DISCIPLINED EQUITY

SMIDCAP

GREAT LAKES ADVISORS

A WINTRUST WEALTH MANAGEMENT COMPANY

MANAGER COMMENTARY

Second Quarter 2020

Jon Quigley, CFA
Chief Investment Officer
Disciplined Equities

John D. Bright, CFA
Senior Portfolio Manager
Disciplined Equities

Dmitri Prokhorov
Research Analyst

Lyn Taylor
Research Analyst

Deepesh Bhatia
Research Analyst

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.

Russell 2500

The Russell 2500 Index recorded a 26.6% advance during Q2, but remains 11.1% lower for the calendar year.

Size/Style

- The 500 largest stocks in the Index narrowly outperformed the Russell 2000 Index - but each was more than 25% higher.
- Despite yet another head fake from mid-May to early June, growth once again dominated value in both the mid-cap and small-cap segments, recording a 12% advantage in each market cap group. Growth stocks have a substantial lead over value stocks for the 3, 5, and 10 year periods.

Russell 2500 Sectors

We observe a negative 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 third best performing sector overall with a 36.4% advance. Energy stocks paced the Russell 2500 Index with a 54.8% gain, and Consumer Discretionary stocks rebounded 41.4%.
- Utilities stocks were the clear laggards during Q2, after posting the second best relative return during Q1. The sector scratched out a 2.5% gain; the next-worst sector (Financial Services) added 14.6%.

SECOND QUARTER ATTRIBUTION

The SMidCap strategy surged about 26.9% during the quarter, topping the benchmark Russell 2500 Index's 26.6% gain. The table on the following page breaks down the contributions from sector positioning and stock selection.

Sector positioning added 1.85% to active return.

Stock selection within the respective sectors detracted 1.51% from active return.

SECTOR	GLA WEIGHTING	R2500 WEIGHTING	% ACTIVE	GLA RETURN	R2500 RETURN	% ADDED	SECTOR ALLOCATION	STOCK SELECTION	ACTIVE CONTRIB
Comm Services	5.10	3.01	2.09	36.75	24.00	12.75	-0.12	0.59	0.47
Consumer Disc.	14.30	10.52	3.78	43.93	47.04	-3.11	0.65	-0.47	0.18
Cons. Staples	0.89	3.07	-2.18	42.49	20.43	22.05	0.15	0.17	0.32
Energy	2.01	1.59	0.42	38.95	48.69	-9.74	-0.05	-0.13	-0.18
Financials	10.79	13.94	-3.15	9.72	15.08	-5.36	0.29	-0.58	-0.29
Health Care	23.23	17.57	5.66	23.65	32.35	-8.70	0.30	-2.01	-1.70
Industrials	12.82	14.20	-1.39	23.00	22.98	0.02	0.06	-0.01	0.05
Technology	17.23	18.55	-1.33	46.68	35.36	11.32	-0.21	1.83	1.62
Materials	4.27	4.86	-0.59	21.83	24.80	-2.97	0.00	-0.14	-0.14
Real Estate	9.01	8.92	0.08	6.01	13.81	-7.80	-0.19	-0.70	-0.89
Utilities	0.37	3.76	-3.40	1.74	1.11	0.63	0.98	-0.07	0.92
TOTAL	**100**	**100**		**26.91**	**26.57**	**0.35**	**1.85**	**-1.51**	**0.35**

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

Financials and Health Care stocks are seeing the widest swing in our models; Health Care (Biotech, Medical Services) are now preferred by the model, while Financials (Banks) are most out-of-favor. Tech stocks are also in favor, led by the Computer Software industry.

From a return-driver perspective, we again see large changes from 3 months ago. Volatility is no longer a negative tilt, and is mostly positive. Quality has fallen negative, as have most valuation metrics. 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.

Financial Advisors please contact us at
sma@greatlakesadvisors.com

Institutional Investors please contact us at
cr@greatlakesadvisors.com

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

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