



**MANAGER
COMMENTARY**
Fourth Quarter 2019

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MARKET REVIEW

U.S. equities charged sharply higher across the board to put an exclamation point on a very strong 2019. Fed rate cuts, an expansion of the balance sheet, optimism around a “Phase One” trade deal with China, and fading poll numbers for Elizabeth Warren each boosted the market.

For all of 2019, stock returns declined as we move down the capitalization spectrum. In addition, growth dominated value within each capitalization tier, with the largest outperformance in the higher capitalization tiers. Thus, for the calendar year, the Russell Top 200 Growth Index was the top performer with a gain of 36.48%. Contrast this with the Russell 2000 Value’s 22.39% gain.

Size/Style

A barbell approach to capitalization exposure within the Russell 3000 Index would have been best during Q4. Although the Russell MidCap 800 Index advanced 7.06%, this trailed the Russell 2000 Index and Russell Top 200 Index, which advanced 9.94% and 9.79%, respectively. No matter the cap group, Growth beat Value once again - by about 3% in each case.

Russell 3000 Sectors

We saw significant rotation and reversal of sector performance within the AllCap universe:

- Health Care stocks posted outstanding performance to close the year, surging 14.51% - a remarkable recovery from the 4% loss the sector recorded during Q3. The Tech sector gained nearly 14%, and paced the Russell 3000 Index with a 45.03% gain for all of 2019.
- Utilities and Consumer Staples recorded the weakest performance - after holding the top two positions during Q3. Energy stocks performed better to close the year, but still posted the weakest for the calendar year.

FOURTH QUARTER ATTRIBUTION

The AllCap strategy advanced over 7% during the quarter, but trailed the benchmark Russell 3000 Index’s 9.10% return. The table on the following page breaks down the contributions from sector positioning and stock selection.

In total, sector positioning detracted 0.64% from active return:

- Overweighting the Consumer Staples sector detracted 26bps, as the sector underperformed the benchmark by almost 6% during the quarter.
- Overweighting the Industrials sector detracted 17bps from active performance, as the sector trailed the Russell 3000 Index by about 3%.
- Underweighting the Utility sector, in contrast, added 25bps to active return; the sector lagged the benchmark’s performance by almost 9% during Q4.

Stock selection within the respective sectors detracted 1.32% from active return.



SECTOR	GLA WEIGHTING	R3000 WEIGHTING	% ACTIVE	GLA RETURN	R3000 RETURN	% ADDED	SECTOR ALLOCATION	STOCK SELECTION	ACTIVE CONTRIB
Comm Services	2.59	9.47	-6.88	9.68	9.15	0.53	-0.01	0.01	0.01
Consumer Disc.	15.03	10.14	4.89	4.14	5.68	-1.55	-0.17	-0.24	-0.41
Cons. Staples	10.87	6.56	4.31	-1.10	3.64	-4.74	-0.26	-0.58	-0.84
Energy	3.29	4.05	-0.76	17.96	5.84	12.11	-0.06	0.35	0.29
Financials	8.19	13.59	-5.40	8.64	9.64	-1.00	-0.05	-0.05	-0.10
Health Care	12.69	13.87	-1.18	9.91	14.91	-4.99	-0.08	-0.57	-0.65
Industrials	14.78	10.05	4.73	5.30	5.87	-0.58	-0.17	-0.07	-0.24
Technology	22.18	21.97	0.21	13.30	14.01	-0.71	0.04	-0.17	-0.13
Materials	4.34	2.87	1.47	6.40	6.88	-0.48	-0.03	-0.03	-0.06
Real Estate	5.47	4.13	1.35	0.90	0.66	0.24	-0.12	0.01	-0.11
Utilities	0.55	3.30	-2.76	4.49	0.37	4.12	0.25	0.02	0.28
TOTAL	100	100		7.14	9.10	-1.96	-0.64	-1.32	-1.96

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

MARKET OUTLOOK

2019 was an incredible year. Unemployment is at a 50 year low. Home prices are at an all-time high. The current bull market is approaching 4,000 days, and stocks are at an all-time high. Why doesn't it feel quite so great?

Part of this is certainly the trade tensions, the political acrimony, and the growing geopolitical uncertainty. Surely the ebb and flow on these fronts is in part responsible for the rather violent rotations in the market of late – rotations largely disguised from the casual observer by the outsized headline index gains. In addition to the widely discussed Momentum meltdown/value melt up back in September, we saw a massive reversal in health care stocks as Elizabeth Warren's (and her "medicare for all" platform) polling numbers faded. Low vol/low beta outperformance gave way to high vol, and momentum stalled. The value rally of September turned into a tug o' war between growth and value. And December's news of a "Phase One" trade deal with China lead to an even bigger high vol rally. What a ride!

As this bull charges into 2020, we seem poised to continue the current expansion. Financial conditions are much more stimulative than one year ago, following not only 3 cuts of the Fed Funds rate, but also a significant expansion of the Treasury's balance sheet (estimated to be the equivalent of an additional 50bps of easing). Not only have domestic financial conditions eased, but as noted last quarter, larger emerging market economies and the bulk of Developed countries are also easing. Easing so far into an expansion is unprecedented – but so are such tame inflation numbers. Stocks are expensive, and so increased volatility should not be discounted – but conditions are so unique that this bull may just persist.

Positioning:

The AllCap model is biased against small-cap growth stocks, while value stocks have swung into favor. Earnings Yield (a value factor) is now the most positive bias in the model, as are Size and Dividend Yield. High Volatility and Earnings Variability remain quite out of favor.

Tech stocks remain modestly out of favor, as do Health Care (especially Biotech and Drugs) stocks. By contrast, Financials (Banks, Equity REITs) are attractive.

From a return-driver perspective, the Quality category is most in favor. Short-term momentum is attractive, while longer-term momentum has fallen out of favor. Value is favorable on balance, while Growth factors have little impact on current forecasts.

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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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