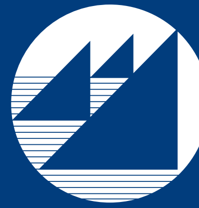
DISCIPLINED EQUITY

LARGECAP



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.

S&P 500

The S&P 500 Index backed up Q2's 20%+ gain with another 8.9% during Q3, leaving the Index 5.6% higher for the year. Hard to believe after all we've been through!

Size/Style

- Mega-caps slightly outperformed large-caps.
- Despite plenty of back-and-forth during the quarter, growth once again trumped 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

Within the S&P 500 Index, relative sector performance was a bit more highly correlated with Q2:

- Consumer Discretionary stocks again led the way, repeating their pole position of Q2. The group advanced 15% during Q3, and 52.8% over the past 6 months.
- Materials and Tech stocks also continued their substantial rebounds.
- Health Care, Financials, and Real Estate sectors remain weak, and Energy faded hard (-19.7%) after a great Q2.

THIRD QUARTER ATTRIBUTION

The LargeCap strategy climbed about 8.6% during Q3, just a touch behind the benchmark S&P 500 Index's solid 8.9% advance. The table on the following page breaks down the contributions from sector positioning and stock selection:

In total, sector positioning added 0.92% to active return:

- Underweighting the Energy sector detracted 31bps, as the sector underperformed the S&P 500 Index by almost 29%.
- Overweighting the Real Estate sector detracted 26bps, as the sector underperformed the S&P 500 Index by almost 7%.

Stock selection within the respective sectors detracted 1.26% 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	S&P 500 WEIGHTING	% ACTIVE	GLA RETURN	S&P500 RETURN	% ADDED	SECTOR ALLOCATION	STOCK SELECTION	ACTIVE CONTRIB
Comm Services	8.97	10.96	-2.00	10.49	8.94	1.55	-0.01	0.14	0.12
Consumer Disc.	15.32	11.27	4.05	10.73	15.06	-4.33	0.22	-0.64	-0.41
Cons. Staples	1.97	7.00	-5.03	9.96	10.38	-0.41	-0.07	-0.04	-0.11
Energy	1.39	2.47	-1.08	-31.69	-19.72	-11.97	0.31	-0.21	0.10
Financials	9.46	9.87	-0.41	9.30	4.45	4.85	0.07	0.34	0.41
Health Care	8.61	14.35	-5.74	1.89	5.87	-3.98	0.19	-0.31	-0.12
Industrials	12.88	8.10	4.77	8.61	12.48	-3.86	0.23	-0.48	-0.25
Technology	29.62	27.65	1.97	10.84	11.95	-1.12	0.06	-0.32	-0.26
Materials	5.31	2.59	2.72	18.01	13.31	4.70	0.12	0.21	0.33
Real Estate	6.21	2.72	3.49	2.42	1.92	0.49	-0.26	0.05	-0.21
Utilities	0.27	3.01	-2.74	-1.94	6.14	-8.08	0.08	-0.01	0.07
TOTAL	**100**	**100**		**8.59**	**8.93**	**-0.34**	**0.92**	**-1.26**	**-0.34**

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 LargeCap models continue to 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, large-cap value stocks are again solidly out of favor.

Technology and Health Care stocks remain 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 once again a negative tilt. Quality has fallen slightly negative on the whole, and most Valuation metrics remain 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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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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