GREAT LAKES ADVISORS

POINT OF VIEW

GREAT LAKES ADVISORS
A WINTRUST WEALTH MANAGEMENT COMPANY

ECONOMIC COMMENTARY AND CAPITAL MARKET UPDATE

For the Quarter Ending June 30, 2020

Recap: Beginning in mid-March, economic activity fell at an unprecedented speed in response to the outbreak of COVID-19 and the measures taken to control its spread. Even after the unexpectedly positive May employment report, nearly 20 million net jobs have been lost since February, and the unemployment rate has risen into double digits.

Real GDP contracted by 5% annualized in the first quarter. The decline in real GDP in the second quarter is likely to be the most severe on record. The burden of the downturn has not fallen equally on all Americans. Instead, those least able to withstand the downturn have been affected the most. If not contained and reversed, the downturn could further widen gaps in economic well-being that the long expansion had made some progress in closing.

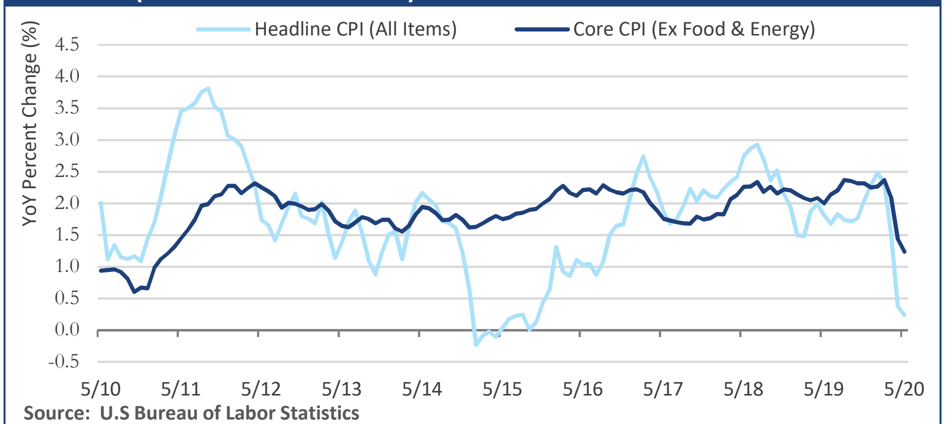
Recently, indicators have pointed to stabilization, and in some areas a modest rebound, in economic activity. With an easing of restrictions on mobility and commerce and the extension of federal loans and grants, some businesses have reopened, while stimulus checks and unemployment benefits have supported household incomes and spending.

That said, the levels of economic output and employment have remained far below their pre-pandemic levels, and significant uncertainty remains about the timing and strength of the future recovery.

Much of that economic unknown has stemmed from uncertainty about the path of the virus and the effectiveness of the measures to contain it. Until the public has confidence that the virus is contained, a full economic recovery is unlikely. Moreover, the longer the downturn lasts, the greater the potential for longer-term damage from permanent job losses and business closures.

With weak demand and large price declines for some goods and services, consumer price inflation has dropped noticeably in recent months. However, indicators of longer-term inflation expectations have been relatively steady. As economic output has stabilized and the recovery moves ahead, inflation should even out and then gradually move back up over time, closer to the Fed's 2% objective. Inflation is nonetheless likely to remain below 2% for some time.

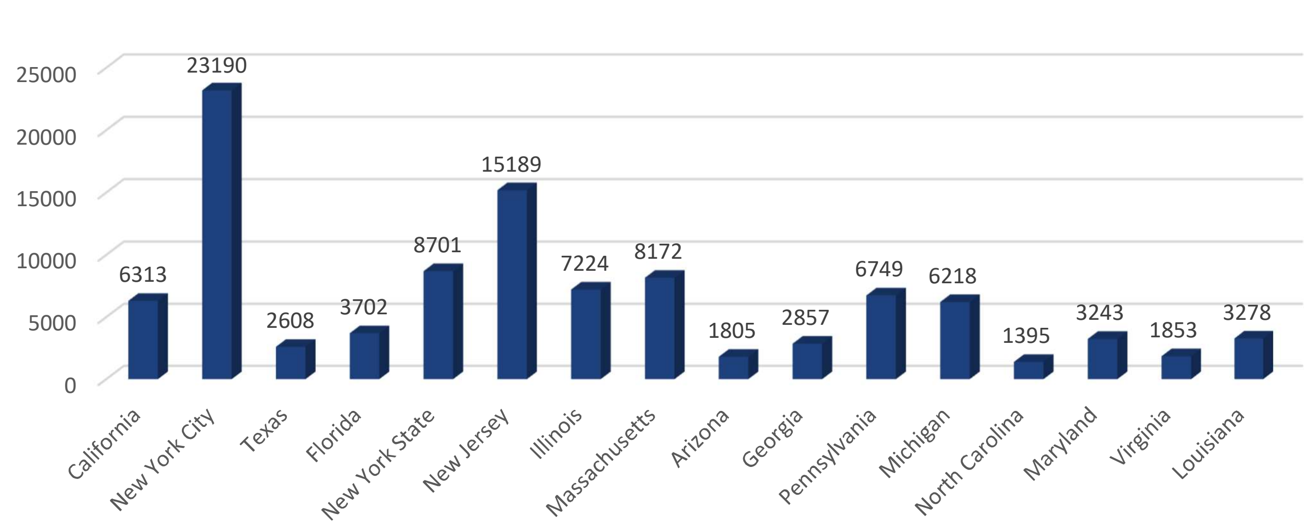
Inflation (Consumer Price Index)



Source: U.S Bureau of Labor Statistics

COVID-19: The rising number of COVID-19 infections has been the big economic story at the end of the quarter, offsetting continuing reports of a rebound in economic activity. Most of his increase has been in the South and West, with California, Arizona, Texas, Florida, Georgia, and the Carolinas accounting for the bulk of the increase. Some increase in COVID-19 cases was expected as the economy reopened and testing ramped up. The rise in infections, however, has been greater than can be explained by testing alone.

United States COVID-19 Deaths (As of 7/6/2020) - Total Deaths: 129,576 [Source: CDC]



Regional Economy: The growing economic crisis triggered by the pandemic is expected to last longer and hit harder in Illinois and Michigan than in the other three states in the Midwest (Indiana, Iowa, and Wisconsin).

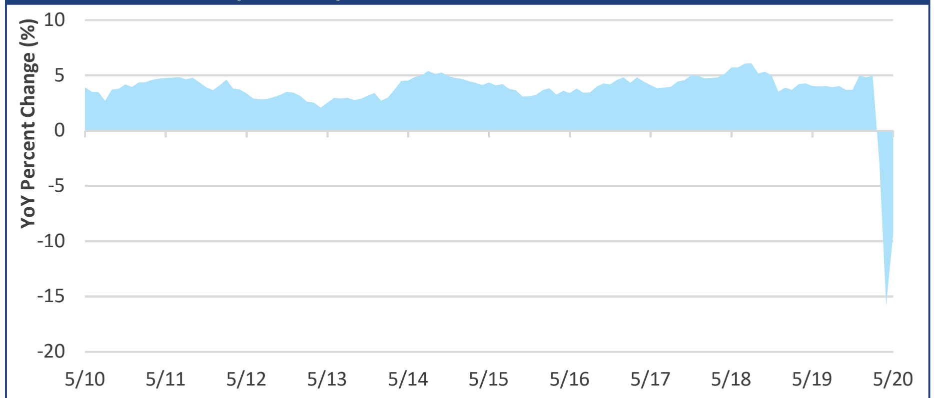
Illinois hit a 16.4% unemployment rate in April, translating to more than 1 million lost jobs. Job losses have been heavily concentrated in the leisure and hospitality, professional and business services and trade, transportation, and utility sectors that are bearing the direct effects of the pandemic and related business closures. The direct job losses in these sectors will further increase unemployment in other sectors, as the individuals affected reduce their own spending.

Michigan's economy has been more cyclical than the national economy, due to its heavy reliance on auto manufacturing which had been completely closed during the state's lockdown. The big jump in COVID-19 cases compared with the rest of the country compounded that impact - forcing the state government to implement quarantine measures stricter than in other states. Manufacturing makes up about 20% of Michigan's gross state product and 14% of its workforce. But the shutdown has also hit the state's service sector, construction industry, agriculture business, and tourism sectors.

Businesses in all industries across the five Midwestern states are bracing for the economic pain to last for some time. Some supply chains have been disrupted. Seasonal businesses have lost out on months of key revenue. All five states are facing the unique challenges of attempting to partially reopen the economy when many sectors are dependent on one another for both supply and demand.

Policymakers are likely to keep in mind that the economy is highly interconnected as successful businesses need functioning suppliers and willing customers. Re-opening the economy will require careful thought to make sure that interconnected businesses can work smoothly and safely with their partners.

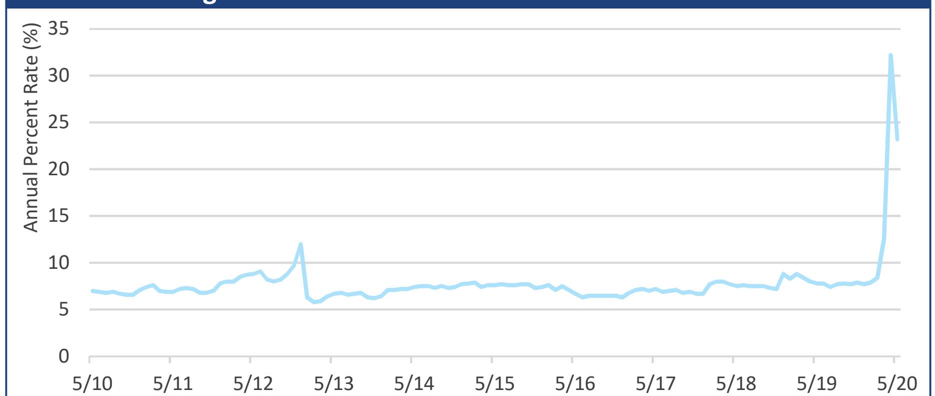
Consumer Spending: Americans cautiously returned to the marketplace in May and June, helping the economy slowly dig out from a severe recession. Household spending on goods and services rose a record 8.2% in May, down 12% from February. This boosted hopes that a good portion of consumers were eager and able to spend despite historically high unemployment. But it also showed just how far the economy must go to recover from a deep recession caused by the pandemic.



Personal Consumption Expenditures

Source: U.S. Bureau of Economic Analysis

Consumer sentiment has remained depressed from near all-time highs reached during the last expansion and slipped in the latter half of June. Americans overall saved more than a fifth of their disposable incomes in May, an exceptionally high savings rate that signaled caution.

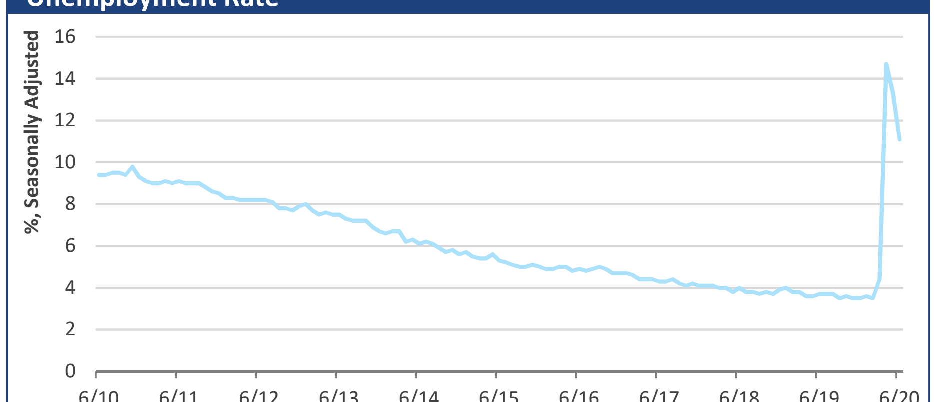


Personal Savings Rate

Source: U.S. Bureau of Economic Analysis

But the federal stimulus package, coupled with the urge among many Americans to get out and spend after months of being in isolation, has likely helped economic growth.

Labor Market: A historically high number of workers have continued to seek unemployment benefits each week, but applications have decreased substantially since an early spring peak amid signs the labor market is stabilizing from the coronavirus-induced shock. Weekly first-time unemployment claims were steady at a historically high 1.5 million in the week ended June 20. However, the job market's slow recovery faced new infections that could impede getting people back to work. Meanwhile, continuing claims were 19.5 million for the week ended June 13.



Unemployment Rate

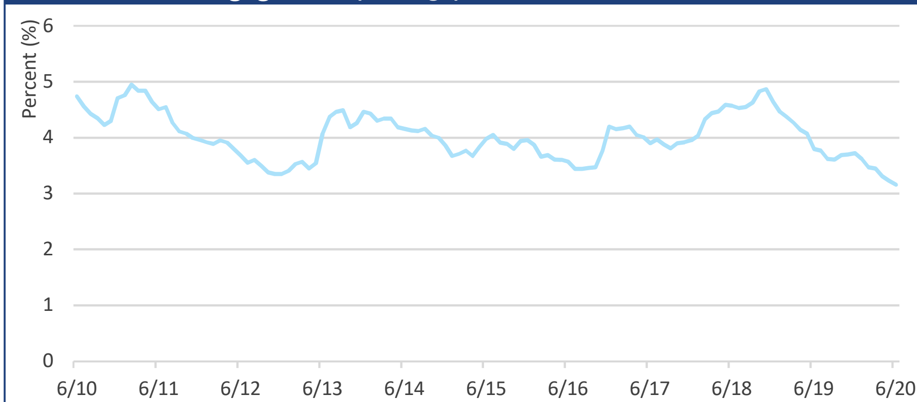
Source: U.S. Board of Governors of the Federal Reserve System

While the declining jobless benefits figures in June have offered signs the labor market is slowly healing, a recent increase in coronavirus cases could affect efforts to reopen the economy and get people back to work.

Housing: Housing has clearly been one of the economy's bright spots. Mortgage applications for the purchase of a home, which have been a reliable leading indicator of new and existing home sales, have steadily risen since bottoming in early April and are now up 18.1% compared to last year.

While existing sales weakened substantially during May, new home sales surged over 16%. Builders reported an increase in buyer traffic along with higher sentiment regarding the sales environment, both current and over the next six months. Underpinning the more positive trend recently have been several tailwinds that should continue to support the housing market in the short term. Mortgage rates have remained low and should remain so for the foreseeable future, which should incentivize more renters to become homeowners and induce higher turnover from those looking to upsize or downsize. Demographics will also remain favorable, as many Millennials are approaching an age that tends to lead to buying a home.

30-Yr Fixed Mortgage Rate (Average)



Source: Freddie Mac

The apparent resiliency of the housing market recently should also provide other areas of the economy with a much-needed boost. Residential fixed investment only comprises about 3.5% of overall GDP. That number rises to over 15%, however, when including consumer spending on housing services such as tenant rents and utilities. But even that underestimates the true economic impact. Home sales drive demand for other ancillary services such as mortgages, insurance, legal services, inspections, and interior designers, as well as for durable goods spending on furniture, household appliances, and home furnishings. A rebound in home sales should also support home prices, which have moderated considerably in a handful of the nation's largest metropolitan areas.

Monetary Policy: The Federal Reserve cut interest rates to near zero in March and introduced a range of emergency lending programs to purchase debts of companies, cities, and states. They expect to keep short-term interest rates pegged near zero through 2022 and have discussed options, including capping bond yields.

The hit to demand will keep inflation pressures contained for some time since many industries are likely to be slow to recover and unemployment remains above previous forecasts over the next two years. As a result, the policy rate is unlikely to increase until at least 2022.

Fiscal Policy: When Congress returns from recess in mid-July, it will face a critical few-week period to consider additional fiscal stimulus. Emergency expanded unemployment benefits expire on July 31, and many states will face tough budget decisions as their fiscal years begin on July 1 and the month-long August recess looms large. The probability of another large bill to support the economy seems about fifty-fifty. The economic data over the next month, particularly the labor market data, will likely play a key role in shaping the outcome. If a bill does come to pass, it is likely to be roughly $1 trillion in size, with the bulk of the money going towards state and local aid and stimulus to households through policies like a payroll tax cut or another round of direct household checks.

Global Economy: Following the sharpest economic decline in recent history, a long uphill climb will be required to get back to pre-pandemic levels. Global economic growth is likely to contract by an unprecedented 4.0-4.5% in 2020. Advanced economies (AEs) should contract by 5.5% and emerging markets (EMs) excluding China by 3.5%. China's economy is anticipated to pull back by 2.5%.

The data currently supports the narrative that a bottoming in most AEs' pandemic-related disruptions occurred in April. Thanks to substantial labor market interventions and large-scale monetary and fiscal measures by some countries, improved financial conditions, a pickup in global demand, and better business and consumer sentiment have emerged.

EMs have been the recipient of the benefits that come from central bank efforts around the globe to boost market liquidity. Many EMs have realized that the economic lockdowns that occurred among AEs were not sustainable amidst a weaker government ability to support livelihoods, large and younger populations living within a high density, and more difficult living conditions. This decision resulted in smaller economic contractions among EMs, although the toll on lives from the virus has only begun to take shape.

The exception has been China. Its stringent lockdowns helped its economy land on its feet. However, weak overseas demand was an automatic restraint on its exports and manufacturing industry. Moreover, China's imports in May contracted sharply, reiterating ongoing supply chain disruptions, and suggesting tentativeness in domestic demand.

The global economy will look drastically different once this has ended, with a high likelihood that potential GDP growth will be lower due to economic scarring. Monetary and fiscal policy will further converge, leading to a greater risk that central bank independence will be compromised. Fiscal stimulus measures have led to large deficits that will correspond with high and persistent debt burdens. This will inevitably lead to higher taxes unless central banks monetize government debt.

Eurozone: News from the Eurozone offered encouragement on two fronts– first, the bottom for economic activity may already be in and, second, the recovery in the Eurozone economy may occur quicker than previously expected. As COVID-19 lockdown measures continue to be lifted, activity has rebounded to some extent. For June, the Eurozone manufacturing PMI rose to 46.9 from 39.4. The rise in the services PMI was even more impressive, to 47.3 from 30.5. What was notable was that not only did the expectations component improve but so too did the assessment of current conditions, the first time the latter has shown any improvement since January.

Eurozone Q2 GDP is likely to fall at least 12.0% quarter-over-quarter. However, aggressive monetary easing, and progress towards further fiscal stimulus would create the potential for a smaller economic decline in Q2 and a faster rebound in Q3.

Outlook: The U.S. entered the pandemic from a position of economic strength, but shutdowns across many nonessential activities were so widespread in the latter half of March that real GDP contracted by 5% annualized in the first quarter. This weak starting point and continued closures across much of the country in April and May have likely led activity to contract by at least 30% annualized in the second quarter. Unemployment should be at least 9.0% in the fourth quarter, with GDP down 6.5% from 2019.

The recovery will be uneven across industries and uncertainty will remain elevated in the absence of a vaccine. This is likely to slow the pace of the rebound after the initial jump in growth due to reopening. As a result, the level of real GDP is likely to remain below its pre-virus level until the end of 2021. Naturally, the outcome could deviate from these expectations depending on policy decisions and virus developments throughout that period.

There has recently been an uptick in new cases in some states as shelter in place measures have been eased. If widespread stay-at-home orders return, the U.S. recovery would reverse course, and unemployment would remain elevated for longer. By extension, there would be deeper scarring from a greater share of permanent job losses, negative wealth impacts, and business insolvencies, even with renewed stimulus measures.

Market Commentary

Recap: As difficult as the first quarter of 2020 was for investors, the second quarter proved to be nearly as spectacular in a positive direction. Despite the severity of the COVID-19-induced recession that began to grip the economy in Q1, in Q2 markets continued to respond to the extraordinary intervention measures of the Federal government. The Federal Reserve successfully launched massive lending facilities, extended credit, purchased government-backed paper, and indicated they were prepared to purchase corporate bonds to support and calm fixed income markets. Their efforts paid off. Additionally, Congress and the Administration provided direct financial support to households as well as small and large businesses alike to keep the economy afloat in hopes that the pandemic recedes soon and an organic economic recovery can ensue. As the quarter ended, economic data began to turn positive but ample uncertainty remains over what the course of its trajectory might be, especially given the recent surge in COVID-19 cases. Given this environment, the U.S. benchmark S&P 500 rose by 20.5% during the quarter. Overseas, the MSCI EAFE Index rose 14.9%, and the MSCI Emerging Markets Index rose 18.1%. Fixed income markets produced solidly positive returns with the relative certainty that interest rates would remain low for some time. The Barclays U.S. Aggregate Bond Index rose 2.9% while the Barclays Global Aggregate ex USD Bond Index rose 3.4%.

Domestic Equities: The quarter began with equity volatility more than double the long-term market average. For the full quarter, however, volatility declined by roughly half though still well above the long-term average. Volatility spikes when fear grips the market. The strong positive result in market performance appears to be explained by investor expectations that the recession has bottomed and that continued monetary and fiscal support will be forthcoming as needed and earnings will pick up. A next fiscal support bill of $1 trillion or more is currently being discussed in the Capital to extend direct household and/or unemployment benefit payments and possibly assist state and local governments.

While many companies have been unable to provide future earnings guidance in this environment and some corporate outlooks appear grim, some businesses have thrived in this social distancing economy. Some of the largest tech firms and companies with strong online business models fall into this camp. And this “right place, right time” continues to be one of the reasons – besides strong fundamentals and low corporate debt – that these stocks have continued to be market leaders despite lofty valuations.

International Equities: Equity markets overseas generally lagged the response of stocks in the U.S. to the developing pandemic, economic, and governmental intervention trends. Despite the inferior relative performance, returns for the quarter outside the U.S. were mid-to-upper teens. The national responses to the pandemic in developed countries in continental Europe and Japan were forceful, disciplined, and lengthy though it caused short-term negative economic results there as well. Current infection data suggests that the pandemic is under greater control in these countries than the U.S., and it would not be unreasonable to expect their economies to recover more quickly than in the U.S. Should that happen, their markets and currencies will respond in kind. Emerging market equities also posted a strong quarterly result, though there were regional variances from South America to Asia.

Fixed Income: Fixed income markets posted strong relative returns with interventions from Central Banks and their guidance that rates will remain low for the foreseeable future. Riskier segments of the fixed income market – like high yield bonds and emerging market debt – posted double-digit gains as nascent signs of recovery surfaced. Investment-grade corporate bonds returned over 8% buoyed by the assurance from the Federal Reserve that they will support that market if needed.

Outlook: In the U.S., the path to economic recovery will depend on the course of the coronavirus and the corresponding public health response. It is not unreasonable to expect the stock market to bounce around for an extended period until the economy finds firmer footing. Despite this expectation, the U.S. stock market appears to be priced for a quick economic recovery. The resulting stretched valuations will become a concern if something other than a quick economic recovery becomes reality. The longer-term outlook appears more positive, however, as the recent slowdown was driven by government policy and not economic imbalances. Relaxing these restrictive policies should eventually lead to economic recovery. While the pain of the economic recession has been widespread, the stock market has produced distinct winners and losers. Online retailers and grocers, for example, have enjoyed growing sales, and providers of broadband services and health care have benefited from strong demand. Conversely, travel and hospitality-related businesses have been pummeled. An environment with clear winners and losers may prove to be a tailwind for active portfolio managers. Emphasizing quality may also be appropriate, given an environment characterized by significant risk and uncertainty.

Valuations help judge the long-term risk-reward ratio for equity markets overall, but they are not as useful for short-term investing. Nonetheless, equities in developed international markets are moderately priced relative to the U.S. In Europe, economies are recovering from the lockdown and, thus far, there has been little evidence of a significant second wave of infections. Europe's perceived disadvantage going into the health crisis was its lack of policy ammunition. The European Central Bank (ECB) policy rate was already negative, and there were strict rules on increasing fiscal deficits. The policy response, however, has been surprisingly effective as the ECB increased its asset purchase program, and rules on fiscal deficits have been temporarily relaxed. Effective fiscal and monetary policy responses should serve as a tailwind for European equities going forward. The outlook in Japan is less attractive. The Japanese economy was struggling before the health crisis, and while fiscal policy has become supportive, structural weaknesses – including weak monetary policy and persistent deflation – are expected to prove to be headwinds. The U.K. has been hit hard by the coronavirus crisis and faces uncertainty related to Brexit. All things considered, the inclusion of an appropriate allocation to foreign stocks in a diversified portfolio remains prudent.

On a more positive note, many emerging markets entered the current health crisis in a stronger financial position than in previous crises. Many, however, also have weak public health systems, and the pandemic appears to have not yet peaked. Economic activity remains locked down in many emerging markets, debt levels are increasing, and some markets have limited ability to cushion the shock of the virus. The typical arguments in favor of emerging market investing, including fast-growing economies, strong balance sheets, and fiscal conservatism, are being challenged by the pandemic. Emerging markets, however, are a diverse group, differing in their abilities to respond to current challenges. Relatively strong balance sheets and the policy flexibility to weather the downturn are characteristic of some markets, while others face financial distress driven by high external imbalances and rising indebtedness. China, the largest emerging market, seems well-positioned for a strong rebound through the second half of 2020 and into 2021 as government stimulus kicks in and the global economy recovers. In short, a benchmark weight exposure to emerging markets may be appropriate, but coronavirus-related risks suggest that caution is prudent. The use of active managers may be wise given differences amongst various emerging market economies and business models.

For fixed-income investors, the environment remains relatively challenging with yields on 10-year Treasuries ending the quarter around 0.67%. Assuming the economy gets past the coronavirus driven recession and begins to expand again, these yields as a starting point for investing are unattractive. However, developed market government bonds serve a useful role as a portfolio ballast against risk-off episodes and spikes of volatility. Credit markets face downside risks and increased uncertainty given the economic outlook though interest rate spreads have already narrowed considerably from the depths of the credit crunch in Q1. Temporary liquidity crunches can happen in moments of apparent crisis where investors pour into perceived safe-haven trades. While there may be select opportunities within the high yield asset class and issues are attractively priced, caution is appropriate as increased defaults are likely in the months ahead. High quality fixed income should continue to play a useful role in managing overall portfolio risk. However, the prospect of an economic recovery, especially if accompanied by high government debt loads, tempers overall enthusiasm for fixed income investment total return prospects.

Sources: Department of Labor, Department of Commerce, Morningstar, Bloomberg, Johns Hopkins University, Federal Reserve of Chicago

Index Performance as of: 6/30/2020

	1 Week	1 Month	QTD	3 Month	YTD	1 Year	3 Year	5 Year
Russell								
3000 Value	-1.10	-0.46	14.55	14.55	-16.74	-9.40	1.41	4.41
3000	-0.87	2.29	22.03	22.03	-3.48	6.52	10.04	10.03
3000 Growth	-0.72	4.32	27.99	27.99	8.98	21.89	18.20	15.22
1000 Value	-1.22	-0.66	14.29	14.29	-16.26	-8.82	1.82	4.64
1000	-0.93	2.21	21.82	21.82	-2.81	7.46	10.64	10.47
1000 Growth	-0.74	4.35	27.84	27.84	9.81	23.23	18.99	15.88
Mid Cap Value	-0.93	1.13	19.95	19.95	-18.09	-11.79	-0.54	3.32
Mid Cap	-0.75	1.80	24.61	24.61	-9.13	-2.24	5.79	6.76
Mid Cap Growth	-0.80	2.34	30.26	30.26	4.16	11.89	14.75	11.59
2000 Value	0.83	2.90	18.91	18.91	-23.50	-17.44	-4.35	1.26
2000	0.19	3.53	25.42	25.42	-12.98	-6.61	2.01	4.29
2000 Growth	-0.44	3.84	30.58	30.58	-3.06	3.47	7.86	6.85
Standard & Poors								
S&P 500	-0.96	1.99	20.54	20.54	-3.08	7.49	10.73	10.72
Consumer Disc	-1.02	4.99	32.86	32.86	7.23	12.57	15.29	13.20
Consumer Staples	-0.34	-0.33	8.12	8.12	-5.66	3.61	5.03	7.22
Energy	-3.69	-1.30	30.51	30.51	-35.34	-36.03	-12.46	-9.18
Financials	-2.72	-0.32	12.20	12.20	-23.62	-13.90	0.11	5.41
Health Care	-0.22	-2.38	13.59	13.59	-0.81	10.88	10.30	8.14
Industrials	-0.46	2.00	17.01	17.01	-14.64	-9.00	1.91	6.73
Information Technology	-0.06	7.14	30.53	30.53	14.95	35.81	26.82	23.40
Materials	0.30	2.16	26.01	26.01	-6.92	-1.11	3.90	5.43
Real Estate	-0.06	1.47	13.22	13.22	-8.53	-2.01	6.32	8.00
Communcation Services	-3.07	-0.51	20.04	20.04	-0.31	11.05	8.58	7.17
Utilities	-0.91	-4.67	2.73	2.73	-11.14	-2.11	6.41	10.17
Other U.S. Equity								
Dow Jones Industrial Avg.	-1.31	1.82	18.51	18.51	-8.43	-0.54	9.08	10.61
Wilshire 5000 (Full Cap)	-0.96	2.41	22.69	22.69	-2.88	6.53	10.02	9.94

Index Performance as of: 6/30/2020

	1 Week	1 Month	QTD	3 Month	YTD	1 Year	3 Year	5 Year
International Equity - Broad Market								
MSCI EAFE	-2.75	3.40	14.88	14.88	-11.34	-5.12	0.81	2.05
MSCI EM	-1.83	7.35	18.08	18.08	-9.78	-3.38	1.90	2.86
MSCI Frontier Markets	-1.16	1.68	14.75	14.75	-15.77	-11.15	-1.77	-0.13
MSCI ACWI	-1.54	3.20	19.22	19.22	-6.25	2.11	6.13	6.45
MSCI ACWI Ex USA	-2.38	4.52	16.12	16.12	-11.00	-4.79	1.13	2.26
MSCI AC Asia Ex Japan	-1.25	8.37	16.71	16.71	-4.74	1.69	3.61	4.40
International Equity - Country Region								
MSCI Brazil	-6.65	7.39	22.85	22.85	-38.86	-33.31	-2.53	0.36
MSCI BRIC	-2.58	7.85	16.91	16.91	-7.55	-0.18	6.05	4.54
MSCI China	-1.91	8.98	15.29	15.29	3.51	13.10	8.55	5.32
MSCI Europe	-2.82	4.07	15.26	15.26	-12.78	-6.77	0.00	1.46
MSCI India	-1.78	6.80	20.58	20.58	-16.95	-17.01	-1.58	0.92
MSCI Japan	-3.09	-0.01	11.61	11.61	-7.12	3.10	2.97	3.45
MSCI EM Latin America	-5.66	5.26	19.10	19.10	-35.23	-32.40	-7.21	-3.22
MSCI Russia	-6.04	-1.98	18.69	18.69	-24.46	-13.01	11.65	8.60
Fixed Income								
Barclays U.S. Aggregate	0.26	0.63	2.90	2.90	6.14	8.72	5.32	4.30
ICE BofAML US 3M Trsy Bill	0.00	0.01	0.02	0.02	0.60	1.63	1.77	1.19
Barclays U.S. Gov't	0.43	0.10	0.49	0.49	8.61	10.32	5.54	4.04
Barclays U.S. Credit	0.21	1.83	8.22	8.22	4.82	9.05	6.14	5.54
Barclays High Yield Corp.	-1.55	0.98	10.18	10.18	-3.80	0.03	3.33	4.79
Barclays Municipal	0.11	0.82	2.72	2.72	2.08	4.44	4.22	3.93
Barclays TIPS	0.03	1.12	4.24	4.24	6.01	8.26	5.04	3.75
Barclays Gbl Agg Ex USD	-0.83	1.01	3.38	3.38	0.61	0.70	2.52	2.89
Barclays Global Aggregate	-0.36	0.89	3.32	3.32	2.98	4.21	3.79	3.55
JPM EMBI Global Div	-0.19	3.51	12.26	12.26	-2.76	0.49	3.60	5.30
Alternative Investments								
Alerian MLP	-8.41	-7.87	50.18	50.18	-35.71	-41.36	-16.78	-12.85
Bloomberg Commodity	0.41	2.28	5.08	5.08	-19.40	-17.35	-6.13	-7.69
FTSE NAREIT Equity REIT	-0.31	3.06	11.82	11.82	-18.71	-13.01	0.03	4.06
S&P Global Natural Res.	-2.82	2.07	20.47	20.47	-19.14	-16.72	-0.11	0.94
S&P N. Amer Natural Res.	-1.59	0.88	31.31	31.31	-26.33	-24.33	-8.01	-6.47

JASON TURNER
HEAD OF MULTI-ASSET STRATEGY
312-373-1475 | jturner@greatlakesadvisors.com