MANAGER COMMENTARY

LARGE CAP VALUE

GREAT LAKES ADVISORS

A WINTRUST WEALTH MANAGEMENT COMPANY

FOURTH QUARTER 2016

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Investment Results

Americans awoke the morning of November 9th, 2016 having elected Donald Trump as the 45th President of the United States. This unexpected outcome set off a series of market responses around the world that led generally to higher asset prices, higher interest rates, and broadly higher expectations for future economic growth. Our primary index, The Russell 1000 Value Index gained 6.7% in the fourth quarter of 2016 on the heels of a 7% advance over the 33 trading days between Election Day and year end. For the full year the index advanced an impressive 17.3%. The broader large company S&P 500 Index closed the quarter 3.8% higher, and gained 12% for the full year. Most major U.S. equity indices are now trading at or very near all-time record levels. Globally, Brazil's Bovespa index vaulted 61% higher, reversing a five-year period in which it had lost almost 70% in value (both in U.S. dollar terms.) Laggards included Italy, Spain and the U.K. (down 12%, 6% and 5%, respectively) as EU financial concerns resurfaced and Brexit fears lingered. China was down slightly, while Japan and Germany each gained about 1%. Emerging equity markets rebounded, gaining about 9% led by Latin America's 30% advance.

Crude oil closed the quarter 7% higher at about $53/barrel, representing a 6% gain for the year. Metals including palladium, copper, and silver closed the year 15-20% higher, while gold gained 8% despite falling 13% in the fourth quarter. The U.S. dollar reversed course in Q4 (again, much of it post-election), climbing 7% which allowed it to post a 3% gain for the full year. The Euro lost 4% of its value in 2016 after declining 6% in the fourth quarter.

Perhaps most importantly, the yield on the 10-year Treasury note rose 88 basis points in Q4 to finish the year at 2.48%, its highest level in over two years and double the post-Brexit low of 1.27% just six months earlier. In a well telegraphed move, the Federal Reserve raised the Federal Funds rate by 25 basis points, and signaled the potential for multiple rate hikes in 2017.

It was another tumultuous year to be sure. Investors were forced to process startling results in both the U.K. (Brexit) and the U.S. inside a five-month timeframe. Our Large Cap Value model portfolio appreciated 6.1% in the fourth quarter, trailing the index by 50 basis points. For the full year the portfolio closed 16.0% higher, trailing the index by 144 basis points. More detailed information related to those factors helping and hurting our quarterly and full-year results follows.

Fourth Quarter Attribution

- Most of the portfolio's outperformance in the fourth quarter resulted from underexposure to Utilities and Real Estate, sectors that do not fare well during rising rates—and which were relative underperformers in the quarter. These sectors provided about 70 bps to relative performance.
- Two holdings in the Consumer Discretionary sector contributed nicely to overall results. One holding was up 12% during the quarter as the firm's continued expansion in non- U.S. markets is improving. A second holding was also up 12% following earnings that were somewhat better than expected.
- Healthcare had a modest negative contribution to results, though our healthcare holdings did outperform the sector. Managed care stocks rose by single digit percentage points as they continued to deliver earnings growth despite higher costs and mounting losses in the exchanges. Two holdings were caught in the down-draft of drug pricing, falling 12% and 14%; however, they fared better than similar stocks in the benchmark that declined dramatically more as concerns about pricing pressures persisted.
- Financials detracted about 70 basis points to relative performance as we were underweight relative to the sector's 26% weighting in the index. Our sector performance of 20% was generally in line with the sector's 21% total return for the quarter. With long term rates rising almost 100 bps over the quarter in tandem with the Federal Reserve's rate hike, interest rate-sensitive banks and life insurers rose over 25%

to 40% and were positive contributors to performance. Less rate sensitive names posted solid gains but did not keep up with the torrid pace of the sector in the quarter.

Full Year 2016 Attribution

The portfolio advanced 16% in 2016, trailing the Russell 1000 Value Index by 144 basis points. Stock selection added substantial value in the Industrial and Consumer Discretionary sectors, while Financial and Health Care holdings penalized results.

- Shares of industrial companies rebounded sharply in 2016, and our overweight position benefited as a result. In aggregate our holdings gained 26%. Only a single position of our nine industrial holdings failed to gain at least 15% in the year.
- In the consumer sector, more stable earnings generators and discretionary products companies impacted results positively. Two securities held back results as they both continued to battle sluggish consumer spending patterns.
- In Financials, our holdings gained 17% in aggregate, a solid result but not quite enough to keep up with the sector's 22% gain. As mentioned previously, our interest rate-sensitive holdings performed quite well, while less sensitive holdings had solid gains but trailed the sector.
- Other observations: Stocks in the Materials sector (a 3% weighting in the index) gained 30% during the year. We have not been able to find good value in the sector and our underweight position (we own only one security, which gained 15%) cost us about 50 bps of relative performance. Our Energy holdings gained 29% in aggregate, slightly edging the sector's 27% return.

Outlook

Investors are beginning to view a Trump Presidency as a potential game changer. U.S. equity markets finished 2016 strong, interest rates rose across the yield curve, and commodity prices generally rose into the final days of the year. In mid-December we commented on market conditions, and much of what we wrote still applies. We wrote:

Investors have poured into U.S. equities in the last five weeks, believing that a Trump Administration will be unabashedly positive for the U.S. economy and U.S. companies. Several reasons supporting this belief are frequently cited:

- *Trump is likely to support increased government spending programs (such as an infrastructure program) in an effort to jumpstart economic growth.*
- *U.S. tax policies are likely to be modified. Frequently cited changes include reductions in both individual and corporate tax rates, amnesty for multinational companies allowing repatriation of billions of dollars of foreign profits, and allowing more generous tax deductibility of capital investments.*
- *Deregulation, especially in areas such as environmental law, energy production and banking and finance could also be a factor.*

The rapid response by investors to these possibilities has been somewhat remarkable. We are mildly concerned that several potential negative factors have been largely ignored. First, increased government spending in tandem with lower tax rates is likely to result in upward pressure on materials and wages, and hence inflation. This additional spending is also likely to require an increase in government borrowing, potentially at a higher rate of interest. Indeed, the ten-year Treasury yield has increased by 65 basis points since Election Day, and now stands at about 2.50%.

Second, President-Elect Trump has been quite vocal about U.S. trade policy and how disadvantageous it is to U.S. workers and consumers. Many multinational companies could suffer to the extent that trade agreements are renegotiated or tariffs on imports are introduced. We estimate that the constituents of the S&P 500 derive about one-half of their revenue outside the U.S., which could be at some risk if trade barriers grow. Indeed, one reason smaller company stocks may be outperforming is that they derive a much larger percentage of their revenue—perhaps as much as 80%—from within the U.S.

As we mentioned in our Election Day note, we are avoiding "short-termism" and instead will evaluate the longer-term impact of these and other potential changes on financial markets. Our investment approach is decidedly "bottom-up", focusing on each potential investment's fundamental condition.

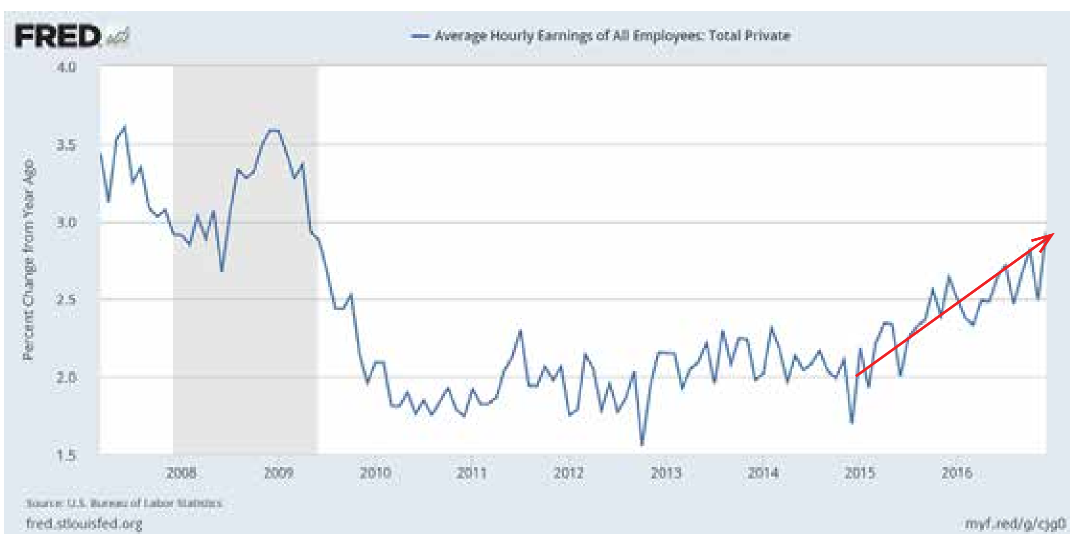
We did allow, however, that we felt compelled to make one change to our analytical process at the time, which we went on to elaborate:

However, we have made one tangible change to our forecasting methodology that is worth highlighting.

As you know, we build our own Fundamental Equity models to forecast earnings and free cash flow generation for many potential investments, including all companies included in our small cap and large cap value portfolios. We now believe it is more likely than not that a new Trump Administration will succeed in reducing the U.S. corporate tax rate, currently set at 35%. There are several competing proposals being discussed, ranging from a reduction to 15% (Trump campaign) to the low 20's (supposedly "revenue neutral") or perhaps 25%. After careful consideration and much discussion among the Fundamental Equity team, we are now assuming in our "high-end" forecast, to which we typically assign a 20% probability of occurrence, that the corporate tax rate will be reduced to 20%. In our "base case" forecast, typically assigned a 40% probability, our tax rate assumption is now 25%. We have not made any change to the tax assumption in our "low-end" cases, which typically also carry a 40% probability of occurrence.

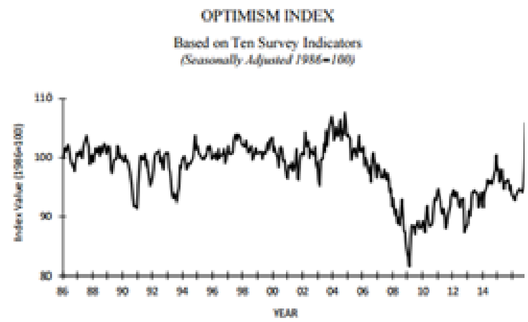
The impact of this change varies across our holdings as a variety of other factors affect a company's "effective" tax rate. The impact has been to increase the value of the stocks we own by as much as 10% in some cases, and 6-8% on average. Of course, we may simply be playing "catch-up" as markets have already moved by this much and more.

We continue to evaluate this political and economic environment and other potential policy changes to determine how they may affect U.S. equity values. In the meantime, the U.S. economy continues to drive global economic growth. Job creation continues apace and inflation appears to be in check. On January 6th the Bureau of Labor Statistics reported that average hourly earnings rose by 2.9% in December, another positive data point as we strive to return to 3%+ wage growth we enjoyed prior to the 2008-2009 recession.



Another positive sign emerged on January 10, when the National Federation of Independent Businesses (NFIB) released the results of its December Small Business Economic Trends survey. In it NFIB stated *"The December Survey confirmed the euphoria observed in the post-election survey... if this optimism continues, it will translate into spending plans ...and ultimately into reports of* *actual hiring, inventory spending and capital outlays."* The report, one of the strongest we have seen in its existence, also noted that job creation plans reached a nine-year high level. Creating well-paying jobs and boosting wage growth above the elusive 3% threshold was a central tenet of President-elect Trump's campaign, and through all of the rhetoric (of which there is certainly no shortage) we suspect that yardstick will be among the most important by which his Presidency shall be measured.

Overview - Small Business Optimism



Source: NFIB Small Business Economic Trends, Dec 2016.

As we wrote last month, it stands to reason that we may experience periods of above-average short term volatility as the new Administration's plans unfold. In any event, 2017 promises to be another exciting year for equity investors around the globe. We continue to turn over every rock in search of good value, and are confident our active approach to investing will continue to produce satisfying results over the longer term.

Great Lakes Advisors Update

Steve Wittwer left Great Lakes Advisors effective December 31. Over the last several years we have added significant analytical capability to the Fundamental Equity Team at Great Lakes. As a result, the current structure of the team does not warrant replacing Steve's role at this time. Should you have any questions, please do not hesitate to reach out to your relationship manager. Thank you for your continuing support of our firm.