JOHNSON INVESTMENT COUNSEL

Quarterly Insight

MARKET UPDATE

2021: THIRD QUARTER

GROWTH AND INFLATION CONCERNS ERASE THIRD QUARTER GAINS

A choppy September offset gains in July and August, resulting in flattish third quarter returns for U.S. stocks. The weakness was broad. Stocks had gained ground most of this year thanks in large part to rebounding earnings growth and positive economic momentum. Central bank accommodation had also been a key support. September is on average the worst month for stocks, however, and this year had its own list of reasons: potential for reduced Fed support, weaker earnings growth, more persistent supply chain issues, energy price spikes, Washington drama, and events in China (which led to an emerging market selloff). These dynamics also led to a rise in interest rates in September, offsetting gains in bonds and leaving them flat for the quarter.

SHIFTS IN SECTOR LEADERSHIP

Volatility has been relatively low this year at the overall index level, but underneath the hood there has been lots of action. Roughly 90% of stocks in the S&P 500 Index and the NASDAQ have declined at least 10% from their highs this year, and 98% of the Russell 2000 Index. There have been numerous shifts in sector leadership, from growth-oriented sectors like technology and communication services to value-oriented sectors like energy and financials. Higher-quality stocks have become more in favor, leaving many of the lower-quality, speculative stocks behind. Many of these lower-quality stocks are still in correction or bear-market territory.

INFLATION AND THE FED

The global economic shutdown of 2020 continues to reverberate into 2021, and is likely to keep doing so in 2022. The economy has strengthened remarkably, and while the healing process continues, imbalances, shortages, bottlenecks, and other distortions remain. These distortions have shown up in many places in the form of higher prices. The big question is how persistent inflation will be across the economy. The Fed has characterized inflation pressures as "transitory," but recently increased its forecast to 4.2% this year, above its previous estimate of 3.4%. In addition, it stated that tapering of quantitative easing will be announced at the November Fed meeting, and would finish by mid-2022. It also released projections showing a faster pace of rate hikes in the coming years. This shift shows that the Fed is attempting to normalize policy without jeopardizing economic growth.

Over the past couple of decades, powerful structural forces have weighed heavily on inflation. Demographic trends have been the most significant headwind. Much of the developed world, including the U.S., has experienced subdued population growth. Further, the population that we do have in the U.S. is beginning to age. In addition, debt levels coming out of the financial crisis were extremely elevated. All of this will continue to weigh on inflation after the initial short-term inflationary data begins to subside. The dire predictions about the negative outcomes of infla-

FEATURING

TOTAL RETURNS

	3Q 2021	2021
S&P 500	0.6%	15.9%
Dow Jones Industrial Average	-1.5%	12.1%
NASDAQ	-0.2%	12.7%
Russell 2000	-4.4%	12.4%
MSCI EAFE (International)	-0.3%	8.8%
Barclays Aggregate Bond Index	0.1%	-1.6%

tion are sure to continue, so it will be helpful to focus on these structural forces that are likely to keep a lid on inflation in the years ahead.

ECONOMY COOLING BUT STILL GROWING

While inflation data has been heating up, economic data has softened of late. Growth data and estimates were robust earlier in the year but have come down in recent weeks. The GDP growth figure remains healthy at nearly +4%, but the directional trend has been downward. Of particular concern are labor market trends, with job growth slowing. Labor market dynamics will be closely watched, particularly as it relates to stimulus and unemployment benefits affecting the labor supply.

CONGRESS DEBATING MAJOR LEGISLATIVE CHANGES

As of this writing, Congress is working on two major pieces of legislation, known informally as the "infrastructure bill" and the "reconciliation bill." Momentum on both bills has stalled in recent weeks as Democrats have struggled to unify around something that could pass the evenly-split Senate. Democrats took control of the White House and Congress in January with plans to raise taxes on those with higher incomes and net worth, both during life and at death. The most aggressive proposals included new and extremely high levels of tax on income, capital gains, and even a "wealth tax." Moderate Democrats have balked at some of these provisions as well as the overall price tag of the reconciliation bill. As a result, some of the more dramatic changes have been watered down. For example, the corporate tax rate currently sits at 21%. Initial proposals to take it back to its previous level of 35% met early resistance, and now the bill has it at 26.5%. It's impossible to know exactly how the details will shake out, but the market always has one eye on the news flow emanating from Washington.

POTENTIAL PLANNING OPPORTUNITIES

Considering the potential for dramatic tax law changes, it is always helpful to direct our focus to the things we can control. While nothing is certain until the law is officially passed, there could be planning opportunities that make sense regardless of the details. It seems likely that the income levels for the top tax brackets will decrease, and the tax rate for that group will increase. It also seems likely that capital gains and business income for those in the highest tax bracket will increase. There are also new rules and restrictions being debated related to IRAs. Finally, it seems likely that the new law will reduce the amount of assets allowable to gift during lifetime and leave to heirs at death free of gift and estate tax.

While many people may be largely unaffected by these potential changes, others may have opportunity to implement certain strategies under the existing rules and tax rates. Fortunately, we have been aware of many of these possibilities for some time. We will continue to provide perspective on this legislation as events unfold. Changes in Washington are just one of the many twists and turns our clients experience along the journey. Regardless of the source, it's our mission to provide wise, trusted counsel amid any of life's challenges.

Disclaimer: Any expectations presented should not be taken as a guarantee or other assurance as to future results. Our opinions are a reflection of our best judgment at the time this presentation was created, and we disclaim any obligation to update or alter forward-looking statements as a result of new information, future events or otherwise. The material contained herein is based upon proprietary information and is provided purely for reference and as such is confidential and intended solely for those to whom it was provided by Johnson Investment Counsel.

CRISIS OR CLARITY? THE FUTURE OF SOCIAL SECURITY

As one of the foundational building blocks of many retirement planning strategies, Social Security income is critical to almost every cash flow plan. So just about any headline casting doubt on its long-term solvency raises retirees' eyebrows at best and incites near panic at worst. The recent release of the Social Security Trustee's Annual Report is the latest instance. The 276-page document indicated that the projected year for "insolvency" for the Social Security Trust Fund was pulled forward to 2033 from 2034. This is a result of the Covid-related impacts of lower payroll tax revenue and many people claiming benefits earlier than previously projected. In addition, the number of workers paying in versus receiving benefits is expected to drop from about 3:1 today to about 2:1 in 2033. Without any changes to assumptions for payroll tax collections, retirement forecasts and the current structure for payment of benefits, Social Security reserves will be depleted by then. It's estimated this deficit would require a 24% reduction in Social Security benefit payouts unless Congress steps in to make changes.

But let's clear one thing up right away—a dramatic 24% reduction in Social Security benefits is extremely unlikely to happen. There are many reasons, but first and foremost, permitting such a draconian cut would be political suicide to most members of Congress and any President. Retirees and people of retirement age are the most active voting bloc in the electorate and the largest campaign donors. According to 2021 US Census data (which can be viewed here), 70.4% of U.S. citizens 55 and older voted in the November 2020 election. This contrasts with an average of 51.4% voter participation for those 18-34 year olds—and this is without any talk of reducing existing benefit payouts prior to that election. If there's any talk about reducing existing Social Security benefits before any election, it's safe to say the older voting bloc would swamp the polls and turnout would be even higher.

WHAT CAN BE DONE TO "FIX" SOCIAL SECURITY?

The good news is that 2033 is still more than a decade away. By implementing some relatively modest changes, Social Security can most likely be stabilized. This is not without precedent. Back in the early 1980's a similar adjustment was made by the Reagan administration. To address the deficits, the Social Security Amendments of 1983 were passed. This included taxing some Social Security benefits and gradually increasing the Full Retirement Age (from 65 to 66 for those born in 1943 and beyond and 67 for those born 1960 or beyond). Here's an easy math question: In 1983, how old were people born in 1943? How old were people born in 1960 in 1983? That's the point.

Today, several measures can also be taken to address the current version of the problem. Given how negotiations work in the halls of Congress, we doubt it would be just one or two of the potential changes outlined below, but rather some mixture of many or all these changes.

1) Modify COLA (cost-of-living adjustment) calculation to reduce annual benefit increases (Note: It is currently estimated the 2022 benefit increase could be about 6% due to recent inflation measures, the largest increase since 2008.)

2) Increase the amount of wages that are subject to the payroll tax (6.2% for employees, 6.2% for employers) at a faster rate. The current cap is $142,800. This could be increased or the cap could be removed altogether.

3) Increase payroll tax rate from 12.4% (has not changed since 1990).

4) Increase initial Full Retirement Ages from current levels. Currently, Full Retirement Age is 66 if you were born between 1943 and 1954. The Full Retirement Age increases gradually if you were born from 1955 to 1960, until it reaches 67. For anyone born 1960 or later, full retirement benefits are payable at age 67.

5) Increase earliest possible age to claim Social Security from the current age of 62.

6) Reduce income level at which Social Security becomes taxable. Under current law, 50% of Social Security income starts to be taxed at $32,000 (married filing jointly) and becomes 85% taxable above $44,000 of total income.

7) Increase the number of years used for average wages from 35 years to something higher. This would capture earlier, lower-income years, which would reduce the average wages used to calculate benefits.

It goes without saying that many retirees receiving benefits would not view these adjustments positively. To make it more palatable, and given the voting data, it's highly unlikely anyone over the age of 60 would see major changes. In all likelihood, any changes would impact those under age 40.

SOCIAL SECURITY PLANNING STRATEGIES

Using history as a guide can be helpful, but not always a perfect way to plan. The world is much different today compared to 1983, and there are many other factors that need to be considered with respect to assumptions about Social Security. A growing population of those over age 65, higher government debt and spending levels, and other differences in the political and economic landscape have changed the dynamics. In light of that, it would be wise to take a conservative approach to assumptions for Social Security benefits moving forward. It is virtually impossible to capture all the potential changes to benefit growth, benefit ages, taxation levels, etc., but it's a good practice to segment expectations based on the age of the retiree.

For those age 60 or over, we don't expect many major changes to current benefits. Still, at a minimum, it makes sense to lower the inflation factor assumed in the annual benefit increase. For those under 50, a wise approach could be to find the current expected Full Retirement Age benefit (downloadable from www.ssa.gov in the annual Social Security statement) and reduce it by a modest percentage to capture some reduction from the current estimate for future benefits. We would much rather be wrong to the upside on our assumptions, especially when it comes to retirement cash flow.

BOTTOM LINE

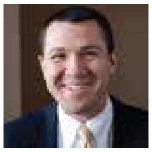
Social Security is a bedrock of retirement planning, and a key planning assumption in almost every wealth planning scenario. But we doubt major benefit reductions will affect those over the age of 55 or 60. A more likely outcome is modest changes to much younger workers. Given its critical and long-lasting impact, it makes sense to conservatively plan ahead!

Disclaimer: This material has been prepared for informational purposes only, and is not intended to provide, and should not be relied on for, tax, legal or accounting advice. You should consult your own tax, legal and accounting advisors prior to taking any action.

NEW SHAREHOLDER

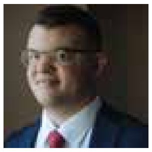
We are pleased to announce and congratulate a new shareholder to the firm. Since 2001 JIC has been a privately-held, employee-owned firm which has allowed us to truly focus on the long term needs of our clients.

William E. Jung, CFA
Johnson Asset Management
Research Analyst, Principal



NEW DESIGNATIONS

Johnson Investment Counsel is committed to continuing education to provide personal development for our employees and better service to our clients. Congratulations to Research Analyst Joe Abbott, CFA, on earning his Chartered Financial Analyst designation.


Abbott, CFA

NEW ADDITIONS TO THE TEAM

> **Anita L. Harney**
> Trust Associate

> **April C. Leygraaf**
> Systems Analyst

> **Anita L. Ridener**
> Receptionist

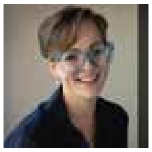
> **Lauren E. Simon**
> Client Support Assistant

> **Summer C. Wanner**
> Operations Associate


Harney


Leygraaf


Ridener


Simon


Wanner

WOMEN, WEALTH, AND JOHNSON

Did you know that 53% of women do not have a financial advisor*? We're working to change that. Women have unique priorities and challenges—whether they are just starting out in their career, starting a family, running a business, planning for retirement, or facing divorce or the loss of a spouse—there are financial aspects to consider along life's journey. Our new Women, Wealth, and Johnson page on our website addresses some of these concerns and highlights ways our wealth mangement professionals can partner with women to help them thrive. Scan the QR code using your smartphone's camera or visit JOHNSONINV.COM to learn more.

*Miami U MBA findings.

If you are a client of Johnson Investment Counsel, you should receive account statements on at least a quarterly basis directly from the qualified custodian that holds and maintains your assets. You are urged to carefully review all custodial statements for accuracy. If you are not receiving custodial statements, please contact our Chief Compliance Officer, Scott Bischoff at (513) 661-3100.

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Johnson Investment Counsel, Inc. is one of the nation's largest independent wealth management firms, managing more than $17 billion in assets for clients in 49 states. 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, families, charitable organizations, foundations, and corporations through four integrated divisions.

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