MANAGER COMMENTARY

DISCIPLINED EQUITY

Great Lakes Advisors
A Wintrust Wealth Management Company

FIRST QUARTER 2017

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Market Overview

Is it merely coincidence that animal spirits were ignited in the wake of Trump's election? Perhaps....

What we do know is corporate profits have resumed growth, up just over 9% y/y. Credit markets reflect an uncertainty over whether the Fed will continue raising rates and curb growth, as well as whether Trump's pro-growth (short-term growth?) agenda can/will advance through Congress. There is a kind of tension here...and rates are locked in a tight range for the near term. Commodities are mirroring this trend, trading in a tight range. Lastly, while stock indices have advanced since the election, leadership—whether viewed by sector, market cap, or style—has been very inconsistent.

Trump's victory lead to considerably greater risk-seeking preferences by investors during Q4 of 2016. As of late, however, we are seeing themes reverse on a quarterly basis. As noted last quarter, one proxy for risk-seeking behavior is small-cap leadership. During Q4, we noted returns increased as we slid down the capitalization spectrum—consistent with risk-seeking behavior. During Q1, this completely reversed; returns decreased as we moved down in market cap. The Russell Top 200 Index led the way, returning 6.38% during Q1, followed by the Russell 1000 Index's 6.03% advance. The Russell MidCap, 2500, and 2000 indices returned 5.15%, 3.76%, and 2.47%, respectively.

Another fashion in which a healthy risk appetite manifests itself is in value outperforming growth. This was very much the case during Q4, with value stocks increasingly outperforming as we slid down the cap spectrum. Q1 was the opposite; growth topped value across the board. The best performing style index was the Top 200 Growth Index, which climbed 9.61%. By contrast, the Russell 2000 Value Index—far and away Q4's best performer—reversed this quarter, losing 0.13%.

Lest we think the reversals stop with cap and style, we turn to sector performance within the S&P 500 Index, where the rank correlation of sector returns for Q4 and Q1 was -0.75. Energy and Financial sectors led the Q4 charge, only to become the worst and third-worst performers this past quarter (Energy stocks lost 6.68%). By contrast, investors pummeled Health Care stocks in the wake of Trump's victory, only to turn and advance 8.37% during Q1.

We also had significant sector reversal within the Russell 2500 Index, where Q4's 1-2-3 ranked sectors performed 7-6-9 (out of 9 this quarter). The worst performer of Q4, Health Care, became the top performer of Q1 by swinging from a 5.68% decline to an 11.59% advance. Strange days indeed...

Market Outlook

Supporting the case for higher rates, headline CPI has surged to 2.7% growth, and PPI has recovered from a contraction to 2.2% growth. Surprisingly, labor costs remain muted and labor productivity continues to grow—despite robust payroll growth (U-3 and U-6 and cycle lows).

The housing market remains solid, with prices advancing 5% y/y. Prices remain 7-10% below 2007 peak prices. This rise in home prices—along with a solid 20% gain for the S&P 500 Index over the past year—has propelled Household Net Worth solidly higher (70% above recent trough). The result? The highest Consumer Confidence reading in 16 years!

So perhaps President Trump took office at an opportune time. Expect tougher challenges if he cannot curb the rhetoric and advance the Administration's agenda....