



Great Lakes Advisors, LLC
Large Cap Value Equity
3Q11 Commentary

Volatility soared and investor risk avoidance activity jumped over the summer as the equity market continued the decline of the late spring, plunging another 14% and evoking memories of the late 2008 – early 2009 collapse. Low US GDP growth, monetary tightening in response to higher reported inflation in China, and the interconnection of fiscal, sovereign debt, and financial industry structural problems in several European nations concerned investors already unnerved by a U.S. credit rating downgrade and tentative, halting fiscal policy responses to U.S. and European economic matters. Value style indexes declined by more than the S&P 500, as they did in the spring.

Again over the summer, areas more sensitive to the global economy limited the strategy. Global industrial commodities positions (chemicals, metals) collapsed about 40% over worries around Chinese demand as its economy grows less rapidly, general fears of a broad economic slowdown, and possibly less investor interest as traded commodity prices fell sharply in September. Global industrial manufacturers (makers of a wide range of products including construction machinery, engines and parts, electricity generation and management products, building controls, factory automation equipment, aircraft components) all declined over 20% on concerns for particular markets (including construction, which in the US has not recovered from the last downturn) and the outlook for world economic movements. Lending oriented positions Bank of America (-44%) and Citigroup (-39%) again fell more than the equity market as 1) mortgage sale and securitization activities during the recent downturn remain as an expense and regulatory problem, 2) rules for future capital levels, set by central banks, are still uncertain, 3) low short and long term interest rates pressure lending margins. Also among financials, life insurers (a business of Hartford and Ameriprise) profit growth is limited by low interest rates; these holdings declined over 30%.

Other areas declined at lesser rates—and a few positions prices actually rose—to lead the strategy. Consumer frequent-purchase goods companies (household cleaning and paper products, food, tobacco) raised prices to preserve profit margins pressured by raw material cost increases, although sales growth is slow. Electric/gas utilities, also relatively stable businesses with attractive relative dividend yields, moved up slightly. Target (+4%) reported improving sales trends even in a sluggish economy. Two well-capitalized financials, American Express and Berkshire Hathaway, declined less than the equity market and many lending-oriented financials in this uncertain period. American Express' credit quality continues to improve while charge card volume is rising and equity capital level is high.

Low interest rates (now both short and long term due to expansionary monetary policy) and reasonable, by historic standards, valuation are still favorable for equities. However, world economic growth has slowed and European problems remain a focus for investors.