DISCIPLINED EQUITY
ALLCAP

GREAT LAKES ADVISORS
A WINTRUST WEALTH MANAGEMENT COMPANY

MANAGER COMMENTARY
First Quarter 2021

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MARKET REVIEW

If the 2021 equity markets could speak, they'd tell 2020 "Hold my beer...” Coming off an unprecedented 2020, 2021 kicked off with incredible short squeeze rallies in the Reddit "meme" stocks, causing severe *agita* for many highly respected hedge funds. Next, while we expected yields to rise, EPS growth to accelerate and spread, and a long-awaited value revival to take place, we did not foresee the violence of these rotations. In fact, Q1 2021 was the worst Treasury rout since 1980, the best performance for Bloomberg's Pure Value portfolio since 2000, and small caps once again outperformed the NASDAQ 100 Index.

Russell 3000

The Russell 3000 Index recorded a 6.4% advance during Q1, adding to a strong Q4 to bring the trailing 12 month return to a staggering 62.5%.

Size/Style

- Small-caps again posted a massive performance edge over both mid- and large-caps during the first quarter of 2021. Over the trailing 12 month period, small-caps outperformed max-caps by over 38%.
- From a style perspective, value stocks outperformed their growth counterparts by 10.7% during the first quarter of 2021. Growth maintains a near 6% advantage over the trailing 12 month period, despite significant outperformance by value stocks over the past 6 months.

Russell 3000 Sectors

We saw greatly increased consistency in sector performance quarter-over-quarter within the Russell 3000 Index, as all sectors advanced during the first quarter:

- Cyclical stocks – especially late-stage cyclicals – continued to pace the Russell 3000 Index, led by Energy's 27.2% gain. Financials also advanced smartly, climbing 15.4% to start the year the way they closed 2020. For the past 12 months, the Consumer Discretionary and Materials sectors paced the Russell 3000.
- Defensive sectors and the Tech sector remained at the bottom of the performance list, as one would expect given extreme bullishness. Consumer Staples and Utilities each returned less than 3%, as did the Tech sector. For the past 12 months, the Utilities and Health Care sectors performed worst, their safe haven status weighing against them in a highly speculative environment.

FIRST QUARTER ATTRIBUTION

The AllCap strategy advanced a solid 4.5% during the quarter, yet trailed the benchmark Russell 3000 Index’s 6.4% advance. The table on the following page breaks down the contributions from sector positioning and stock selection.

In total, sector positioning contributed 0.57% to active return:

- Overweighting the Energy sector added 31bps, as the sector outperformed the Russell 3000 Index by about 25%.
- Underweighting the Technology sector added another 31bps, as the sector underperformed the Russell 3000 Index by about 5%.

Stock selection within the respective sectors detracted 2.42% from active return.

FIRST QUARTER ATTRIBUTION

SECTOR	GLA WEIGHTING	R3000 WEIGHTING	% ACTIVE	GLA RETURN	R3000 RETURN	% ADDED	SECTOR ALLOCATION	STOCK SELECTION	ACTIVE CONTRIBUTION
Comm. Services	11.95	9.93	2.02	5.49	7.41	-1.91	-0.04	-0.38	-0.42
Consumer Disc.	14.88	12.42	2.46	6.22	5.18	1.04	0.02	0.20	0.22
Consumer Staples	4.94	5.55	-0.61	18.68	2.09	16.59	0.12	0.64	0.76
Energy	4.36	2.50	1.86	24.73	31.48	-6.76	0.31	-0.24	0.07
Financials	10.36	11.24	-0.89	15.82	16.35	-0.52	-0.28	0.16	-0.13
Health Care	12.02	13.86	-1.85	-10.81	2.44	-13.25	0.02	-1.81	-1.79
Industrials	10.84	9.44	1.40	7.82	11.35	-3.53	0.02	-0.43	-0.41
Technology	20.46	26.50	-6.04	0.95	1.40	-0.46	0.31	-0.10	0.21
Materials	2.81	2.85	-0.05	3.31	10.36	-7.05	-0.01	-0.16	-0.17
Real Estate	5.88	3.16	2.72	4.73	8.71	-3.97	-0.02	-0.25	-0.27
Utilities	1.53	2.55	-1.02	1.43	2.89	-1.46	0.12	-0.05	0.07
Total	**100**	**100**		**4.49**	**6.35**	**-1.86**	**0.57**	**-2.42**	**-1.86**

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 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, the most surreal of Presidential races, a COVID vaccine, a change in control of the Senate decided in a run-off some 2 months after the general election, another $2T in fiscal stimulus, and finally the worst quarter for U.S. treasuries since 1980. Ho hum.

We weren't surprised to see much of what came to pass during the opening quarter of 2021, but we were once again taken aback by the speed and violence of the rotation. Then again, I suppose one would be foolish to have "expected" the most violent rotation since Ronald Reagan's first year in office!

The economic data looks quite good at this point, as does the vaccine rollout. There's every reason to be optimistic in the short run, but also cautious in the long run. Corporate profits have recovered nicely and remain near record levels. Equity markets remain volatile under the surface to be sure, but headline equity volatility has receded. A recession is really off the table, and in fact, GDP growth in the high single digits is the most likely scenario over the next couple of quarters.

Although commodity prices are on the rise, inflation numbers remain in check at this point – but merit careful study. Manufacturing hours worked are down a bit, and while payroll expansion is robust, we still have slack in the labor market to counter commodity inflation.

Housing remains incredibly strong, with prices up 10% y/y. But there may be some signs of rising mortgage rates taking a bite out of demand, with both permits and new home sales down slightly. However, at least some of this decline is also due to very long wait times for building materials.

Consumers appear to be in good shape. Household balance sheets are robust, with low debt levels and plenty of excess savings. This makes for solid consumer confidence numbers, and impressive retail sales growth.

Stock prices are certainly elevated if one uses any kind of backward-looking valuation metrics. Stocks are trading higher based on optimism for a broad, robust economic recovery – and that is what we have underway, by most all indicators.

Positioning:

The AllCap models are demonstrating increased preference for value, in both the mega-cap and large-cap tiers. From a risk factor perspective, this means Value, Yield, and Earnings Yield (opposite of P/E ratio) have become increasingly attractive, while Growth, Momentum, and Volatility factors have all decreased in importance.

From a sector/industry perspective, Financials (Insurance, Asset Managers, small-cap Banks), Utilities, Consumer Staples, and Materials sectors are all increasingly in favor. By contrast, the Tech sector has fallen out of favor – especially the Software group. Outside of the Tech sector, Medical Products and Information Services industries have become less attractive, as have small-cap Biotech companies.

From a stock selection factor perspective, Forecasted Earnings Yield, Sales to Enterprise Value, EBIT to Enterprise Value, and Yield all became more heavily weighted in the models. On the other end of the spectrum, risk factors fell out of favor. Stock-specific volatility, co-skewness, and beta were among the factors with significantly decreased exposure.

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. The sector weights are the average weight throughout the calendar quarter. Individual account returns may vary.

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