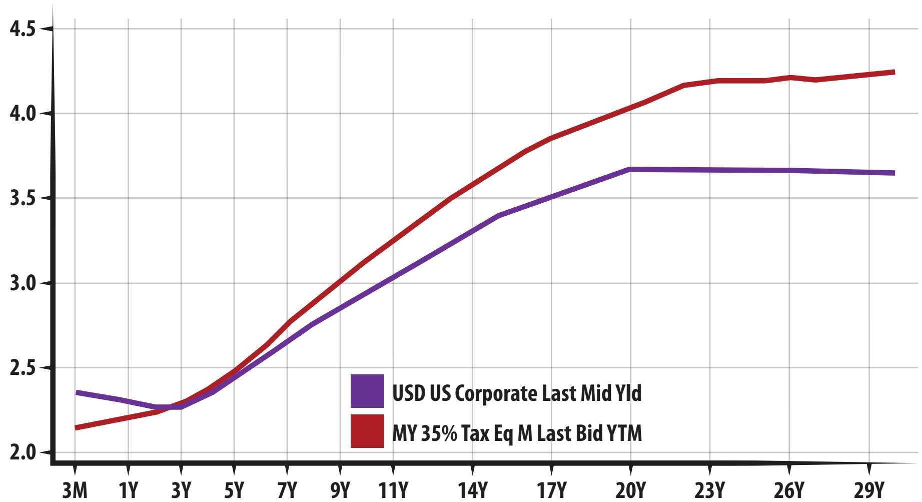


Source: 2019 Bloomberg Finance L.P.

Exhibit 20

TAXABLE EQUIVALENT MUNICIPAL VS CORPORATE YIELDS

Municipal Bonds Remain Attractive at Higher Tax Brackets

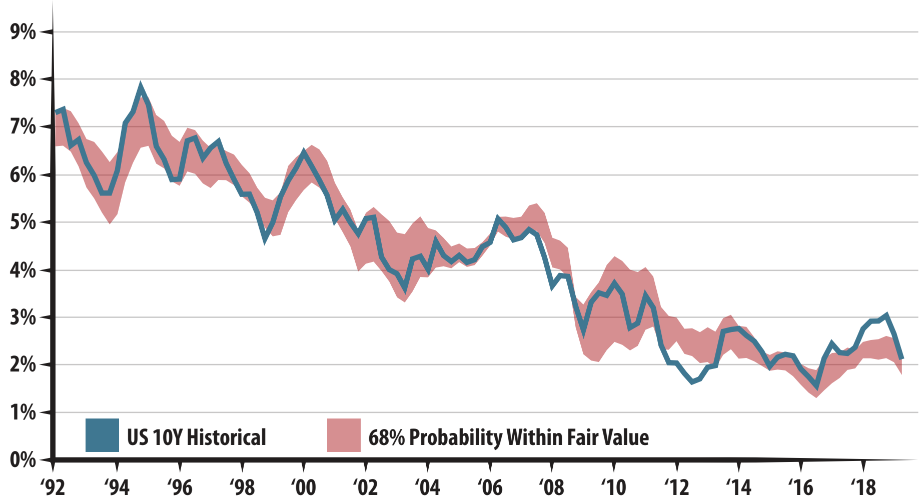


Taxable equivalent municipal yields = dividing tax-exempt municipal yields by 1 minus the marginal tax rate (marginal tax rate = 35% for this graph). Both yield curves are single-A rated indexes (single-A municipal and single-A corporate). Source: 2019 Bloomberg

Exhibit 21

JOHNSON FINANCIAL GROUP 10-YEAR U.S. TREASURY MODEL

June 2019



Source: Johnson Financial Group

Municipal bonds have had an excellent first half of the year due to favorable supply/demand dynamics and the continued effects of tax reform, whose limits on state and local tax deductions have increased the value of tax-exempt income for investors in high-tax states. While valuations are not cheap at current levels, the municipal market continues to benefit from steady fundamentals and an upward sloping yield curve that rewards investors for extending maturities. We continue to like investment grade municipals for investors in the highest tax brackets [Exhibit 20].

For the remainder of the year, our base case is for the Treasury yield curve to remain relatively flat with the 10-year Treasury yield in the range of 1.80% to 2.3%, although a shock could widen this range materially. Our proprietary Treasury model shows that the current level of the 10-year Treasury is close to our estimate of fair value [Exhibit 21]. Negative surprises, including further trade escalation or a deterioration in economic data, could accelerate a new easing cycle, while a resolution to the trade war or an improved economic outlook could result in Treasury yields retracing some of their recent declines. Rising geopolitical tensions with Iran or North Korea could also move markets, and investors will keep an eye on any signs of a resolution to the ongoing Brexit saga, including the possibility of either a hard Brexit or a second referendum that may result in Britons voting to scrap their plan to leave the European Union.

Our intermediate-term outlook is for rates to remain historically low due to lackluster inflation, economic growth that is forecast to decline but remain at or above the average for this expansion, and continued Treasury demand from global investors seeking safety and income in a world with over $12 trillion of negative yielding debt. We do not believe that the U.S. is on the verge of a recession over the next 12-18 months.

Perhaps the most noticeable consequence of Federal Reserve policy that individuals may see over the near term is declining cash yields. Today it is not uncommon to earn 2% on a money market fund invested in ultra-short U.S. Government bonds. If we are on the cusp of a new cycle of interest rate cuts as markets are predicting, those yields could decline quickly due to easier Fed policy and lower short-term rates. In such a circumstance, investors who now ask themselves why they should own low-yielding bonds when they are earning 2% in cash may be wishing they had taken Charmain Powell's advice and exercised an ounce of prevention by buying intermediate-term bonds whose low nominal yields may seem attractive in six months.

> **"We do not believe that the U.S. is on the verge of a recession over the next 12-18 months."**

CONCLUSION

Financial markets recovered from a difficult fourth quarter 2018 and delivered strong performance across asset classes. Whether that growth will continue will depend on earnings expectations, the resolution of trade tensions, and a continued Federal Reserve bias toward easing. With markets at fair valuation, we took advantage of strong equity markets to reduce equity exposure and bring client portfolios in line with long-term allocations.

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