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MANAGER COMMENTARY

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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.

S&P 500

The S&P 500 Index surged a further 8.6% during Q2, leaving the Index 15.3% higher for the first half of the year.

Size/Style

- Reversing Q1's relative performance, mega-caps outperformed large-caps by about 2% during the quarter.
- A more surprising and significant reversal was the outperformance of Growth stocks, with the S&P 500 Growth Index outpacing its value counterpart by nearly 7% (after trailing by over 8% during Q1).

S&P 500 Sectors

While sector performance within the S&P 500 was somewhat consistent with the prior quarter, there were a couple of notable changes:

- Technology stocks - especially the biggest Tech stocks - posted a nice recovery after lagging to start the year. The sector gained 11.6%, trailing only the Real Estate group, which notched a 13.1% advance.
- While Energy continued its long-awaited rebound, other late-stage cyclicals faded on a relative basis; Materials and Industrials each underperformed the Index. Utilities, meanwhile, were the only group to post a loss.

SECOND QUARTER ATTRIBUTION

The LargeCap strategy climbed about 5.3% during Q2, but trailed the benchmark S&P 500 Index's 8.6% advance. The table on the following page breaks down the contributions from sector positioning and stock selection.

In total, sector positioning had little impact on active return:

- Overweighting the Energy sector added 9bps, as the sector outperformed the S&P 500 Index by about 3%.
- A modest overweighting of the Industrials sector detracted 11bps, as the sector underperformed the S&P 500 Index by about 4%.

Stock selection within the respective sectors detracted 3.31% 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	S&P 500 WEIGHTING	% ACTIVE	GLA RETURN	S&P 500 RETURN	% ADDED	SECTOR ALLOCATION	STOCK SELECTION	ACTIVE CONTRIBUTION
Comm. Services	12.16	11.06	1.10	5.22	10.72	-5.50	0.01	-0.71	-0.70
Consumer Disc.	7.96	12.30	-4.33	5.28	6.95	-1.67	0.07	-0.13	-0.06
Consumer Staples	5.53	6.00	-0.48	3.20	3.83	-0.63	0.05	-0.11	-0.06
Energy	5.72	2.81	2.91	7.08	11.30	-4.22	0.09	-0.24	-0.16
Financials	13.53	11.55	1.98	8.36	8.36	-0.01	0.06	0.01	0.07
Health Care	7.99	12.93	-4.94	-0.11	8.41	-8.52	-0.06	-0.63	-0.69
Industrials	10.51	8.77	1.73	-1.57	4.48	-6.04	-0.11	-0.66	-0.76
Technology	26.01	26.70	-0.69	8.64	11.56	-2.92	-0.02	-0.77	-0.79
Materials	2.81	2.74	0.08	-4.14	4.97	-9.11	0.02	-0.25	-0.23
Real Estate	3.92	2.54	1.39	12.97	13.09	-0.12	0.01	0.02	0.02
Utilities	3.86	2.59	1.27	4.41	-0.41	4.82	-0.08	0.15	0.08
Total	**100**	**100**		**5.27**	**8.55**	**-3.28**	**0.03**	**-3.31**	**-3.28**

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 in both the mega-cap and large-cap market segments. Overall, large-caps appear more attractive than mega-caps as we enter Q3.

From a sector/industry perspective, Consumer Discretionary (Entertainment, Hotels) and Energy stocks (Energy Reserves) are in favor. 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.

From a stock selection factor perspective, many value factors suffered sharp reductions in coefficients (dividend yield, cash flow yield, forecasted earnings yield, sales/price), while several growth and risk characteristics became more positive (sales growth, earnings growth, and idiosyncratic risk).

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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