SMIDCAP

GREAT LAKES ADVISORS

A WINTRUST WEALTH MANAGEMENT COMPANY

MANAGER COMMENTARY
Second Quarter 2019

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MARKET REVIEW

U.S. equities again moved solidly higher across the board during the second quarter, with a spectacular June accounting for all of the gains - and then some. In a reversal of Q1 performance, large-caps outpaced smid-caps during the second quarter, as the S&P 500 Index advanced 4.30% versus the Russell 2500 Index's 2.96% gain.

Size/Style

Russell 2500 Growth stocks massively outperformed their Russell 2500 Value counterparts during Q1, and posted the most sizeable advantage of any cap group yet again during Q2.

- Mid-caps outperformed small-caps
- Growth topped value in both the mid-cap and small-cap segments

Russell 2500 Sectors

We saw higher quarter-to-quarter correlation of relative sector performance among smid-caps than among large-caps, and Cyclicals dominated Q2 leadership. However, it was a mix of early, mid, and late-stage cyclicals that performed best:

- Tech stocks have been consistently solid performers in 2019, advancing over 28% during the first six months of the year. Producer Durables were the only sector to perform better during Q2, advancing about 5.8%.
- Consumer Staples and Utilities stocks continue their poor relative performance, and each recorded a decline during Q2. Energy stocks dropped 10%, while Consumer Staples slid about 4.5% during Q2.

SECOND QUARTER ATTRIBUTION

The SMidCap strategy added about 1.4% during the quarter, well under the benchmark Russell 2500 Index's 2.9% return. The table on the following page breaks down the contributions from sector positioning and stock selection.

Sector positioning detracted 0.20% from active return:

- Underweighting the Industrial sector detracted 14bps; the sector outperformed the Russell 2500 Index by about 4% during the quarter.
- Overweighting the Consumer Discretionary sector detracted 15 bps from active return, as the sector underperformed the benchmark by about 1.5% during Q2.

Stock selection within the respective sectors was the largest detractor, subtracting an additional 1.38% from active return.

MARKET OUTLOOK

Six months into 2019, the longest (and one of the slowest) expansions remains intact, and a strong first half of 2019 for U.S. equities leaves stocks trading at a premium to historic averages.

The economic picture is fairly good, especially considering how long in the tooth this expansion is. Price pressure is non-existent to this point, despite the very low headline unemployment rate. Payroll growth has slowed a bit, but employment costs remain in check, accelerating less than 3% per year. Consumer confidence remains quite high, just off of recent cycle highs. The recent pull back in interest rates appears to have extended the real estate cycle's expansion as well, albeit at a more moderate rate.

SECTOR	GLA WEIGHTING	R2500 WEIGHTING	% ACTIVE	GLA RETURN	R2500 RETURN	% ADDED	SECTOR ALLOCATION	STOCK SELECTION	ACTIVE CONTRIB
Comm Services	0.78	3.31	-2.53	11.42	1.13	10.29	0.05	0.05	0.10
Consumer Disc.	16.76	11.19	5.57	5.36	1.45	3.92	-0.15	0.63	0.49
Cons. Staples	2.21	2.55	-0.34	-16.49	-4.40	-12.09	0.02	-0.33	-0.32
Energy	2.40	2.98	-0.58	-17.34	-11.81	-5.53	0.06	-0.18	-0.12
Financials	13.39	15.52	-2.12	3.09	6.29	-3.20	-0.02	-0.41	-0.44
Health Care	17.37	12.88	4.49	1.21	2.38	-1.17	-0.11	-0.20	-0.31
Industrials	10.70	15.13	-4.43	2.46	7.16	-4.71	-0.14	-0.50	-0.64
Technology	20.40	17.59	2.81	2.41	4.85	-2.44	0.02	-0.47	-0.45
Materials	4.77	5.10	-0.33	-0.43	0.85	-1.28	0.02	-0.07	-0.05
Real Estate	8.88	10.06	-1.17	1.83	-0.01	1.84	-0.01	0.08	0.07
Utilities	2.33	3.70	-1.36	1.95	1.04	0.90	0.06	0.01	0.07
TOTAL	**100**	**100**		**1.38**	**2.96**	**-1.58**	**-0.20**	**-1.38**	**-1.58**

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

It's difficult to be very constructive on U.S. equities – as you might expect after the strongest first half in many years. Earnings growth has ground to a near halt, and with multiples at high levels, we don't currently see fuel for much rational appreciation during the latter half of the year. Investors appear to have already discounted two cuts in the Fed Funds rate later this year. The optimist will see this, combined with a trade deal with China, as ample room to fuel further growth.

The pessimist has concerns that the China deal will not materialize – or will not be a meaningful win for the U.S. if the deal materializes. The pessimist keeps an eye on the U.S.'s dealings with Iran, the latter of which has now violated the cap on enriching uranium. The pessimist also worries about acrimony increasing further in our capital, with Democratic debates featuring soundbites excoriating corporate profits (oh by the way, pensioners and 401k beneficiaries benefit by owning shares of profitable U.S. companies), and calling for more testimony from Robert Mueller.

The realist knows the market is the ultimate discounting mechanism, and the U.S. economic system is wonderfully self-adapting. While it would be imprudent to expect large returns from U.S. equities in the latter half of the year, we also don't expect an exceptionally bad half of the year.

The SMidCap model remains strongly biased against stocks with higher price volatility and earnings variability. The model also continues to exhibit 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; 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 for 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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