DISCIPLINED EQUITY

SMIDCAP

GREAT LAKES ADVISORS

A WINTRUST WEALTH MANAGEMENT COMPANY

MANAGER COMMENTARY

First Quarter 2019

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MARKET REVIEW

U.S. equities went on an absolute tear during the first quarter, posting their strongest quarterly gains since 2009. However, the mathematics of recouping a drawdown being what they are, we did not quite recoup the losses of Q4. In addition to the reversal in market direction, we also saw a dramatic rotation in the characteristics associated with market leadership.

Size/Style

- Within the R2500, small-caps rallied strongly during January, but mid-caps re-asserted themselves over the balance of Q1.
- From a style perspective, growth handily topped value in both mid-caps and small-caps.

Russell 2500 Sectors

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

- Health Care and Energy stocks rebounded from poor Q4 performance (the Energy sector was 40% lower during Q4).
- Technology stocks recorded the sharpest advance, notching a 23% gain.
- The Consumer Staples and Utilities sectors fell from being the top performers during Q4 to the worst performers during Q1.

FIRST QUARTER ATTRIBUTION

The SMidCap strategy added about 13.1% during the quarter, well under the benchmark Russell 2500 Index's 15.8% return. The table on the following page breaks down the contributions from sector positioning and stock selection.

In total, sector positioning dadded 0.10% to active return:

- Underweighting the Utilities sector added 16bps, as the sector underperformed the Russell 2500 Index by about 5%.
- Overweighting the Consumer Discretionary sector detracted 23 bps from active return, as the sector underperformed the benchmark by nearly 4% during Q1.

Stock selection within the respective sectors was the largest detractor, removing 2.82% from active return.

MARKET OUTLOOK

Economic conditions remained solid heading into 2019, and valuations continued to be favorable for U.S. equities. We pointed to Washington, D.C. as the source of most of the market's concern during Q4 and a couple of concerns were resolved quite favorably. First, the Mueller report resulted in no further indictments and did not find collusion between the Trump campaign and Russia. So, the worst-case political scenario was taken off the table – for now. A cloud of uncertainty which will linger over the market is the campaigning for the Democratic presidential nominations. Many early candidates have tax hikes, wealth redistribution, central planning, and the break-up of tech giants as key platform elements.

A second concern which was resolved for the time being is the dual threat of Fed rate hikes and balance sheet reduction. We hit a bit of a soft demand patch late last year, and this combined with the absence of inflationary pressure means "smart" money now leans toward no hike, or even a reduction (or two) in the Fed funds rate in the back half of 2019. The Fed also appreciates the negative impact of accelerating the drawdown in Reserve Funds, and appears to have allayed related concerns.

The employment picture remains very strong. Job creating had re-accelerated heading into the year, but the

SECTOR	GLA WEIGHTING	R2500 WEIGHTING	% ACTIVE	GLA RETURN	R2500 RETURN	% ADDED	SECTOR ALLOCATION	STOCK SELECTION	ACTIVE CONTRIB
Comm Services	1.60	3.27	-1.67	3.35	13.76	-10.41	0.03	-0.18	-0.15
Consumer Disc.	17.04	11.32	5.73	10.91	12.20	-1.30	-0.23	-0.27	-0.49
Cons. Staples	2.59	2.65	-0.06	2.31	6.96	-4.65	0.00	-0.16	-0.16
Energy	4.09	3.32	0.78	31.82	17.73	14.08	0.13	0.46	0.59
Financials	13.97	15.68	-1.70	7.55	10.06	-2.51	0.02	-0.37	-0.35
Health Care	17.91	13.02	4.89	15.18	19.06	-3.87	0.14	-0.64	-0.51
Industrials	13.69	15.02	-1.32	7.94	14.82	-6.88	0.03	-1.00	-0.97
Technology	16.57	16.82	-0.25	22.16	24.90	-2.74	-0.07	-0.42	-0.50
Materials	5.59	5.26	0.33	7.77	15.78	-8.01	-0.02	-0.50	-0.52
Real Estate	6.32	9.97	-3.64	20.21	16.58	3.62	-0.09	0.23	0.14
Utilities	0.61	3.68	-3.07	15.80	10.45	5.35	0.16	0.03	0.19
TOTAL	**100**	**100**		**13.11**	**15.83**	**-2.72**	**0.10**	**-2.82**	**-2.72**

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

government shutdown did have a negative impact. The shutdown also combined with the Q4 stock market correction softened consumer confidence. It will be interesting to see whether the aforementioned easier credit conditions can serve to ignite the housing market, which has certainly slowed over the past 18 months. Looking out, we're a bit less constructive on U.S. equities – as you might expect after the strongest quarter in many years. The first quarter rally served to bring valuations back above long-term norms. We also note that while prices have been on a tear, the rate of EPS growth has slowed to the mid- to high- single digits, but the rate of return on assets/equity remains above norm. From here, we may need some positive surprises (rate cuts, trade deal anyone?) to drive prices appreciably higher.

The SMidCap model is strongly biased against stocks with higher price volatility and earnings variability. The model now exhibits a preference for stronger relative price appreciation, as well as, stocks with a higher market cap. From a style perspective, the model prefers mid-cap over small-cap and is most strongly tilted against small value stocks. Financials (Equity REITs, Banks) and Utilities are preferred in the model. Health Care stocks (Biotech, Drugs) and Energy (Energy Reserves, Oil Services) are most out-of-favor.

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The data in the attribution table represent the returns for each sector and 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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