DISCIPLINED EQUITY

ALLCAP

GREAT LAKES ADVISORS

A WINTRUST WEALTH MANAGEMENT COMPANY

MANAGER COMMENTARY

Second Quarter 2021

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MARKET REVIEW

U.S. equities continued to push sharply higher during the second quarter, fueled by very easy monetary policy and massive fiscal stimulus. Valuations are stretched here, with investors cumulatively betting the robust earnings rebound continues WHILE bond yields also remain low. Disappointment on either side of the equation could lead to heightened volatility and/or a pullback in equities.

Russell 3000

The Russell 3000 Index recorded an 8.2% advance during Q2 bringing the first half gain to 15.1%.

Size/Style

- After two quarters of marked outperformance, small-caps underperformed large-caps during the second quarter.
- From a style perspective, the Russell 3000 Growth Index posted a 6.2% advantage over the 3000 Value Index, with all of the advantage occurring during June. This marked a sharp reversal from the prior quarter.

Russell 3000 Sectors

Within the Russell 3000, counter-cyclicals continued to lag, but we saw some changes atop the sector leaderboard:

- Technology stocks rebounded from a relatively weak Q1, notching a 13.6% advance to pace the Index. Energy stocks continued their solid start to 2021, and Health Care stocks also posted solid gains.
- Consumer Staples continued their relatively weak performance, but the Utilities sector was the sole loser, sliding 1.2% during Q2.

SECOND QUARTER ATTRIBUTION

The AllCap strategy advanced a solid 5.7% during the quarter, yet trailed the benchmark Russell 3000 Index's 8.2% advance. The table on the following page breaks down the contributions from sector positioning and stock selection.

In total, sector positioning contributed 0.07% to active return:

- Overweighting the Energy sector added 11bps, as the sector outperformed the Russell 3000 Index by about 4.3%.
- Overweighting the Consumer Staples sector detracted 11bps, as the sector underperformed the Russell 3000 Index by about 4.6%.

Stock selection within the respective sectors detracted 2.64% from active return.

MARKET OUTLOOK

The surprises keep coming. Despite unprecedented stimulus (and talk of much more to come), and signs of building price pressure (especially in PPI and manufacturing prices paid), Treasury yields actually moved lower on the quarter, the curve flattened, and real yields hit the most negative on record. This is largely due to massive purchases from the Treasury. The markets are focused on whether inflation will be "transitory", or if the observed price increases will lead to something similar to the early 80's.

With yields halting their increase, the long-awaited value rotation retraced its strong run of outperformance, sliding sharply during June. Rising yields increase the discount rate for future earnings, making growth stocks less attractive. Declining yields have the opposite effect. We expect value to outperform growth after this recent setback.

SECOND QUARTER ATTRIBUTION

SECTOR	GLA WEIGHTING	R3000 WEIGHTING	% ACTIVE	GLA RETURN	R3000 RETURN	% ADDED	SECTOR ALLOCATION	STOCK SELECTION	ACTIVE CONTRIBUTION
Comm. Services	11.32	10.09	1.23	6.72	11.08	-4.36	0.04	-0.51	-0.48
Consumer Disc.	11.09	12.17	-1.08	-1.50	6.65	-8.15	0.03	-1.00	-0.97
Consumer Staples	7.82	5.52	2.30	3.46	3.58	-0.13	-0.11	-0.05	-0.16
Energy	5.35	2.66	2.69	7.17	12.55	-5.38	0.11	-0.29	-0.18
Financials	13.82	11.90	1.92	8.00	7.30	0.70	0.00	0.11	0.11
Health Care	9.38	13.45	-4.06	1.67	8.24	-6.57	-0.02	-0.59	-0.61
Industrials	8.59	9.72	-1.13	-0.33	3.88	-4.21	0.05	-0.38	-0.33
Technology	22.81	25.70	-2.89	10.98	11.37	-0.40	-0.05	-0.16	-0.21
Materials	2.36	2.97	-0.60	17.78	4.68	13.10	-0.04	0.22	0.18
Real Estate	4.60	3.33	1.26	11.86	11.69	0.17	0.07	0.02	0.09
Utilities	2.87	2.50	0.37	-0.13	-0.43	0.30	0.00	-0.02	-0.02
Total	**100**	**100**		**5.67**	**8.23**	**-2.56**	**0.07**	**-2.64**	**-2.56**

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

The strong stimulus is showing its impact in many areas. Corporate profits hit an all-time high in Q1. Capacity Utilization has moved higher – but remains at a moderate level. Commodity prices continue to edge higher, as do input prices such as lumber, steel, and concrete. The labor market continues to recover, with about 70% of the jobs lost during COVID now recouped. The housing market remains very strong, with the highest year-over-year increases in home prices in 15 years. Industrial Production and purchasing indices are also strong. Lastly, the preponderance of good news has buoyed consumer confidence.

The next quarter or two should inform the Fed's future policy far more than the past quarter or two. More stimulus (infrastructure bill, anyone?) offset by tax raises will come into play, and year-over-year changes in economic data will become more meaningful as COVID-hampered periods drop from the observations. The conversation will start to turn to tapering as the Fed evaluates the quantity of their monthly asset purchases, and how long this should continue.

As for equity markets, we'll need plenty of robust, profitable growth to justify valuations here – especially if inflation is not transitory.

Positioning:

With the economy awash in liquidity but the economic rebound not looking as powerful as hoped, forecasted returns for growth stocks have improved sharply across all parts of the cap spectrum. In addition, smaller stocks remain more attractive than larger-caps as we enter Q3.

From a risk factor perspective, the models moved to a more aggressive stance, with Volatility, Leverage, and Earnings Variation the most significant positive biases. Earnings Yield had been a strong positive bias, but has now reversed into a negative tilt.

From a sector/industry perspective, Consumer Discretionary (Entertainment, Hotels) and Energy stocks (Energy Reserves) are in favor. Within the large-cap realm, Health Care became significantly more attractive during Q2, especially Biotech, Medical Products, and Drugs. The Technology sector shows significant forecast dispersion, with Software and Internet industries rated attractive, while Electronic Equipment and Semiconductors are out of favor. Financials became significantly less attractive given the flattening yield curve, and now have a neutral outlook.

In terms of stock selection characteristics, higher volatility (idiosyncratic risk, beta, low share price) swung back into favor after a brief respite. A number of Value and Quality characteristics became less attractive, with Forecasted Earnings yield, Earnings-based Return on Capital, and Earnings/Debt all declining sharply.

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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