Madison INVESTMENTS

Market and Economic Review

Client Communication for the Second Quarter 2023

Table of Contents

550 SCIENCE DRIVE, MADISON, WI 53711 888.971.7135 MADISONINVESTMENTS.COM

S&P 500 index advances another 8.7% in Q2, ending first half of year up almost 17%.

- Breadth continues to be very narrow – only ten companies contributed over 13% of the index's return. Over 200 companies declined in the first half of the year.
- Corporate earnings have been relatively flat, meaning the market's advance has been mostly from companies' valuations becoming more expensive.
- Fixed income continues to look attractive relative to equities, with investment grade corporate yields in the 5% range.
- Fed funds rate is now over 5%. A year ago it was still below 2%. One of the biggest unknowns moving forward is what the impact will be from the lag effects of the Fed's aggressive actions over the past twelve months.

"What I need is a list of specific unknown problems we will encounter."

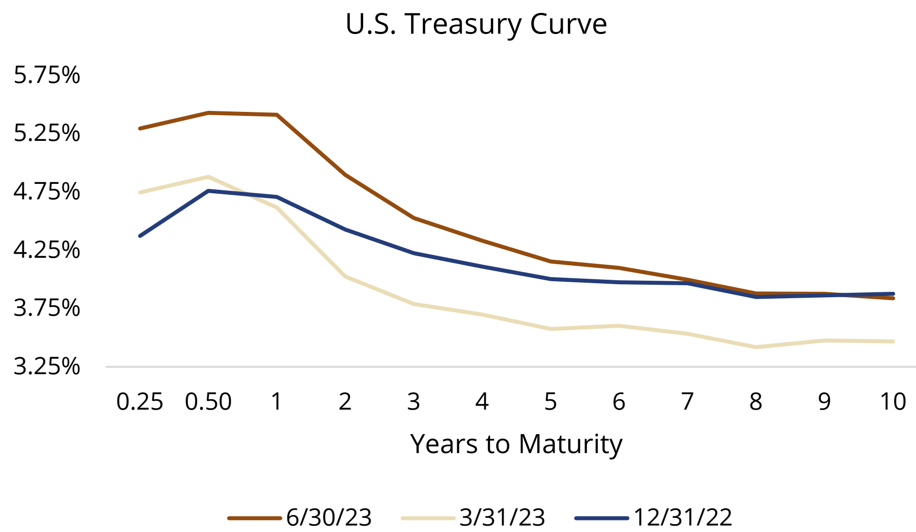
Advisor Corner: Inflation and Taxes

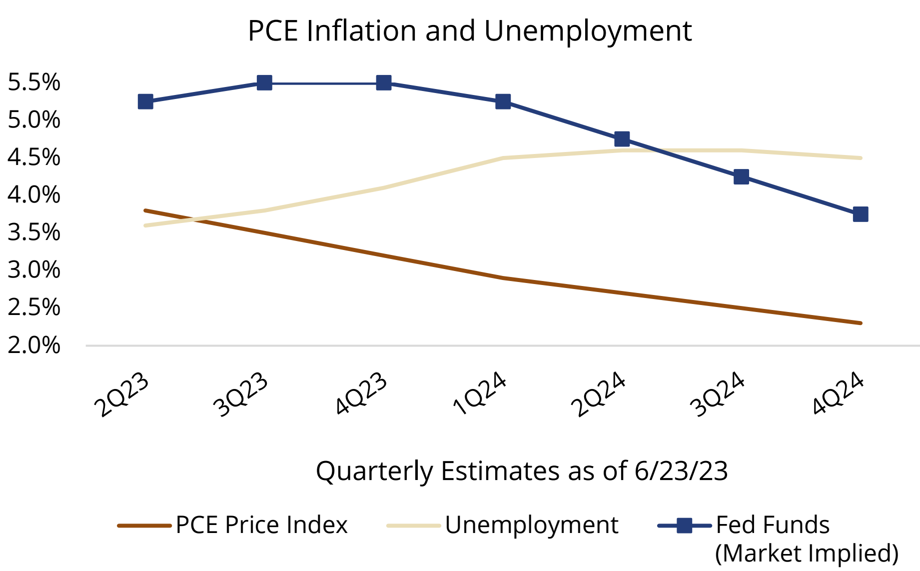
- Inflation also has an impact on the tax code. The gift tax exclusion amount increased to $17,000 per person this year, up from $16,000 last year. This means you can gift away $17,000 in cash or property in 2023 to as many individuals as you would like without any required filing with the IRS.
- Inflation caused tax brackets and the standard deduction to shift upward by about 7%. For example, married couples filing a joint return get a standard deduction of $27,700 in 2023 versus $25,900 last year, and the threshold for moving from the 12% marginal tax bracket to the 22% bracket increased from $83,550 of taxable income last year to $89,450 this year. Combined with the standard deduction, a married couple can have gross ordinary income of $117,150 before each marginal dollar of income is taxed above the 12% federal rate in 2023.

Short rates moved higher as Fed remains hawkish

In June, the Federal Reserve (Fed) decided to leave the 5.25% federal funds rate unchanged. Since March 2022, the Fed hiked rates ten consecutive times by a total of 5%. Market consensus currently anticipates a 0.25% rate increase in the coming months and the first rate cut in early 2024.

The Fed's aggressive policy actions have affected the shortest portion of the yield curve much more than longer maturities. This implies the Fed will have successfully guided inflation to lower levels within the next 12 to 18 months, thereby orchestrating a path for lower interest rates.



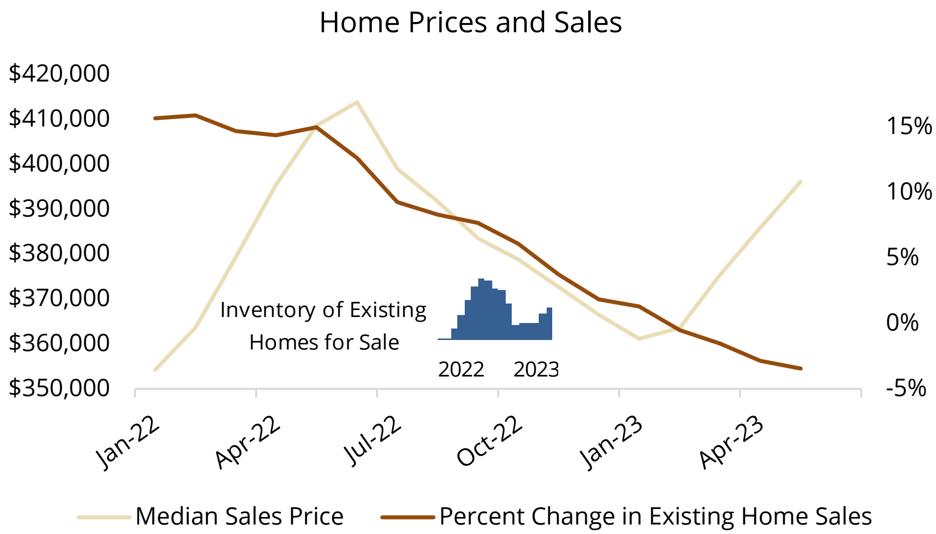


Inflation and employment forecasts support lower rates during 2024

The Federal Reserve's efforts to suppress inflation are expected to result in higher unemployment and slower U.S. economic growth. Forecasts suggest inflation will gradually fall towards 2% during the next 18 months while unemployment is expected to rise above 4% early next year. Projections for a lower federal funds rate in early 2024 suggest the Fed will have accomplished its dual objective of price stability and full employment. In our view, a minor recession could occur within the next year.

Source: Bloomberg,

MACRO COMMENTARY

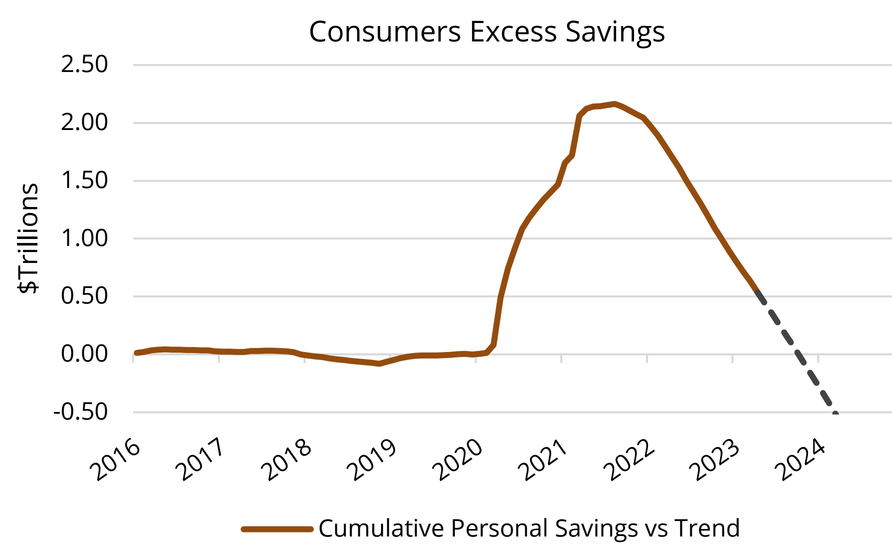


Home prices have been supported by the limited inventory of existing homes available for sale

Higher interest rates have impacted the housing market, as evidenced by the limited inventory of existing homes for sale. Homeowners with low mortgage rates are less willing to sell given the likelihood they'd have to finance the purchase of a different home at a substantially higher rate. Low housing inventory coupled with strong demand has pushed the median sales price higher. We believe a resilient housing market will limit the downside of potentially slower economic growth.

Consumers continue to spend down excess Covid savings

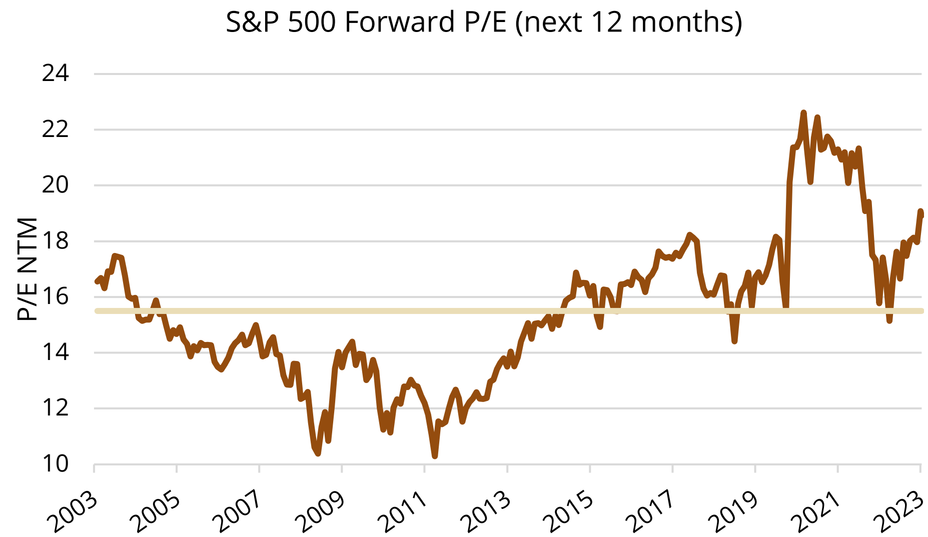
U.S. consumers continue to spend down their excess Covid savings that peaked at over $2 trillion during Covid and is now heading below $500 billion. This continued decline in excess spending ability should bode well for reducing inflation over the next six months, but also leaves the unknown question of what the effect will be on goods and services demand and the economy once this excess savings is spent.



Source: Bloomberg, Factset, Piper Sandler

Price to earnings multiple of stocks expanded throughout first half of 2023

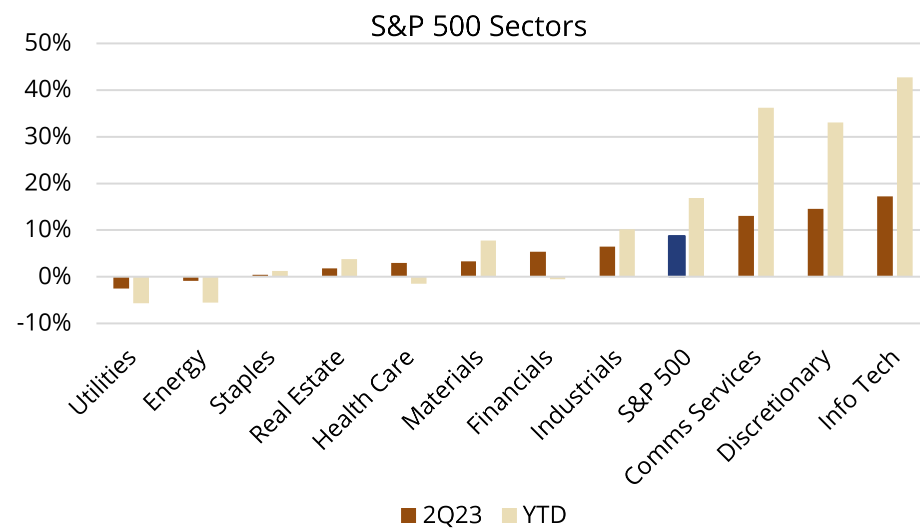
The S&P 500's 16.9% advance in the first half of 2023 was its second highest in the past 25 years. Corporate earnings were relatively flat, leading to significant price to earnings expansion, with the S&P 500 now trading at about a 19x forward multiple, above its 20-year average. We view today's equity market as one in which selective stock picking is necessary to avoid excessive valuations, particularly in areas of the market where artificial intelligence is creating speculation.



Tech driving the 2023 equity market

In what seems like déjà vu of the 2010-20 decade, mega cap technology stocks are the dominant drivers of 2023's returns so far, while consumer staples, energy, utility, health care, and financial companies are flat to negative on the year.

The primary debate among market analysts is whether corporate earnings have already troughed in this cycle or whether the lag effects of the Fed's monetary tightening will cause corporate earnings to stagnate or decline as we head into 2024.

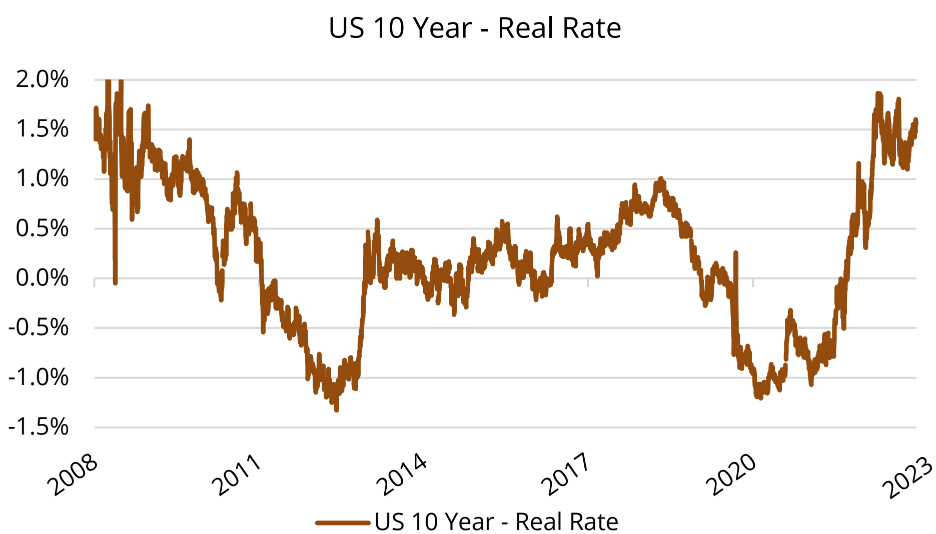


Sources: Factset, Bloomberg

FIXED INCOME MARKETS

Refinancing maturing debt should not be an issue for corporations in the near term

Many corporations extended debt maturities when rates were much lower, thereby reducing the amount of paper coming due over the near term. New issue supply (e.g. the combination of debt maturities plus new incremental issuance) is projected to be met with ample investor demand for corporate paper. Even though an economic slowdown could pressure credit spreads, an advantageous balance between supply and demand would likely help stabilize risk premiums. We continue to find attractive opportunities in the corporate bond market with investment grade yields in the 5% range.



Fixed income producing positive real returns

Higher interest rates and lower inflation has resulted in positive real returns coming back to the fixed income markets. Real return is the nominal yield of an investment subtracted by the anticipated inflation rate.

The real rate of return on the 10-year U.S. Treasury bond is now heading toward 2% for the first time since 2008.

Source: Bloomberg, Factset, ICE Data Indices

DISCLOSURES

"Madison" and/or "Madison Investments" is the unifying tradename of Madison Investment Holdings, Inc., Madison Asset Management, LLC ("MAM"), and Madison Investment Advisors, LLC ("MIA"). MAM and MIA are registered as investment advisers with the U.S. Securities and Exchange Commission. Madison Funds are distributed by MFD Distributor, LLC. MFD Distributor, LLC is registered with the U.S. Securities and Exchange Commission as a broker-dealer and is a member firm of the Financial Industry Regulatory Authority. The home office for each firm listed above is 550 Science Drive, Madison, WI 53711. Madison's toll-free number is 800-767-0300.Any performance data shown represents past performance. Past performance is no guarantee of future results.

Non-deposit investment products are not federally insured, involve investment risk, may lose value and are not obligations of, or guaranteed by, any financial institution. Investment returns and principal value will fluctuate.

This report is for informational purposes only and is not intended as an offer or solicitation with respect to the purchase or sale of any security.

Although the information in this report has been obtained from sources that the firm believes to be reliable, we do not guarantee its accuracy, and any such information may be incomplete or condensed. All opinions included in this report constitute the firm's judgment as of the date of this report and are subject to change without notice.

Indices are unmanaged. An investor cannot invest directly in an index. They are shown for illustrative purposes only, and do not represent the performance of any specific investment. Index returns do not include any expenses, fees or sales charges, which would lower performance.

All investments contain risk and may lose value. Equities may decline in value due to both real and perceived general market, economic and industry conditions. Investing in foreign-denominated and/or -domiciled securities may involve heightened risk due to currency fluctuations, and economic and political risks, which may be enhanced in emerging markets.