DISCIPLINED EQUITY

SMIDCAP

GREAT LAKES ADVISORS

A WINTRUST WEALTH MANAGEMENT COMPANY

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

In contrast with what we observed in the U.S. LargeCap segment, returns improved as we moved down in capitalization. Here, the Russell 2000's 9.94% return topped the Russell 2500 Index's 8.54%, which in turn topped the Russell MidCap 800 Index's 7.06% gain.

From a style perspective, the hard turn toward Value during September gave way to a style tug-of-war, which Growth won by about 3% on balance.

Russell 2500 Sectors

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

- Heath Care stocks posted outstanding performance to close the year, surging 18.45% - a remarkable recovery from the near 9% loss the sector recorded during Q3. The Tech sector gained over 10%, and paced the Russell 2500 Index with a 39.79% gain for all of 2019.
- Utilities, Financial Services, and Consumer Staples recorded the weakest performance - after holding the top three positions during Q3. Energy stocks staged a solid comeback to close the year, but still declined 7.60% for the year.

FOURTH QUARTER ATTRIBUTION

The SMidCap strategy added just over 6% during the quarter, but lagged the benchmark Russell 2500 Index's 8.5% gain. The table on the following page breaks down the contributions from sector positioning and stock selection.

Sector positioning added 0.45% to active return:

- Overweighting the Health Care sector added 35bps; the sector handily beat the Russell 2500 Index by almost 10% during the quarter.
- Underweighting the Utilities sector added 16 bps to active return, as the sector trailed the benchmark by over 10% during Q4.

Stock selection within the respective sectors was a negative contributor, detracting 2.92% from active return.

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

SECTOR	GLA WEIGHTING	R2500 WEIGHTING	% ACTIVE	GLA RETURN	R2500 RETURN	% ADDED	SECTOR ALLOCATION	STOCK SELECTION	ACTIVE CONTRIB
Comm Services	1.49	3.18	-1.69	13.01	8.29	4.72	0.01	0.07	0.08
Consumer Disc.	16.05	11.44	4.61	7.22	7.15	0.07	-0.04	-0.03	-0.08
Cons. Staples	1.71	2.80	-1.09	6.34	6.00	0.34	0.04	0.02	0.06
Energy	2.50	2.57	-0.07	12.61	8.58	4.03	0.08	0.08	0.15
Financials	15.85	16.32	-0.47	6.27	7.06	-0.80	0.01	-0.14	-0.13
Health Care	17.19	13.11	4.09	8.82	18.27	-9.45	0.35	-1.53	-1.18
Industrials	12.61	15.28	-2.67	8.26	8.16	0.09	0.02	-0.03	-0.01
Technology	12.06	15.86	-3.80	4.16	11.00	-6.84	-0.06	-0.81	-0.87
Materials	7.06	5.14	1.92	2.02	8.04	-6.02	-0.01	-0.50	-0.51
Real Estate	11.32	10.53	0.79	2.44	2.80	-0.36	-0.11	-0.03	-0.14
Utilities	2.16	3.78	-1.62	-1.81	-1.99	0.18	0.16	-0.01	0.15
TOTAL	**100**	**100**		**6.06**	**8.53**	**-2.47**	**0.45**	**-2.92**	**-2.47**

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

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 SMidCap model remains strongly biased against stocks with higher Volatility and Earnings Variability. Earnings Yield, Dividend Yield, and Size remain in favor as we head into 2020. From a style perspective, the model prefers mid-cap over small-cap and continues to be most strongly tilted against small growth stocks.

Financials (Banks, Equity REITs) are preferred by the model, while Health Care stocks (Biotech, Drugs) are most out-of-favor.

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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