DISCIPLINED EQUITY
ALLCAP

Great Lakes Advisors
A Wintrust Wealth Management Company

MANAGER COMMENTARY
Third Quarter 2020

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MARKET REVIEW

Yet another surprisingly strong quarter for U.S. Equities, despite mixed signals with respect to ongoing coronavirus flare-ups, progress on a vaccine, additional rounds of government stimulus, and growing socio-political angst. Perhaps we're climbing the proverbial wall of worry, perhaps the unprecedented fiscal and monetary policy from this spring is the impetus... or more likely both.

Russell 3000

The Russell 3000 Index recorded a 9.2% advance during Q3, and has advanced 5.4% for the calendar year.

Size/Style

- After pacing the market during Q2, small-caps lagged both mid-caps and large-caps during Q3.
- From a style perspective, growth outpaced value across the capitalization spectrum (a continuation of Q1 & Q2). Growth stocks have a substantial lead over value stocks for the 3, 5, and 10 year periods.

Russell 3000 Sectors

We saw more consistent relative sector performance among smid-caps, with a strange dichotomy atop the list:

- Consumer Discretionary stocks topped sector performance for the quarter, and the Tech sector once again was the next-best performer.
    - » This was a second consecutive stellar quarter for Discretionaries, which have soared 53.2% the past 6 months.
- Financials and Utilities continue their poor relative performance.
    - » In contrast to the Consumer Discretionary sector, these sectors have advanced only 2.7% and 3.6% over the past 6 months.
- Energy stocks faded from the top performer in Q2 to a 17.4% decline.

THIRD QUARTER ATTRIBUTION

The AllCap strategy advanced a solid 8.3% during the quarter, just behind the benchmark Russell 3000 Index's 9.2% advance. The table on the following page breaks down the contributions from sector positioning and stock selection.

In total, sector positioning added 1.03% to active return:

- Overweighting the Consumer Discretionary sector added 70bps, as the sector outperformed the benchmark by nearly 10% during the quarter.
- Underweighting the Financials sector added an additional 29bps to active performance, as the sector trailed the Russell 3000 Index by 3%.

Stock selection within the respective sectors detracted 1.95% from active return.

MARKET OUTLOOK

Following a quantitative investment discipline allows us to bypass emotion in the investment process. The world's greatest detective, Sherlock Holmes, knew:

"The emotional qualities are antagonistic to clear reasoning."

–Sherlock, *The Sign of Four*

This does not, however, mean we don't acutely feel the tumult of the equity market, the political to and fro, the suffering caused by the COVID-induced economic shutdown, or the social unrest in our great country. And judging by the exceptional noise in the U.S. equity market – noise often below the surface and

SECTOR	GLA WEIGHTING	R3000 WEIGHTING	% ACTIVE	GLA RETURN	R3000 RETURN	% ADDED	SECTOR ALLOCATION	STOCK SELECTION	ACTIVE CONTRIB
Comm Services	7.93	9.96	-2.03	12.21	9.26	2.95	0.00	0.24	0.24
Consumer Disc.	20.10	11.99	8.11	10.21	19.03	-8.82	0.70	-1.66	-0.96
Cons. Staples	1.67	6.29	-4.62	-0.46	10.21	-10.67	-0.06	-0.23	-0.29
Energy	2.39	2.31	0.08	-25.66	-18.83	-6.83	-0.06	-0.20	-0.26
Financials	5.74	10.22	-4.49	6.15	3.43	2.72	0.29	0.00	0.29
Health Care	9.59	14.60	-5.01	8.35	6.22	2.13	0.17	0.27	0.45
Industrials	13.80	8.85	4.95	8.26	11.91	-3.65	0.16	-0.51	-0.35
Technology	25.69	26.70	-1.02	10.65	11.84	-1.19	-0.08	-0.29	-0.37
Materials	5.94	2.76	3.19	17.92	11.94	5.98	0.09	0.32	0.41
Real Estate	7.16	3.43	3.73	2.46	1.34	1.12	-0.30	0.11	-0.19
Utilities	0.00	2.89	-2.89	0.00	5.15	-5.15	0.12	0.00	0.12
TOTAL	**100**	**100**		**8.30**	**9.21**	**-0.91**	**1.03**	**-1.95**	**-0.91**

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

unobserved to those who follow the headline indices – investors are clearly not immune to wild swings of emotion. Our discipline allows us to have an upset stomach mid-day, but execute by process.

On to the Economic Review:

- Profits are down, volatility is up, and doubts about the path of recovery are manifest.
- To combat this, the Fed and Treasury are maintaining easy conditions, which have resulted in positive economic surprises since May. Will positive surprises hold for the rest of the year?
- Despite the easy conditions, underlying demand weakness has resulted in well-contained prices.
- This demand weakness is reflected in soft commodity prices, with the exception of gold.
- Marginal growth in doubt regarding the future of the Dollar as the reserve currency often results in rising gold prices.
- Why the marginal increase in doubt? Money Supply is up 23% year over year, and Debt to GDP ratio has soared to 136%.
- The economy shed an unprecedented number of jobs this spring. To date, we've recovered about half of these positions.
- Despite the job losses, rate cuts from last fall plus an additional leg down this spring have led to an incredibly robust housing market.
- Stable, strong house prices combined with a solid rebound in equity markets have left asset-heavy households better off, and have abated the slide in consumer confidence.
- It's also true that those whose household wealth is driven primarily by income are suffering inordinately – thus the "k-shaped recovery" description is accurate.
- Retail sales have rebounded nicely, with a shift to online shopping having accelerated.
- The Inventory to Sales ratio is very low, and a precursor to a demand shock at some point. ISM Manufacturing and Non-manufacturing indices are indicating expansions ahead – so poor Industrial Production numbers may fade in the months ahead.

In terms of where this leaves equity markets, the sole truth is poor visibility. Stocks remain very expensive relative to fundamentals, but the duration of the poor EPS numbers is an unknown. A high P/E ratio based on a non-recurring event means little. We can say that stocks are rich at this point – but it's hard to know just how expensive. One thing we do know is stocks are certainly more attractive than bonds, sporting a 1-3% yield premium – despite their low earnings yield.

We'll continue to follow our systematic approach rather than guess what may or may not lay ahead. To bring it back home, we evoke one more quote from Mr. Holmes in *The Sign of Four*:

"I never guess. It is a shocking habit — destructive to the logical faculty."

Positioning:

The AllCap models are demonstrating a modest appetite for risk. Momentum, Size, and Growth are the characteristics most in favor, while Value and Dividend Yield are all out of favor. Growth is also in favor across all capitalization and style groups, while small-cap value remains quite out of favor.

Tech stocks have swung modestly into favor, led by the Software industry group. Health Care (especially Biotech and Medical Service) remains most in favor; by contrast, Financials (especially Banks) remain unattractive.

From a return-driver perspective, the Quality and Value categories are both out of favor. Growth factors are modestly in favor, led by trailing 5 year Sales & Earnings growth, respectively. Momentum has turned favorable, as have most factors which proxy volatility.

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