MANAGER COMMENTARY

LARGE CAP VALUE

GREAT LAKES ADVISORS
A WINTRUST WEALTH MANAGEMENT COMPANY

FOURTH QUARTER 2017

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Market Review

The Russell 1000 Value Index gained 5.3% in the final quarter of 2017, finishing the year with a gain of 13.7%. The broader market, represented by the S&P 500, gained 6.6% in the fourth quarter and closed the year near its all time high, having advanced by 21.8%. Since markets turned higher in March 2009, toward the end of the "great recession," the S&P 500 Index has risen more than 370%, or almost 19% per year for almost nine years.

Global equity markets were led in the fourth quarter by Vietnam and South Africa (up about 20% each), while Mexico declined by almost 10%; All of Latin America was relatively weak, declining by 2.6%. For all of 2017, emerging markets as a whole gained almost 35%. China gained +33%, Italy and Germany were up approximately +25%, Latin America +24%, Japan +22%, and the UK +17%. Most global equity indices also remained at or near all-time high levels.

Crude oil prices improved by almost 17% in the quarter, leading to 6-7% gains in the Energy sector. The fourth quarter recovery helped oil prices to increase 13% for the full year, though natural gas prices declined by 11%. The yield on 10-year U.S. Treasury Notes was 2.33% at year end, virtually unchanged from September 30th and 12 bps lower than where it started the year. The U.S. dollar was also unaffected in the fourth quarter, stemming its losses earlier in the year and finishing down about 9% in 2017.

The Great Lakes Advisors Large Cap Value model portfolio grew 5.3% in value in the fourth quarter, in line with the Russell 1000 Value Index. For all of 2017, the portfolio gained 19.6%, nearly 600 basis points higher than the benchmark return of 13.7%.

Fourth Quarter Attribution

Sector	GLA Weighting	GLA Return	R1000V Weighting	R1000V Return	Active Contribution
Financials	23.9%	9.2%	27.5%	8.2%	0.1%
Health Care	16.0%	3.8%	13.7%	2.1%	0.2%
Energy	14.1%	4.8%	10.7%	6.4%	-0.2%
Consumer Staples	8.5%	-2.1%	8.6%	4.0%	-0.5%
Technology	10.8%	9.7%	8.5%	10.3%	0.2%
Industrials	13.0%	-0.2%	8.2%	1.2%	-0.3%
Cons Discretionary	6.9%	8.6%	6.7%	5.9%	0.2%
Utilities	3.5%	8.9%	6.3%	0.6%	0.4%
Real Estate	0.0%	0.0%	3.9%	2.0%	0.1%
Materials	0.0%	0.0%	3.0%	9.1%	-0.1%
Telecom	0.0%	0.0%	3.0%	1.6%	0.1%
Cash	3.2%	0.3%	0.0%	0.0%	-0.2%
TOTAL	**100.0%**	**5.3%**	**100.0%**	**5.3%**	**0.0%**

Underweight position relative to benchmark   Overweight position relative to benchmark

Source: GLA, FactSet

The Large Cap Value strategy's 5.3% return kept pace with its benchmark. Solid stock selection in the Utility, Health Care, and Financial sectors, coupled with Technology's over 10% return for the quarter, contributed to results. We underperformed modestly in both the Consumer Staples and Industrials sectors.

- Two holdings specifically outperformed the broader Utility sector, benefiting the strategy by 40 bps. Both companies continue to increase earnings and dividends primarily by investments in transmission and generating assets already approved for inclusion in their respective rate bases.
- Technology stocks gained almost 10% in the quarter. One holding continued to benefit from improved demand trends and higher ASPs and later reached our price target in the first week of January and we exited our remaining position. Two other holdings had gains of +10% and +15%, rounding out the strong Technology performance. Both companies benefited from industry trends of improving margins and growth fueled by the shift to the cloud.
- Within Healthcare, the managed care stocks continued to generate solid results due to an acquisition and industry-leading.
- Consumer Staples detracted about 50 bps from relative performance. Most of the drag came from one holding due to more tangible actions taken by Amazon to enter into the healthcare supply chain.
- Industrial holdings reduced relative returns by 29 bps during the quarter, reflecting our modest overweight, and in particular, one holding down nearly 30% as other holdings had positive returns. The aerospace segment, particularly aircraft engines specified on a number of new aircraft models just starting production,and healthcare equipment are strong earners and high cash flow generators.

Full Year 2017 Attribution

Sector	GLA Weighting	GLA Return	R1000V Weighting	R1000V Return	Active Contribution
Financials	23.0%	25.8%	27.4%	20.1%	1.1%
Health Care	16.7%	34.8%	12.4%	18.8%	3.1%
Energy	12.9%	4.5%	11.3%	-1.5%	1.1%
Industrials	12.7%	12.1%	9.2%	9.2%	0.3%
Technology	13.0%	30.2%	8.8%	27.5%	1.0%
Consumer Staples	9.3%	6.3%	8.6%	13.3%	-0.2%
Utilities	3.4%	20.8%	6.3%	12.1%	0.3%
Cons Discretionary	6.4%	-1.2%	5.7%	14.0%	-0.9%
Real Estate	0.0%	0.0%	3.9%	5.9%	0.3%
Telecom	0.0%	0.0%	3.4%	-2.8%	0.7%
Materials	0.1%	7.3%	3.0%	26.3%	-0.3%
Cash	2.6%	0.9%	0.0%	0.0%	-0.3%
TOTAL	**100.0%**	**19.6%**	**100.0%**	**13.7%**	**6.0%**

Underweight position relative to benchmark   Overweight position relative to benchmark

Source: GLA, FactSet

The portfolio advanced more than 19.6% in 2017, beating the Russell 1000 Value Index by almost 600 basis points. Stock selection added substantial value in the Healthcare, Energy, Financial, and Technology sectors, while Consumer Discretionary and Consumer Staples holdings penalized results.

- Almost one-half of the relative outperformance came from Healthcare. Biopharmaceutical stocks increased substantially as their key drugs proved enduring and both made significant progress in advancing their pipelines. Another company also generated a robust return as the overhang of integrating two large acquisitions was lifted and favorable FDA approvals for diagnostic equipment and devices position the company for accelerating growth and margin improvement. The managed care stocks in the strategy were up over 30% as they grew membership and generated strong profits and cash flows despite the regulatory maelstrom and devolution of the ACA.
- Shares of Energy companies rebounded modestly as the price of oil steadily improved throughout 2017, providing a positive 111 bps relative return primarily due to stock selection. In aggregate, our holdings gained more than 4.5. Of the six holdings in this sector, only one declined by more than 5%.

- Financials returned 25% and contributed 110 bps to relative performance. Most of that relative performance came from one stock in particular with gains over 50%. Its wealth management franchise is strengthening in asset size and margins, which has allowed it to increase its returns to shareholders. Two consumer finance companies both benefited from increasing consumer spend activity and a benign credit environment.
- In the Information Technology sector, we benefited both from our modest sector overweight as well as positive stock selection.
- Consumer Discretionary holdings cost the strategy 93 bps of performance. One company declined as concerns about continued slow growth of new sales and some higher than expected dealer inventory weighed on the stock. We feel the firm is taking a measured approach to current markets by increasing efforts to attract new potential buyers in the U.S. and expanding prudently in non-U.S. markets where there is unmet demand. Another company declined, despite a +12% rebound during the 4th quarter, reflecting the potential additional disruption given Amazon's bid to acquire Whole Foods and enter the physical, as well as, e-commerce grocery market. While this is no doubt an issue to monitor and will very likely increase the already intense competition in the grocery market, we believe the stock's decline has been an overreaction.

Market Outlook

The New Year began much as last year ended: Equity markets are at or near all-time highs, interest rates remain low as the Federal Reserve continues to worry about pushing inflation higher toward its 2% objective, and global markets continue to rally, with equity indices up 1-3% in the first three trading days of 2018.

The Trump Administration and Republicans in Congress won a hard-fought battle to bring tax "reform" to fruition, providing many corporations with lower tax rates and additional incentives to invest domestically. Many "experts" agree the plan will add more than $1 trillion to our nation's debt over the next 10 years, a worrisome prospect, but one that is deemed manageable for a country that is currently $20 trillion in debt. We do believe that the plan will provide a modest boost to corporate earnings growth, not only because of the reduction of the corporate tax rate to 21%, but also because the tax plan provides other incentives to invest in capital equipment and allows cash balances trapped overseas to be repatriated at a relatively low tax rate. More importantly, we think most, if not all, of the benefits of the tax bill are already embedded in current stock prices, as investors bid up share prices on several occasions in the last 18 months as the prospect for passage improved.

While the Federal Reserve frets over relatively low levels of "traditional" inflation (i.e. prices of consumer goods and services), it is apparent to us that there has been widespread inflation in asset prices (most notably equities) resulting from its injection of $4 trillion into the global economy since 2008. As noted earlier, the S&P 500 has compounded by 19% per year since early 2009. In its efforts to rekindle economic growth, which we agree was necessary in 2008-2009, the Fed and other central banks have unleashed a torrent of inflation in asset values that has resulted in: stretched equity valuations, historically low (and in some cases negative) interest rates around the world, the evaporation of measured volatility (VIX) and liquidity in fixed income markets, and the creation of cryptocurrencies, among other things. We are intently focused now on the Fed's efforts to begin extracting the liquidity it has created in the last 10 years. Thus far, the market's response has been measured, but any bump in the road may require the Fed to reverse course and pause in this effort.

Perhaps we have been at this for too long. The notion of the Fed pushing inflation higher is anathema to us; we are a product of the early 1980s when inflation was measured in double digits, mortgage rates were 15%, the prime rate of interest hit 21%, and no one would buy the 30-year treasury with a 14% yield – bonds were considered "certificates of confiscation." Today, the 30-year yields 2.79% and no one will sell them – they are treasured. We hope the Fed can stop inflation on a dime when it hits 2%, but we are dubious. Wages are showing signs of growth and many small employers are complaining of the inability to hire enough qualified workers.

Investors continue to hunt for yield (my fixed income colleague Patrick Morrissey tells me that a 3%+

yield on a municipal bond is considered “high yield”), and have bid prices up on dividend paying stocks, REITs (other than those investing in shopping mall properties), and Utilities. In the never-ending hunt for earnings growth, investors also are paying very high prices for “growth stocks,” in many cases mistaking revenue growth with earnings ability. “Growth” styles outperformed “value” in 2017 by 1200-1400 basis points, led by biotechnology and certain technology sectors of the market. The small cap Biotechnology sector rocketed higher by almost 50% in 2017; 23 of the 181 stocks in this space gained more than 100%. These 23 companies have a combined market value exceeding $60 billion, despite having only $1.6 billion in aggregate revenue and having lost $2.6 billion in the prior year.

Earnings growth has certainly been hard to come by in the last eight years as the economy is still scarred by the recession of 2008-2009. The Fed has gone to extraordinary lengths with monetary policy to “create” it, and the Trump Administration is pushing hard on fiscal policy to do so. We are hopeful that these efforts will provide balanced and sustainable growth in wages in the U.S., and will allow corporate earnings to grow to levels that support today’s high valuation levels. We are concerned that the global economy and global markets are wound very tight, and any hiccup along the way could lead to a loss of confidence in these policies and a deterioration in financial conditions.

We are not “market timers” nor macroeconomic forecasters, and we are not suggesting any one particular outcome is more likely than not in 2018. As we said last quarter, our style of investing continues to place value on high returns on invested capital, goal congruence with management, prudent capital structures, and abundant free cash flow. We believe this approach, which has worked well in the past, should continue to work well for our clients in the future.