Madison INVESTMENTS

Market and Economic Review

Client Communication for the Third Quarter 2023

Table of Contents

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

EXECUTIVE SUMMARY

Q3: Equities decline, interest rates continue their rise

- S&P 500 -3.3%; Bloomberg Agg Bond -3.2% for the quarter.
- Entire yield curve shifted up during the quarter:
  - 5-yr Treasury 4.1% → 4.6%
  - 10-yr Treasury 3.8% → 4.6%
- Oil increased from $70 to $91 per barrel.
- Q3 earnings and revenue expected to be flat year over year.
- Equity market continues to struggle with the tug of war between higher interest rates, contracting valuations, and whether earnings growth will meet robust expectations of 12% earnings growth next year.
- Anecdotal evidence that consumer spending is slowing and weakening:
  - One of the nation's largest used car dealer networks recently reported a 9% year over year decline in vehicle sales volume.
  - Financial institutions are increasing loan write-offs.
- Investment grade bond yields breaking into the 6% range in some industries.
- Best bond yields we have seen for the past 20 years

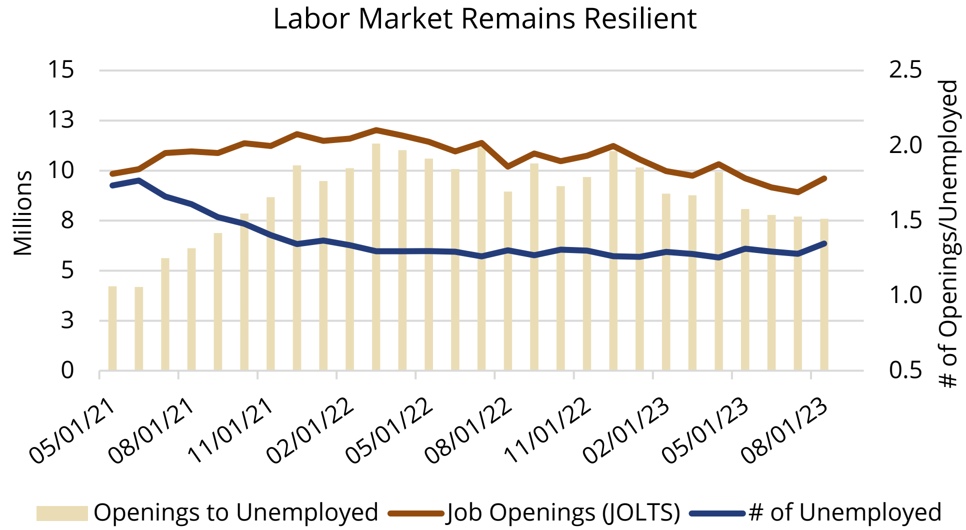
"Can you increase its range?"

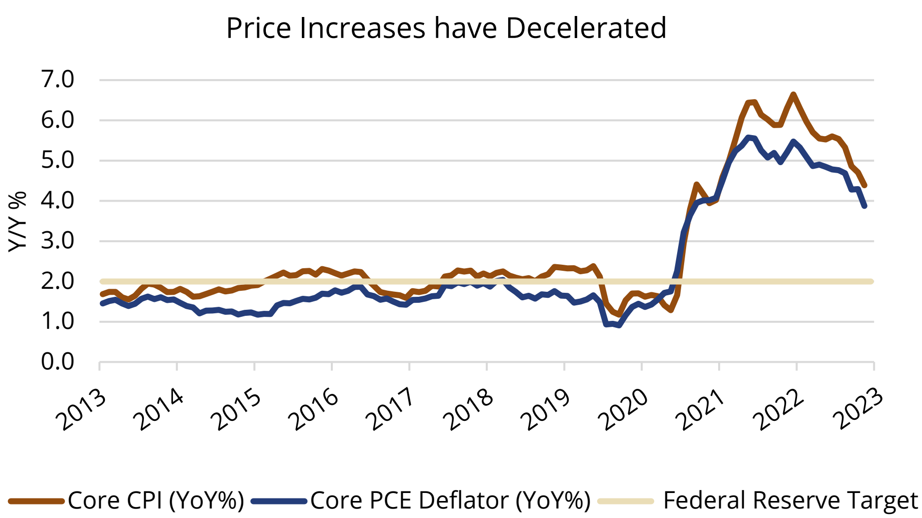
In other news

- Social Security payments will be increasing 3.2% in 2024 based on this year's increase in the Consumer Price Index (CPI).

Labor market has remained strong in the face of rate hikes

Thus far in the Fed's rate hiking cycle, the labor market has remained strong, with job openings continuing to outpace the number of unemployed workers. The strong job market continues to favor the view of no recession (or the "soft landing") scenario and makes the Fed's inflation fight more difficult.



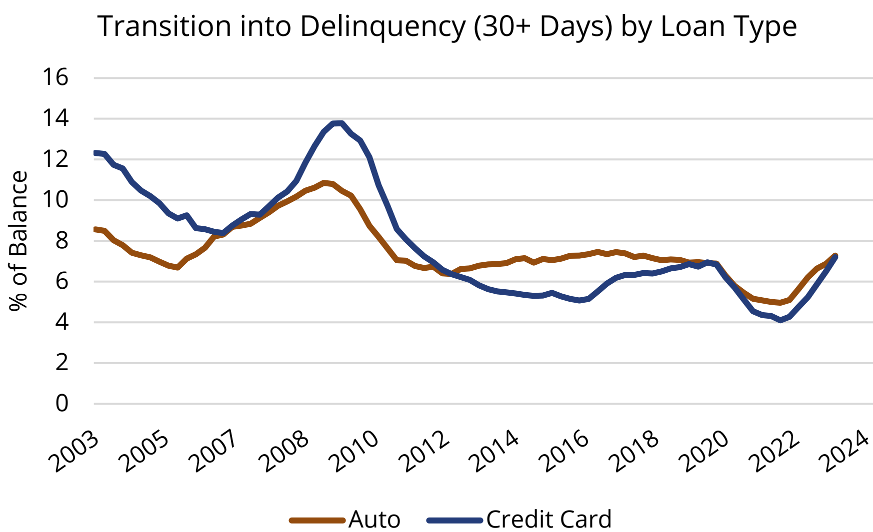


Inflation continues to decline, but not at the rate the Fed had hoped

Inflation is finally falling below the 4% mark but still has a ways to go to get to the Fed's 2% target. The strong labor market is making it difficult for the Fed to slow consumer demand. However, excess savings from Covid stimulus is set to run out by the end of this year, which should decelerate consumer spending and help supply catch up with demand, particularly in the services sector.

Source: Factset

Madison INVESTMENTS



Signs of consumer weakening

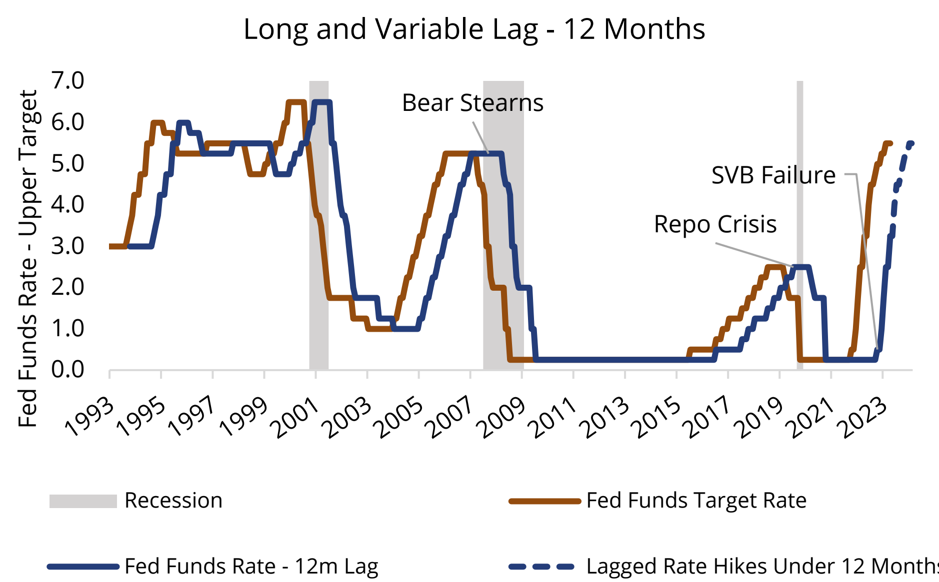
Auto and credit card loan delinquencies are increasing. With consumer spending comprising about 70% of the nation's GDP, a weakening consumer does not bode well for robust growth heading into 2024.

Retailers are also reporting declining spending on consumer discretionary items, and more price sensitivity on necessary items.

What will be the unknown lag effects of the current rate hiking cycle?

The delayed effects of the unprecedented rate hikes of the early 1980s produced the worst farm debt crisis in U.S. history and the Savings & Loan crisis of the late 1980s.

It may be too early to tell what the unintended consequences of the 550 basis points (bps) in rate hikes will be this cycle. So far, the Fed was able to contain the regional banking crisis in March by expanding rules relating to banks' borrowing facilities with the Federal Home Loan Bank. It is difficult to believe that 5.5% of interest rates hikes in a 1-year time period will not have other unintended consequences.



Source: Federal Reserve Bank of New York, Factset

EQUITY MARKETS

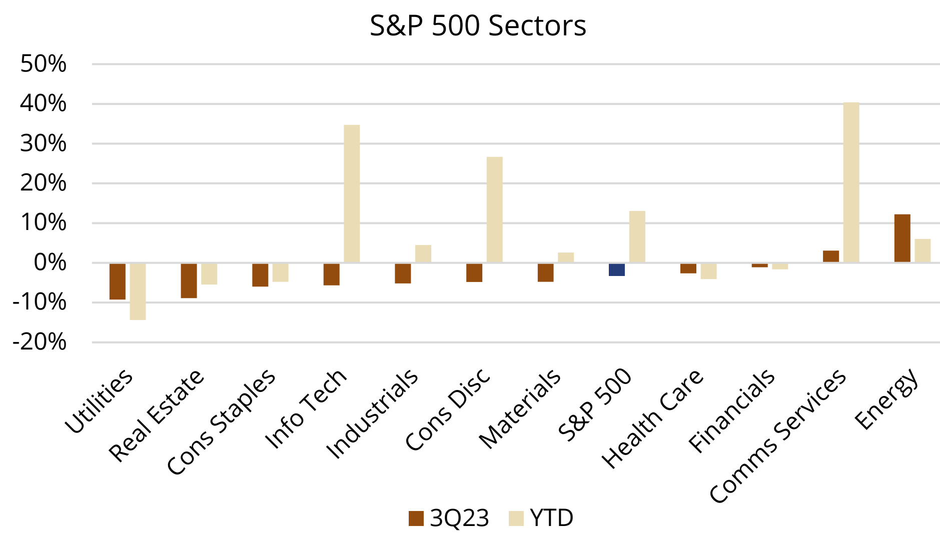
Madison INVESTMENTS

2023 Equity market continues to be driven by only a dozen companies

Nvidia, Apple, Microsoft, Meta, Amazon, Tesla, Alphabet, Eli Lilly, Broadcom, Salesforce, Adobe, and AMD comprise 12.5% of the S&P 500's 13% YTD return.

247 companies in the S&P 500 are negative so far this year; of those 152 are down more than 10%.

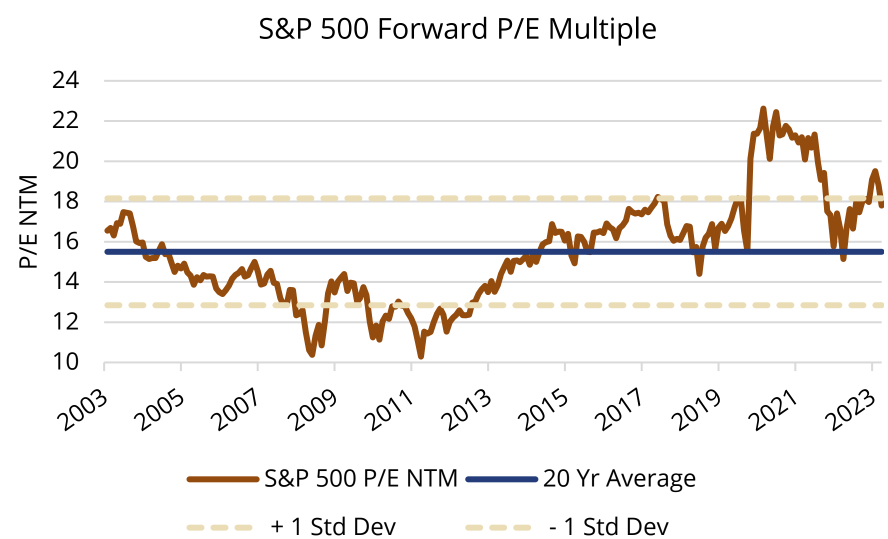
Valuation differences between some tech stocks (driven by fervor over artificial intelligence) and blue-chip dividend paying stocks are at their greatest disparity since the dot-com bubble.



Equity market continues to trade at a premium multiple

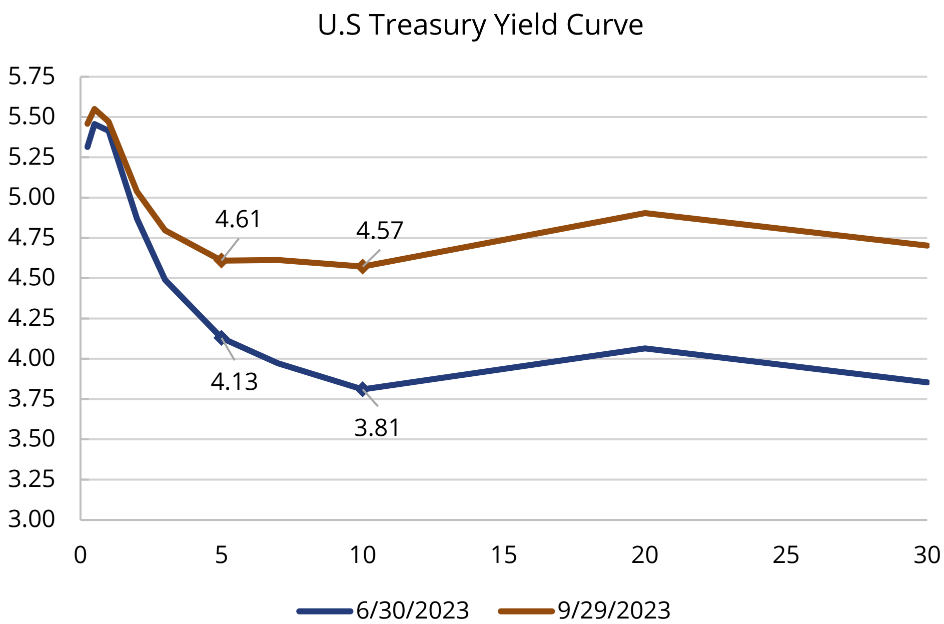
The forward price to earnings multiple on the S&P 500 continues to trade in the 18x range, well above its long-term average of about 16x. This ratio also assumes that the S&P 500 will increase earnings next year by 12% over 2023. These estimates are optimistic given elevated interest rates and signs of decelerating consumer spending.

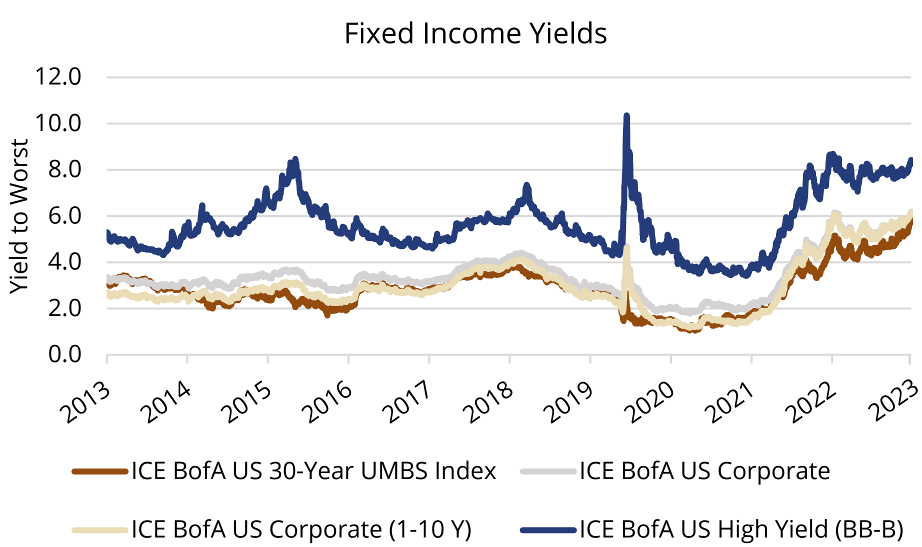
In this interest rate environment, we would normally expect the market to be trading at an average to below average P/E multiple.



Sources: Factset, Bloomberg

FIXED INCOME MARKETS





Intermediate and long-term yields moved dramatically higher during the quarter

The Fed directly controls short-term rates via the overnight Fed funds rate, which was raised 0.25% in Q3, up to 5.50%. However, the bond market priced more dramatic moves in intermediate and long-term rates with the 10-year Treasury yield now at its highest level since the early 2000s.

The yield curve is still significantly inverted with the Fed funds rate almost 100bps higher than the 10-year yield, which typically indicates a slowdown will be coming. Another question swirling in bond markets is how long can the U.S. Treasury sustain higher costs of borrowing when the debt to GDP ratio is at its highest level since WWII, which was a time when the Fed had to artificially keep rates low to finance the debt.

Climbing bond yields make fixed income the most attractive it has been since before 2008

Investors putting new money into bonds are now able to obtain investment grade yields in the 5-6% range across the yield curve, providing the best entry point into fixed income that we have seen in over 15 years.

Fixed income returns are poised to potentially compete with equity returns over the next 2-3 years.

Source: 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.

A basis point is one hundredth of a percent.