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LARGECAP

GREAT LAKES ADVISORS

A WINTRUST WEALTH MANAGEMENT COMPANY

MANAGER COMMENTARY

Second Quarter 2020

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MARKET REVIEW

U.S. equities recovered sharply across the board during the second quarter, following the bloodbath of Q1. Year-to-date losses for larger-cap stocks now stand in the low single digits, while smaller-cap stocks have losses in the low double-digits.

S&P 500

The S&P 500 Index screamed to a 20.5% gain during Q2, leaving the Index just 3.1% lower for the year.

Size/Style

- Mega-caps slightly outperformed large-caps with each posting 20%+ gains.
- Despite yet another head fake from mid-May to early June, growth once again dominated value in both the mega-cap and large-cap segments. Growth stocks have a substantial lead over value stocks for the 3, 5, and 10 year periods.

S&P 500 Sectors

We observe little quarter-to-quarter correlation of relative sector performance. Defensive stocks faded the rebound, which was instead led by cyclicals:

- Technology was able to continue its strong relative performance, and was the second best performing sector overall with a 30.5% advance. Consumer Discretionary stocks paced the S&P 500 Index with a 32.9% gain, and Energy stocks made up a third of their Q1 loss of 50%.
- Consumer Staples and Utilities stocks were unable to repeat their strong relative showing from Q1, but still added 8.1% and 2.7%, respectively.

SECOND QUARTER ATTRIBUTION

The LargeCap strategy climbed nearly 24% during Q2, easily eclipsing the benchmark S&P 500 Index's strong 20.5% advance. The table on the following page breaks down the contributions from sector positioning and stock selection.

In total, sector positioning added 0.99% to active return.

Stock selection within the respective sectors added an additional 2.37% to active return.

SECTOR	GLA WEIGHTING	S&P 500 WEIGHTING	% ACTIVE	GLA RETURN	S&P 500 RETURN	% ADDED	SECTOR ALLOCATION	STOCK SELECTION	ACTIVE CONTRIB
Comm Services	8.80	10.87	-2.07	22.55	20.04	2.50	0.01	0.24	0.25
Consumer Disc.	11.42	10.42	1.00	33.37	32.86	0.52	0.11	-0.06	0.05
Cons. Staples	3.42	7.35	-3.93	5.26	8.12	-2.86	0.52	-0.16	0.36
Energy	0.24	2.93	-2.69	-7.31	30.51	-37.82	-0.39	-0.01	-0.40
Financials	9.30	10.52	-1.23	14.66	12.20	2.46	0.17	0.13	0.30
Health Care	10.38	15.16	-4.78	25.34	13.59	11.75	0.34	1.25	1.60
Industrials	13.68	7.94	5.73	17.84	17.01	0.83	-0.24	0.10	-0.14
Technology	28.85	26.14	2.71	34.37	30.53	3.84	0.15	1.03	1.18
Materials	6.40	2.50	3.90	22.53	26.04	-3.51	0.22	-0.24	-0.02
Real Estate	6.21	2.89	3.32	14.80	13.22	1.58	-0.28	0.10	-0.18
Utilities	1.32	3.28	-1.96	9.16	2.73	6.43	0.38	-0.02	0.37
TOTAL	**100**	**100**		**23.91**	**20.54**	**3.37**	**0.99**	**2.37**	**3.37**

Source: GLA and Bloomberg. Performance numbers are gross of fees.

MARKET OUTLOOK

This quarter reveals the exceptional nature of this COVID-19-driven recession (as formally declared by the NBER). And this says little or nothing of the massive dislocation of the oil market, the unprecedented fiscal and monetary policy responses, and the social and political unrest in the country at this time. And the financial markets appear to be confounding many an investment legend, from Cliff Asness to David Tepper to Stan Druckenmiller and even Warren Buffet.

But we must ground ourselves in data. As Sherlock Holmes said: "Data! Data! Data! ... I can't make bricks without clay."

A number of widely-followed economic indicators hit record levels, some by a wide margin. Among the data which highlight the damage:

- Highest level of unemployment since the Great Depression
- Consumer Confidence falls off a cliff
- Retail sales drop the most on record during April
- Industrial Production posts its sharpest monthly decline
- Capacity Utilization hits record low
- Leading Economic Indicators turn negative; Coincident to Lagging Indicators hitting all-time low
- Housing permits, starts, and existing home sales plunged early in Q2
- Oil Prices drop below $0 briefly, and Goldman Sachs Commodity Index hits 30+ year low

The collective policy response to the first wave of COVID-19 has been quite effective. Financial conditions have eased substantially as the Fed's balance sheet swelled by some 85% over the past 10 months (recall, quantitative easing actually began last September) and M2 leapt by 20%+. This led to a string of positive economic surprises as the quarter wore on. Yields on 10yr Treasuries remain near record lows, the USD remains strong – even while Gold approaches a record high – quality spreads have narrowed, and home prices have remained surprisingly resilient. A true second wave could, however, bring about the need for additional stimulus.

The U.S. equity market appears to have priced in a pretty solid and quick recovery scenario. By almost any traditional valuation metric (granted, valuation metrics under this type of economic volatility are iffy), U.S. equities are expensive. The exception points to TINA* as the excuse to drive sustained gains: both the S&P 500 and Russell 2500 are inexpensive relative to bonds as measured by the Equity Risk Premium.

*TINA: There is no alternative

Positioning:

The LargeCap models show dampened risk aversion. Positive biases include Momentum, Growth, and Size (market cap). Negative biases include Value, Earnings Yield, Dividend Yield, and Volatility. The growth bias can also be seen in the style box breakdown: max-cap and large-cap growth stocks are in favor, max-cap value and large-cap value stocks are again solidly out of favor.

Technology and Health Care stocks are most in favor within our models; Health Care is paced by Medical Services and Biotech, while Technology is led by Computer Software and Internet industries. Consumer Staples, Industrials, and Materials are all modestly out of favor.

From a return-driver perspective, we again see large changes from 3 months ago. Volatility is no longer a negative tilt, and is instead mixed. Quality has fallen slightly negative on the whole, and most Valuation metrics are extremely out of favor. Growth characteristics such as 5 year Sales and Earnings Growth are in favor, and our positive momentum tilts – both short and longer-term – have strengthened as well.

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