LARGECAP

GREAT LAKES ADVISORS
A WINTRUST WEALTH MANAGEMENT COMPANY

MANAGER COMMENTARY

Fourth Quarter 2020

Jon Quigley, CFA®
Chief Investment Officer
Disciplined Equity

John D. Bright, CFA®
Senior Portfolio Manager
Disciplined Equity

Dmitri Prokhorov
Director of Research
Disciplined Equity

Lyn Taylor
Research Analyst

Deepesh Bhatia
Research Analyst

MARKET REVIEW

Did 2020 really just happen?! Despite U.S. equities getting absolutely demolished during the four weeks following February 2020 (the most rapid bull-to-bear transition in history), we finished the year about 20% higher for most main indices. This strangest of years did not disappoint during Q4, either; the stocks with the most volatile profiles led the market sharply higher, propelled both by the notion of more fiscal stimulus enabled by a possible blue wave and announcement of an effective COVID vaccine. Yes, 2020 really did happen - and none of us is likely to soon forget.

S&P 500

The S&P 500 Index surged a further 12.1% during Q4, leaving the Index 18.4% higher for the year.

Size/Style

- Mega-caps underperformed large-caps by about 8% during the quarter, but each posted double-digit gains. For all of 2020, mega-caps held the edge.
- Value stocks outpaced Growth stocks by about 4% for Q4, up and down the large-cap spectrum. On the year, however, Value stocks once again had historic underperformance: 32 to 37%, depending on your preferred index.

S&P 500 Sectors

We again saw a lack of quarter-to-quarter correlation of relative sector performance, driven by a resurgence in extremely bullish sentiment:

- Cyclical stocks - especially late-stage cyclicals - went to the front of the line during Q4, paced by Energy's 27.8% gain. Financials also recovered nicely, bounding 23.2% to close the year. For the full year, however, Tech and Consumer Discretionary sectors paced the S&P 500.
- Defensive sectors fell to the bottom of the sort, as one would expect given extreme bullishness. Real Estate posted a second weak quarter, and Consumer Staples, Utilities, and Health Care sectors also lagged on a relative basis. For all of 2020, the Energy sector's 33.7% plummet was by far the worst. This put Energy at a 77%+ disadvantage to the Tech sector!

FOURTH QUARTER ATTRIBUTION

The LargeCap strategy climbed about 10.9% during Q4, trailing the benchmark S&P 500 Index's solid 12.1% advance. The table on the following page breaks down the contributions from sector positioning and stock selection.

In total, sector positioning detracted 0.31% from active return:

- Underweighting the Financial sector detracted 38bps, as the sector outperformed the S&P 500 Index by about 11%.
- Underweighting the Health Care sector added 23bps, as the sector underperformed the S&P 500 Index by over 4%.

Stock selection within the respective sectors detracted 0.93% from active return.

FOURTH QUARTER ATTRIBUTION

SECTOR	GLA WEIGHTING	S&P 500 WEIGHTING	% ACTIVE	GLA RETURN	S&P 500 RETURN	% ADDED	SECTOR ALLOCATION	STOCK SELECTION	ACTIVE CONTRIBUTION
Comm. Services	10.75	10.94	-0.18	20.00	13.82	6.18	-0.09	0.75	0.66
Consumer Disc.	15.43	11.62	3.81	11.06	8.04	3.02	-0.18	0.51	0.32
Consumer Staples	3.12	6.83	-3.71	13.56	6.35	7.21	0.21	0.26	0.47
Energy	1.85	2.20	-0.35	36.23	27.77	8.46	-0.19	-0.02	-0.21
Financials	6.75	10.14	-3.39	10.59	23.22	-12.63	-0.38	-0.76	-1.13
Health Care	8.94	13.86	-4.92	11.41	8.02	3.39	0.23	0.35	0.58
Industrials	13.46	8.53	4.93	8.58	15.71	-7.14	0.14	-0.95	-0.81
Technology	29.41	27.68	1.73	10.97	11.80	-0.82	-0.08	-0.17	-0.25
Materials	4.66	2.66	2.00	2.84	14.47	-11.63	0.07	-0.61	-0.54
Real Estate	5.15	2.56	2.59	-0.22	4.90	-5.12	-0.19	-0.25	-0.45
Utilities	0.48	2.98	-2.50	-0.63	6.54	-7.17	0.14	-0.04	0.10
Total	**100**	**100**		**10.90**	**12.14**	**-1.24**	**-0.31**	**-0.93**	**-1.24**

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

MARKET OUTLOOK

Not-so-bold Prediction: 2019 – 2021 will go down in history as one of the more unique periods for U.S. equities. From an incredibly swift bear-to-bull transition to start 2019, to the Fed easing and injecting liquidity at the end of a long economic expansion in late summer 2019, to COVID/shelter-in-place/#WFH, to unprecedented monetary response, to the most surreal of Presidential races, to a COVID vaccine, and finally a change in control of the Senate decided in a run-off some 2 months after the general election. This latter combination means a shift in balance from monetary to fiscal stimulus to carry us through to the light at the end of the COVID tunnel. Let's just hope that light isn't from an oncoming inflation train.

On balance, economic news looks quite good, although time will tell whether this is simply Red Bull economics.* Leading Economic Indicators are recovering to break-even, and corporate profits have rebounded swiftly to pre-COVID levels, with strong profit margins. Credit markets are rich, but well-behaved. Easy credit conditions, plus the aforementioned expected forthcoming spike in fiscal stimulus, plus the developing herd immunity is resulting in a shift toward more economically-sensitive cyclical and small cap stocks. We are concurrently at a risk for rising yields, which would likely have the impact of an improving outlook for Banks as the curve steepens, a rotation toward beleaguered value stocks, and an eventual compression of P/E ratios.

Prices are well-contained at the turn of 2021, but year-over-year comps will lead to a spike in inflation numbers. This one-time impact may be further boosted as consumers release pent-up demand, given their robust collective balance sheet. Outside of this, the economy has plenty of excess capacity which should keep underlying price pressure from building to exorbitant levels. Unemployment levels, while improving nicely, should stay above prior cyclical lows, as we sort through the permanent damage on small services businesses caused by sheltering in place.

A particular highlight for 2020 is the robust housing market. All indicators are at record highs: permits, starts, sales (new and existing), and prices. Affordability, however, is consequently suffering. Any meaningful rise in rates can take the air out of this segment quickly – this will be key to watch as we hit the summer and fall of 2021 – with summer and fall being seasonally weak regardless. Something else to watch for is the dramatically weakened U.S. Dollar. This means foreign goods become more expensive to U.S. consumers – but can also be a boon to the U.S. manufacturing industry.

Typically, we'd look to prevailing valuation levels and the economic outlook to inform market outlook. However, any metrics using trailing sales, earnings, cash flow, etc. are invalid in the current situation. Instead, the strength of the rebound will determine whether or not the market is fairly priced at present. At a minimum, we expect the aforementioned rotations. And if yields rise as expected, this may undercut both multiples and the relative attractiveness of stocks versus bonds. As always:

"I know a lot of people have very strong and definite plans that they've worked out on all kinds of things, but we're subject to a tremendous number of outside influences and the vast majority of them cannot be predicted. So my idea is to stay flexible."

- Henry Singleton, longtime CEO of Teledyne

Positioning:

The LargeCap models are demonstrating increased risk appetite. Positive biases include Volatility, Earnings Variability, and Liquidity. Negative biases include Earnings Yield, Size, and Dividend Yield. In the style box breakdown, a strong growth bias has evolved into more of a positive bias toward large-cap stock versus mega-caps.

The Energy sector has swung sharply into favor, paced by Energy Reserves. Financials have turned positive, propelled by Banks. Defensive sectors Consumer Staples and Utilities are now most out of favor, along with Industrials.

From a return-driver perspective, we again see large changes from 3 months ago. Risk/Volatility metrics have swung decidedly favorable, while momentum and Growth measures have fallen to neutral. Valuation metrics remain mixed.

Financial Advisors please contact us at *sma@greatlakesadvisors.com*

Institutional Investors please contact us at *cr@greatlakesadvisors.com*

*Coined by Bob Rodriguez, the longtime stalwart manager of FPA Crescent Fund, Red Bull economics is an economy juiced by outsized monetary and/or fiscal stimulus.

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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