



## MANAGER COMMENTARY SECOND QUARTER 2018



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### Market Review

U.S. equities moved solidly higher across the board during the quarter. Small-cap stocks posted a sizable advantage over large-cap stocks, with investors likely rotating due to both decent relative valuation and the threat of increased trade barriers harming larger companies.

#### Size/Style

- Within the R2500, small-caps rallied strongly during the quarter, pulling them to a solid performance advantage over mid-caps.
- From a style perspective, growth topped value in mid-caps, while the small-cap segment was the lone part of the Russell 3000 Index where value stocks edged growth stocks.

#### Russell 2500 Sectors

Relative sector performance was inconsistent within the Russell 2500 Index quarter over quarter.

- Health Care stocks backed up a strong Q1 with an additional 8.8% gain.
- The Energy sector performed even better, vaulting 16.6%.
- Producer Durables advanced, but recorded the worst relative performance.
- Materials & Processing continue to struggle.

### Attribution

The SMidCap strategy advanced about 5.3% during the quarter, but lagged the benchmark Russell 2500 Index's 5.7% return. The table below breaks down the contributions from sector positioning and stock selection.

In total, sector positioning added 0.74% to active return:

- Overweighting the Energy sector contributed 44bps to active return, as the sector outperformed the benchmark by over 12% during Q2.
- Underweighting the Industrials sector added 36bps, as the sector underperformed the Russell 2500 Index by about 5%.

Conversely, stock selection within the respective sectors detracted 1.10% from active return:

- Stock selection within the Financials & Energy sectors was poor.
- Stock selection was best within the Consumer Discretionary sector.

Sector	DE-GLA Weighting	Russell 2500 Weighting	%Active	DE-GLA Return	Russell 2500 Return	%Added	Sector Allocation	Stock Selection	Active Contribution
Consumer Discretionary	18.89	12.47	6.42	12.13	7.54	4.58	0.14	0.85	0.99
Consumer Staples	2.25	2.64	-0.39	14.93	7.87	7.06	0.06	0.14	0.20
Energy	8.22	4.68	3.54	4.94	18.32	-13.39	0.44	-1.00	-0.56
Financials	20.27	16.50	3.77	-3.47	1.78	-5.25	-0.11	-1.11	-1.23
Health Care	12.95	12.01	0.94	8.97	8.88	0.10	0.04	-0.01	0.03
Industrials	9.23	16.10	-6.87	-0.73	0.60	-1.33	0.36	-0.15	0.21
Information Technology	20.06	17.09	2.98	8.31	5.69	2.62	-0.03	0.56	0.53
Materials	3.46	5.75	-2.29	3.66	2.28	1.37	0.10	0.09	0.19
Real Estate	4.40	8.84	-4.44	-0.10	10.52	-10.61	-0.22	-0.47	-0.69
Telecom Services	0.26	0.48	-0.21	7.25	8.00	-0.75	0.01	0.00	0.02
Utilities	0.00	3.45	-3.45	0.00	7.19	-7.19	-0.05	0.00	-0.05
<b>Total</b>	<b>100</b>	<b>100</b>		<b>5.34</b>	<b>5.70</b>	<b>-0.36</b>	<b>0.74</b>	<b>-1.10</b>	<b>-0.36</b>

Source: DE Team and Bloomberg. Performance numbers are gross of fees.

## Market Outlook

U.S. equity markets continue their rolling sideways correction, with stocks up about 2% for the year, while earnings look to be 20-25% higher year-over-year. Building inflation pressure, the Federal Reserve's series of rate hikes, and growing trade tensions appear to be the primary threats at this time.

The SMidCap model remains biased against stocks with high earnings yield, as well as various other valuation metrics, favoring instead companies with short-term technicals and higher volatility. From a style perspective, the model prefers growth over value, especially within small-caps. The pro long-term price momentum bias has been reduced, and the model has shifted toward a higher volatility bias. Technology (Software, Internet) and Health Care (Medical Services) stocks are most in favor, while Financials (Banks) are most out-of-favor.

The data in the attribution table represent the returns for each sector and for gross return for a representative composite account for one quarter ending the current calendar quarter. Individual account returns may vary.

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