MANAGER COMMENTARY

LARGE CAP VALUE

GREAT LAKES ADVISORS

A WINTRUST WEALTH MANAGEMENT COMPANY

THIRD QUARTER 2017

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Market Review

The Russell 1000 Value Index gained 3.1% in the quarter ending September 30 and has appreciated by 7.9% as we enter the final quarter of the year. The broader market, represented by the S&P 500, gained 4.5% and closed at an all-time high; it is now up 14.2% year to date.

Global equity markets were led in the third quarter by Brazil (+22%), Russia (+16%), and Italy (+12%). Most European markets have gained more than 25% thus far in 2017, as have China and Brazil. In fact, most global equity indices gained ground in the quarter, and also remain at or near all-time high levels.

Oil prices jumped almost 10% in the quarter, leading to an almost 7% gain in the Energy sector. Natural gas prices, however, declined. The yield on 10-year U.S. Treasury Notes was 2.33%, up only slightly from the end of the second quarter, but well off its early September lows of 2.04%. The U.S. dollar weakened about 5% against the Euro and is now off more than 12% in 2017.

The Great Lakes Advisors Large Cap Value model portfolio returned 5.5% in the third quarter, outperforming the Russell 1000 Index by 240 basis points. Thus far in 2017 the portfolio has gained 12.6%, or 460 basis points better than the benchmark.

Third Quarter Attribution

Sector	GLA Weighting	GLA Return	R1000V Weighting	R1000V Return	Active Contribution
Financials	23.8%	5.7%	26.6%	4.7%	0.2%
Health Care	16.2%	7.6%	14.1%	0.3%	1.1%
Energy	13.9%	11.2%	10.4%	6.9%	0.7%
Consumer Staples	8.2%	-3.2%	9.1%	-0.4%	-0.2%
Industrials	12.2%	3.1%	8.4%	0.5%	0.2%
Technology	13.3%	6.4%	8.2%	5.3%	0.3%
Cons Discretionary	6.4%	3.0%	6.8%	1.6%	0.1%
Utilities	3.5%	4.4%	6.3%	2.8%	0.1%
Real Estate	0.0%	0.0%	4.0%	-0.5%	0.1%
Telecom	0.0%	0.0%	3.2%	5.3%	-0.1%
Materials	0.0%	0.0%	2.9%	8.6%	-0.2%
Cash	2.5%	0.3%	0.0%	0.0%	-0.1%
TOTAL	**100.0%**	**5.5%**	**100.0%**	**3.1%**	**2.4%**

Underweight position relative to benchmark   Overweight position relative to benchmark

Source: GLA, FactSet

Most of the portfolio's outperformance in the third quarter resulted from positive relative returns and strong stock selection in the Healthcare, Energy, Information Technology, Industrials, and Financials sectors.

- Healthcare continues to be the strategy's strongest performer, adding another 100 bps of relative performance this quarter. One holding in particular contributed almost half of the relative contribution, gaining 24% in the quarter. Strong data from its pipeline coupled with its ability to defend against competition supported the strong results. Likewise, another security continues to keep biosimilar competition to a minimum while operating efficiently to generate shareholder return of almost 10% in the quarter. A third holding in the sector also gained over 10% in the quarter, making progress expanding its margins as it builds out its cardiology franchise among other initiatives.

- Energy rebounded during the quarter with a positive return and contributed to performance due to both strong stock selection and the benefit of our overweight position. Two securities led the way with 15% gains, followed closely by another holding in the sector. All three firms have been executing well on their plans to sell assets and are nearing the end of major capital expenditure projects, which should allow them to sustain cash flow and distribute cash to shareholders.
- Technology was another solid contributor to performance. One security generated an 18% return as it realized increased revenue and margin expansion from improved unit sales and retention of higher selling prices. The firm also increased its outlook for the remainder of the year. Another security, which contributed 11 bps to the strategy's performance, also had revenue growth higher than expected at 8%, somewhat improved profit margins, and bookings for future activity above expectations. Two other securities also contributed nicely.
- Despite a subdued interest rate environment, uncertain economic backdrop, and the short-term impact of large catastrophic events on the insurance industry, the Financial stocks in the strategy outperformed the benchmark and generated about 20 bps of positive relative performance. One particular security gained 17% in the quarter as the company's margins within its wealth management segment expanded and asset growth surprised to the upside.
- The Industrial sector also provided a positive relative return. One security, which provided 18 bps of positive performance, continues to execute well on the a specific project. Another holding, which gained 9% during the quarter, is benefiting from improved railcar loadings resulting from a combination of more normal coal traffic and some short-term disruption in service at its major competitor. One holding did lag in the quarter, though the company continues to move apace with its substantial corporate restructuring.
- Consumer Staples cost the strategy 20 bps of performance. Most of the strategy's holdings declined by mid-single digits, weaker than the flat performance of the benchmark sector. One holding was down 12% on news that the FDA may look at regulating nicotine levels in cigarettes. Accordingly, we assessed the impact of this development and shifted the strategy's exposure to a substitute holding which is more insulated from regulation and is farther along in developing risk-reducing products.

Market Outlook

Equity markets sailed through the third quarter seemingly unfazed by the words and actions of "Little Rocket Man," the "Dotard," or Mother Nature. Perhaps Janet Yellen's voice trumps them all, as the Federal Reserve's clear signaling of future monetary policy, bolstered by several indicators suggesting economic activity is picking up, was well received by investors around the globe.

It is more than a little disconcerting when two world leaders in possession of nuclear weapons threaten to settle a juvenile name-calling spat by obliterating each other's existence. Perhaps equity prices should not move materially in such an event, as the likelihood of either of these reckless men taking such action is (we sure hope!) quite remote. However, how do we explain the apathetic response of the "fear gauge," or VIX, which supposedly measures short-term expected equity market volatility? The index briefly touched 15, which we consider to be its long-term average, before dropping back below 10 by month end. It seems clear to us that equity investors have placed enormous faith in the Federal Reserve's ability to reduce volatility and "manage" asset prices with monetary policy in almost any circumstance.

Hurricanes Harvey, Irma, and Maria wrought extensive damage in southeast Texas, Florida, and Puerto Rico, respectively. Estimates of damages run in the hundreds of billions, while insured losses could reach $200 billion. The storms left large swaths of human suffering in their wake, and it will take many years for those affected to rebuild. The storms will distort some economic indicators in the short run, and we may likewise see short term surges in other areas (autos, transportation, construction activity) as recovery continues.

The Trump Administration has thus far failed to bring any meaningful legislative changes to bear in the United States. Having failed several times at repealing and replacing the Affordable Care Act, they now move on to the subject of taxes. The administration's proposals at this time remain somewhat vague, but their stated objectives are to reduce the corporate tax burden, close loopholes, and provide tax relief to American taxpayers. These are all noble objectives, but early indications suggest that their cost ($2-5 trillion depending on the source) may simply be unsustainable in a country already carrying more than $20 trillion in debt. We will watch these developments closely, as “winners” and “losers” in this battle will see the value of their businesses affected.

As mentioned, economic activity in the U.S. does appear to have picked up as summer came to a close. The notable exception, however, is wage growth, which continues to be stuck near 2% per year. The unemployment rate hovers between 4-5%, which suggests wages should be improving, and small businesses in particular appear to be having a hard time filling skilled positions. Construction costs may face pressure as hurricane-stricken areas begin the arduous process of rebuilding. Interest rates have ticked back up, and the Fed has made it clear that there is likely one more rate increase coming in December, and that they will begin to slowly peel off some of the $4 trillion in fixed income securities they have purchased since the great recession.

With signs of economic activity perking up, investors seem to have taken renewed interest recently in “value” strategies. Nonetheless, thus far in 2017 “growth” strategies across all market capitalization ranges have outperformed their “value” counterparts by more than 1200 basis points (twelve percentage points). We have lamented the fact that investors have been reaching for returns, increasingly buying into “stories” of high revenue growth regardless of the likelihood that such stories will ever result in returns on investment that exceed the cost of capital, or ultimately provide a cash return to owners of the business. A shift back to a focus on buying good businesses at a fair price would certainly benefit our portfolios, and provide the cornerstone for solid long-term investment returns for our clients.

The stated Large Cap Value GLA Return data in the attribution table represent the net return for each sector and for a representative account for one quarter ending 9/30/17. Individual account returns may vary.

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