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MANAGER COMMENTARY

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MARKET REVIEW

While investors continue to adjust their collective outlook in response to the evolution of the COVID pandemic and massive government stimulus, the U.S. equity market reflected evolving consensus. The long-awaited value rally this spring was brought to a grinding halt in large part due to delta variant concerns, which resulted in a sharp decline in yields and a significant rotation into growth stocks. While this ruled the day early in the quarter, this effect faded as the worst fears of this variant being both severe and widespread faded. Concerns about a Fed leadership transition, the debt ceiling, and an evolving infrastructure bill did cast a pall over the market as the quarter came to a close.

S&P 500

Despite a fade toward quarter-end, the S&P 500 Index eked out a 0.58% gain for the quarter.

Size/Style

- Q3 returns declined slightly as we roll down the large-cap spectrum (S&P 100 > Russell Top 200 > S&P 500). The opposite was true as the market pulled back during September.
- The S&P 500 Growth Index had quite strong relative performance early during Q3, and so underperformance versus its Value Index peer during September wasn't enough to erase Growth's advantage for the full quarter. For the calendar year through September, Growth maintains a slim 1.1% advantage.

S&P 500 Sectors

All-in-all, defensive counter-cyclicals held up well during Q3, but the more cyclical Financial sector paced the S&P 500 sector returns:

- Counter-cyclicals including Utilities, Telecom, and Health Care all performed well during Q3. Surprisingly, their relative performance was weak during the September selloff.
- Cyclicals actually performed best during the September decline, led by the Energy sector's 9.4% advance for the month. Financials and Consumer Discretionary stocks were the next best performing groups for the month.

THIRD QUARTER ATTRIBUTION

The LargeCap strategy slipped about 1.5% during Q3, trailing the benchmark S&P 500 Index's 0.6% advance. The table on the following page breaks down the contributions from sector positioning and stock selection.

In total, sector positioning had a modestly negative impact on active return:

- Overweighting the Energy sector detracted 53bps, as the sector trailed the S&P 500 Index by about 2.2%.
- Underweighting the Health Care sector detracted 12bps, as the sector outperformed the S&P 500 Index by almost 1%.

Stock selection within the respective sectors detracted 1.4% from active return.

MARKET OUTLOOK

These are unprecedented times – that much is for sure.

Do record high profit margins fueling record high corporate profits justify a pricy stock market? Do incredibly easy financial conditions? So far, they have. Rapid expansion of the Fed's balance sheet, huge fiscal stimulus, and record low real yields are fueling a sharp corporate recovery – but have also fueled inflation. Strong increases in crude oil and many other commodities have led to a 40 year high in PPI; the jury remains out on whether this will continue to fuel consumer price increases.

THIRD 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	14.00	11.29	2.72	-1.95	1.60	-3.56	0.02	-0.50	-0.48
Consumer Disc.	8.95	12.12	-3.17	2.71	0.00	2.71	-0.01	0.21	0.19
Consumer Staples	6.56	5.81	0.75	3.96	-0.31	4.28	-0.02	0.27	0.25
Energy	3.86	2.54	1.32	2.87	-1.64	4.50	-0.53	0.19	-0.34
Financials	11.79	11.13	0.66	3.21	2.74	0.46	-0.01	0.06	0.05
Health Care	8.69	13.34	-4.65	3.40	1.43	1.97	-0.12	0.16	0.05
Industrials	7.73	8.26	-0.52	-12.34	-4.28	-8.06	0.02	-0.69	-0.67
Technology	27.40	27.84	-0.44	-1.26	1.34	-2.61	0.02	-0.75	-0.72
Materials	2.15	2.55	-0.40	-12.47	-3.51	-8.97	0.02	-0.20	-0.18
Real Estate	5.53	2.62	2.90	-0.83	0.88	-1.70	-0.02	-0.10	-0.12
Utilities	3.34	2.50	0.84	-0.69	1.74	-2.44	0.03	-0.09	-0.06
Total	**100**	**100**		**-1.46**	**0.58**	**-2.04**	**-0.61**	**-1.43**	**-2.04**

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

The stimulus has certainly also boosted the jobs market, with payrolls – and wages – still growing solidly. The housing market has also been a significant beneficiary of easy conditions and COVID-driven re-prioritization. New home permits, starts, and sales remain solid, existing home sales continue at a robust pace, and the Case-Shiller indices are each up close to 20% year over year. Kind of reminiscent of 2003-2005.

Industrial production has continued its strong recovery, and ISM readings indicate this will continue. Global shipping has awoken from its long slumber, and the Baltic Freight Index is up quite sharply – to 13 year highs.

So yes, stimulus has gotten investors wonderful stock price appreciation up through now, but caution is certainly warranted at these lofty levels.

Positioning:

With the economy still awash in liquidity and the impact of the delta variant showing signs of rolling lower, we see a percolating reopening trade combined with positioning for inflation, which may not be as transitory as we'd like to imagine. This interplay has led to another pop in Treasury yields since early August, and with this has come a rotation back out of growth and towards value, and especially large-cap (rather than mega-cap) value. Other **risk factors** which appear favorable include leverage, earnings variability, momentum, and volatility.

From a **sector/industry** perspective, the increase in yields has pulled the Banks back into favor, and the reopening trade is leading to a resurgence of oil-related stocks and retailers. Financials have swung into the pole position among sectors, while Tech is most out of favor, with Software and Electronic Equipment least favorable.

From a **stock selection factor** perspective, we again see the resurgent reopening hopes reflected in higher risk appetite (estimate dispersion, Beta), building price momentum (WRSI), and increased emphasis on valuation (Sales/Price, Cash Flow/Price, Forecasted Earnings/Price).

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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