DISCIPLINED EQUITY

LARGECAP

GREAT LAKES ADVISORS

A WINTRUST WEALTH MANAGEMENT COMPANY

MANAGER COMMENTARY

Third Quarter 2018

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MARKET REVIEW

U.S. equities again moved solidly higher across the board during the quarter. Unlike the second quarter, small-cap stocks underperformed large-cap stocks, with investors likely rotating due to reduced fear about the impact of new tariffs.

Year to date, growth stocks have outperformed value stocks by a significant margin - in some segments by an even wider margin than what we experienced in 2017. Overall, the S&P 500 Index has advanced over 10% for the year.

Size/Style

As has been the case for an extended period, growth stocks outperformed value stocks within the S&P 500 Index, and have about a 13.5% advantage year-to-date.

- Mega-caps outperformed large-caps.
- Growth dominated value in both the mega-cap and large-cap segments (the advantage was more substantial among mega-caps).

S&P 500 Sectors

We again saw a lack of quarter-to-quarter correlation of relative sector performance:

- Energy went from being the top-performing sector during Q2 to the next-to-worst performer during Q3.
- Industrials was the worst-performing sector during Q2, but rebounded to be the second-best performer during Q3.
- Year to date, the Consumer Discretionary and Technology sectors have paced the market - each recording over 20% gains.

THIRD QUARTER ATTRIBUTION

The LargeCap strategy advanced about 7.6% during the quarter, just behind the benchmark S&P 500 Index's return of 7.7%. The table on the following page breaks down the contributions from sector positioning and stock selection:

In total, sector positioning added 1.23% to active return:

- Overweighting the Technology sector added 30bps to active return, as the sector outperformed the total S&P 500 Index by almost 5% during Q3.
- Underweighting the Energy sector added 15bps, as the sector underperformed the Index by about 7%.

Stock selection within the respective sectors detracted 1.30% from active return:

- Stock selection within the Health Care sector was poor.
- Stock selection was best within the Industrials sector.

SECTOR	GLA WEIGHTING	S&P 500 WEIGHTING	% ACTIVE	GLA RETURN	S&P 500 RETURN	% ADDED	SECTOR ALLOCATION	STOCK SELECTION	ACTIVE CONTRIB
Comm Services	7.81	10.24	-2.43	-0.41	1.06	-1.47	0.15	-0.15	0.00
Consumer Disc.	12.95	10.08	2.88	6.64	9.34	-2.69	0.05	-0.32	-0.27
Cons. Staples	5.08	6.82	-1.73	5.29	5.70	-0.41	0.05	-0.07	-0.02
Energy	3.70	6.01	-2.31	4.44	0.61	3.82	0.15	0.15	0.30
Financials	10.70	13.88	-3.18	-0.05	4.35	-4.41	0.10	-0.53	-0.43
Health Care	15.58	14.51	1.07	9.24	14.53	-5.30	0.05	-0.71	-0.66
Industrials	12.82	9.67	3.15	11.71	10.00	1.71	0.09	0.23	0.32
Technology	27.56	20.63	6.93	13.19	12.41	0.77	0.30	0.20	0.50
Materials	1.58	2.53	-0.95	0.17	0.36	-0.19	0.09	-0.02	0.07
Real Estate	1.76	2.76	-1.00	3.17	0.86	2.31	0.11	0.00	0.11
Utilities	0.45	2.88	-2.42	-1.81	2.39	-4.20	0.09	-0.08	0.02
TOTAL	**99.99**	**100**	**0.00**	**7.64**	**7.71**	**-0.07**	**1.23**	**-1.30**	**-0.07**

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

MARKET OUTLOOK

The U.S. economy is surging, interest rates are slowly normalizing, and U.S. equity markets are continuing to surge higher.

Corporate profits hit yet another record level, and profit margins continue to sit close to 10%. Quality spreads remain subdued on the economic strength, but the absolute level of both 10-year Treasuries and the Fed Funds rate have pushed slowly higher over the past couple of years. Add to this a yield curve which is precariously close to inverting, and we can see the interest rate environment is morphing into a state which should eventually dampen economic growth at the margin. One might argue we are already seeing signs of this via a more slowly growing housing market.

Price pressures remain well-contained, however. Although capacity utilization is over 78% and WTI crude oil has pushed north of $70/bbl, headline CPI is 2.7% - and only 2.2% ex food & energy. Corporate earnings calls have alluded to building input price pressure in some segments of the economy – but apparently not enough to curtail extremely strong business confidence. Industrial production has surged to over 3% growth on the back of a white-hot Manufacturing ISM Report On Business survey reading (14-year high).

Against this solid economic growth, employment conditions are excellent. Beyond the bullish headline U-3 and U-6 unemployment rates and non-farm payroll numbers, weekly manufacturing hours worked is hovering at all-time highs, and unemployment duration near a cyclical low. Labor productivity is growing at an acceptable rate, and the Employment Cost Index is rising at a moderate rate as well.

The robust employment market has bolstered consumer confidence to an 18 year high, and this has led to retail sales increasing at a rate of over 6% per year – very strong indeed. This is pretty Goldilocks, even if the world outside of the economy and stock market doesn't quite feel that way at times.

The LargeCap model remains biased against stocks with high earnings yield, high estimate dispersion, and high dividend yield, favoring instead companies with strong intermediate-term price momentum. From a style perspective, the model still prefers growth over value – both in mega- and large-cap. Health Care (Medical Services) and Technology (Software) stocks are most in favor, while Financials (Banks, Asset Managers, Equity REITs) are most out-of-favor.

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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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