Special Equity

As of 31 Mar 2021

Market review

U.S. equities rose in the first quarter, as the prospects for strong earnings and economic growth, an accelerating vaccination rollout, and massive fiscal stimulus drove markets higher during the period, in spite of fears around rising bond yields and potential inflation. The broader equity market climbed to new highs, with the S&P 500 gaining 6.2% and the Russell small cap index (Russell 2000) rising 12.7%. International equity markets also increased, albeit by a more modest amount. Value outperformed growth by a substantial margin for the second straight quarter, possibly signaling a major shift in market leadership between styles. Sectors most geared to an economic recovery such as energy, financials, and industrials significantly outperformed, aided by improving macroeconomic fundamentals, strong earnings revisions and momentum, and rising interest rates, while some speculative stocks sold off and traditionally defensive sectors such as utilities, health care, and consumer staples lagged.

Over the past decade, growth stocks have outperformed value stocks by 6% per annum. Could the return of value investing be upon us? The Russell 1000 Value index returned 11.3%, outperforming the Russell 1000 Growth index by 10.3%. The cyclical rally also benefitted small cap companies, which posted a 12.7% return and outperformed large caps by 6.8%. The Russell 2000 Value index outperformed its growth peer by 16.3%. With markets expecting higher economic growth and rising inflation expectations, the U.S. yield curve steepened dramatically, as the 10-year Treasury yield ended the quarter up 83 basis points to 1.74%. The Federal Reserve has still maintained its zero short term rate target for the next several years. Oil prices continued to increase as the price of WTI rose 22% to $61.49 per barrel to close the quarter, driven by increased demand and the surprise Saudi Arabia announcement in early January to remove an additional one million barrels of oil from the market in the midst of an OPEC+ discussion on increasing supply.

The first three months of 2021 were certainly eventful. Democrat victories in both Georgia Senate run-off elections thereby giving Democrats control of the Senate as well as the Presidency and House of Representatives, the violent January 6 attack on the Capitol, and a historic short-squeeze of GameStop stock along with several other speculative stocks involving a horde of Reddit investors dominated headlines in the midst of an ongoing pandemic. All the while, COVID-19 infections continued to trend lower in the U.S. as vaccine distribution accelerated over the quarter. Adding to the supply of the Pfizer-BioNtech and Moderna vaccines, Johnson & Johnson's single-shot vaccine was authorized for emergency use in February - another pivotal step towards covering the entire adult U.S. population over the next number of months. Many state and local governments have begun the process of easing restrictions on indoor dining, gyms, movie theaters, and other forms of mass gathering. Trends overseas have not nearly been as promising as lockdowns have been put in place in many European countries, where rates of vaccination lag far behind the U.S. In March, Congress approved the $1.9 trillion "American Rescue Plan" economic relief package, extending many provisions of the December fiscal deal that were set to expire at the end of March, while topping off the $600 individual stimulus checks approved from the previous deal with an additional $1,400. In terms of total dollars, the U.S. fiscal response to COVID-19 has been the largest in the world and would equate to roughly 27% of U.S. GDP according to some economists.

U.S. economic data continued its positive momentum as Q4 GDP grew 4.3% quarter-over-quarter and manufacturing and services PMIs (Markit Purchasing Managers Index) improved to 58.6 and 59.8, respectively, in February. Retail sales also showed a 7.6% improvement month-over-month in January, boosted by the December 2020 stimulus checks. In the private sector, earnings momentum was strong again, with approximately 80% of S&P 500 companies reporting positive earnings per share surprises – the third highest mark since 2008 – and increasing 3.5% year-over-year (YoY) in Q4. A stronger-than-expected economic recovery story in addition to an immense fiscal package has led to growing inflation concerns, which spooked markets into brief mini selloffs during a strong market quarter. Despite the brighter economic picture, the Federal Reserve has kept monetary policy loose, making no policy changes at its Federal Reserve's Open Market Committee (FOMC) meeting in March. With YoY Core PCE (personal consumption expenditures) at 1.4% and unemployment at 6.2%, a solid majority of FOMC members still believe that rates will remain zero-bound

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through 2023. The Fed and U.S. government risk pouring fuel on an economy that is experiencing an economic acceleration on its own.

As we look ahead, the inflation outlook becomes a bit more uncertain; hence, the sense of anxiety pervading the bond market, which as of yet, seems not to concern equity investors other than the debate over value vs growth. In the near term, inflation is likely to rise in the coming months (the Fed is signaling “transitory” inflation) but expected to remain short-lived due to lockdown-related base effects. This is a significant risk. Longer term, a newly proposed $2.25 trillion infrastructure plan, the recently passed $1.9 trillion stimulus plan, significant funds not yet spent from the prior plans, and risks of global supply chain shocks could pressure inflation higher and elevate market volatility. How much money can you spend or pour into an economy before it has undesirable impacts is certainly not an issue to dismiss. Post quarter end, the producer price index for March came in at 1%, doubling expectations of 0.5%: bonds sold off modestly while stocks rose.

Portfolio review

The Special Equity Value Portfolio outperformed its benchmark again as it did in the prior quarter, particularly driven by the strong absolute returns and outperformance of our investments in the consumer discretionary, technology, consumer staples, and producer durables sectors. The Russell 3000 Value index rose 11.90% for the quarter, with all sectors generating positive returns. Cyclical sectors (energy, financial services, producer durables) produced the highest returns, while the defensive sectors (utilities, health care, consumer staples) continued to lag with returns ranging from 3-6%. Our top performing investments for the quarter were TripAdvisor, ViaSat, Teradata, and American Eagle Outfitters. Our bottom contributors include new investment ADMA Biologics, in addition to T-Mobile US, RenaissanceRe Holdings, and Walmart. Our investments in the consumer discretionary, financial services, and technology sectors contributed the most to our absolute return, given the combination of both appreciation and their large respective weightings in the portfolios.

TripAdvisor was our top contributor as the stock rose due to excitement over the company’s new subscription model (TripAdvisor Plus offers member only pricing on deals for hotels and other services for $99/year) in addition to the increase in travel and investor interest in companies that will benefit from an economic recovery. In addition, its variable cost structure and healthy balance sheet should protect on the downside. We did trim our investment after the substantial stock price increase, but it remains a significant position. ViaSat (VSAT) stock rose after its miserable 2020 stock performance, as strong fundamental performance continued, with Q4 results exceeding expectations. VSAT was awarded the Delta IFC (inflight connectivity) contract in January, and a recovery in leisure travel continues to build business momentum. The core defense business continues to generate substantial profitability and free cash flow. The market is finally beginning to recognize the value of the capacity additions that will be generated by the first VSAT-3 launch in early ’22. This is one of the stocks that we have been extremely excited about, as we believed its value and strong fundamentals were being completely ignored in the market.

Teradata, a database management provider, was a top performing investment due to stronger December results and an outlook that suggested both revenue and free cash flow will grow this year. Additionally, management disclosed that recurring software (think cloud software) grew more than 100% to roughly $200MM and will double again this year. New CEO Stephen McMillan has brought much need strategy, focus, and accountability to the company. We did trim our position after substantial appreciation, but believe a meaningful re-rating opportunity remains. American Eagle (AEO) stock rose on the back of a rotation into companies that benefit from the economy reopening in addition to the rapid growth of Aerie which is now a $1 billion brand and expected to double in the next few years. Additionally, there are early signs that a denim trend is emerging which will be a nice tailwind for AEO’s $1 billion denim business. We trimmed our position during the quarter.

ADMA Biologics (ADMA) is a manufacturer of plasma therapeutics in a market with attractive industry dynamics. We believe the market value of the stock does not adequately ascribe value to the manufacturing production capabilities of the company’s plant, at-scale. ADMA stock fell during the quarter on higher costs related to current production and management commentary regarding the potential need to raise additional capital later in the year to scale up manufacturing product. We believe the decision is prudent given the opportunity in front of the company and the commentary did not take us by surprise, although we expected that positive developments at the company should have enabled the company to raise capital more opportunistically. We remain confident in the fundamental value of the assets of the business.

Gross of fee performance may not include the deduction of trading commissions and other transaction costs and does not include fees. Net of fee performance will be lower than the gross of fee performance and may or may not have outperformed the index referenced.
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Our other bottom contributors declined, partly due to minor fundamental issues in addition to suffering from the rotation into more economically sensitive securities. T-Mobile US underperformed in the quarter after substantial appreciation in 2020 following strong results and the close of the Sprint merger. The company issued guidance in January that was in line with consensus. Although likely beatable targets, some investors were disappointed the targets weren't more aggressive. RenaissanceRe underperformed largely due to continued uncertainty related to COVID-19 exposures, elevated natural catastrophe losses, and disappointment over January renewal property catastrophe reinsurance pricing increasing less than expected. RNR remains one of the best managed, highest quality reinsurance companies, and risk/reward is extremely attractive. Finally, Walmart underperformed on the back of weaker than expected earnings and guidance.

During the quarter we established new investments in Baker Hughes, Curtiss-Wright, Flowserve, Houghton Mifflin Harcourt, ADMA Biologics, Rigel Pharmaceuticals, Takeda Pharmaceutical, and Wells Fargo. We eliminated our positions in Bio-Rad Laboratories, Loews, Terex, and Trinity Industries, the rationale primarily being share price appreciation and less favorable risk/reward.

Baker Hughes (BKR) is one of the largest diversified oil services companies in the world. The company has the strongest balance sheet among the majors, and we believe it has the most sustainable business model given its significant exposure to liquefied natural gas (LNG), and the potential for hydrogen as an alternative fuel. BKR will also benefit from the coming inflection in international capital expenditures. We initiated positions in industrial companies Curtiss-Wright and Flowserve. Curtiss-Wright, is a supplier of mission critical valves, pumps, sensors, electronics and controls. Shares have meaningfully underperformed year-to-date as concerns over peaking defense budgets have offset the strong recovery potential in non-defense end markets. While we acknowledge a "defense overhang", revenues tied to high priority Naval and Air Force programs should prove resilient while the 50% of sales tied to non-defense end markets rebound. Flowserve primarily services the oil and gas and petrochemical markets with pumps, valves, and seals. We expect significant operating leverage on aftermarket revenues as customers (refineries, pipelines) catch-up on deferred maintenance. Houghton Mifflin Harcourt is an education materials provider to K-12 schools. The company is in the midst of a digital transformation and is focusing on selling software into school districts to improve teacher productivity and student outcomes. Any increase in federal funding to schools under the new administration would provide an added benefit.

We initiated positions in four health care related companies during the first quarter. Our investment in ADMA Biologics is discussed above in the paragraph detailing stock detracting from first quarter performance. We invested in Rigel Pharmaceutical based on its undervalued core business with a rich catalyst path and free upside optionality in the pipeline. We see the company as having 5 independent pillars of value that could each make up the value of the company. Subsequent to the initiation of our position, value was realized for one of those pillars when Rigel out-licensed a pipeline asset to Eli Lilly in a deal that could bring in north of $1B over time (substantially more than its current market capitalization). Syneos Health (SYNH) is an outsourced contract resource organization for biopharma companies that has seen its backlog meaningfully inflect over the past few quarters. The robust backlog coupled with new full-service contract wins should translate into higher growth and an improved margin profile for the business. We initiated a position in Takeda Pharmaceutical in the quarter as it remains one of the cheapest pharma companies globally, despite a diverse and durable set of marketed products, a solid pipeline, and a meaningfully reduced leverage profile. We look forward to pipeline updates, Japan vaccine distribution, and possible initiation of a share repurchase as further levers for upside through the year.

Once one of the most admired companies overall, Wells Fargo stumbled over management missteps over the past several years including an overly aggressive culture that put growth over customers and ethics. We had eliminated the investment in our large cap value portfolios prior to the problems, and believe that the company is now positioned to execute with new management, positive rate sensitivity, and the likely removal of the company's punitive regulatory asset cap by regulators.

We eliminated our Bio-Rad Laboratories (BIO) position given that "core" BIO has re-rated closer to expensive peers. We believe the company benefited from some one-time COVID-related diagnostic instrument sales throughout the bulk of 2020. Although new management has been pulling the correct levers with respect to driving significant operational improvements, risk/reward has become more balanced as the stock has appreciated massively over our long holding period. We exited our Loews investment after the stock substantially rebounded and we don't believe that the company will pursue a path to fully unlock the intrinsic

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value of its various businesses (insurance, energy, hotels) and wanted to make room for other investments that had more favorable risk/reward.

Terex's share price rose substantially reflecting the optimism regarding a large infrastructure bill and hopes for a new construction equipment cycle. The company was able to reduce significant costs throughout the pandemic, but the risk-reward became much less favorable as the stock had developed into a consensus buy. Finally, we eliminated our position in Trinity Industries as the share price reached our estimate of fair value. Given the company's integrated business model which precludes its ability to recognize profits from railcar sales to its wholly owned leasing division, clarity of value creation and economic profitability is difficult. Trinity has taken substantial steps to improve over the past several years, including spinning off their non-rail Industrial business, bringing in new CEO Jean Savage from Caterpillar, navigating through a steep railcar downturn, and returning meaningful cash to shareholders through dividends and share buybacks. While the company is well-positioned to benefit from improving end markets as the rail car cycle improves, its shares have substantially re-rated so we eliminated our position and deployed the proceeds into other investments with more attractive risk-reward profiles.

We also added to Alliant Energy, DuPont, General Dynamics, Medtronic, National Fuel Gas, Oracle, Parsons Corp., Walmart, Yelp Inc. and trimmed our positions in Activision, Advance Auto Parts, Amdocs, American Eagle Outfitters, B. Riley Financial, Change Healthcare, Hess, Morgan Stanley, Rambus and Seagate Technology. We swapped part of our DuPont (DD) position advantageously for shares of Intl Flavors & Fragrances (IFF) as part of the DD's sale of its nutrition business in a tax efficient Reverse Morris Trust transaction, then sold our IFF shares at a gain and repurchased shares of DD at lower prices.

Outlook

We are heartened that absolute and relative performance has been strong the past two quarters, and that value has done well vs growth. What is exciting at this time, for value investors anyway, is that it's not just a question of low valuation; the fundamentals of strong economic growth, positive earnings revisions and momentum, and increasing interest rates and inflation combined with the valuation argument might finally be aligned for sustained value outperformance. We remain concerned regarding the potential for inflation and runaway government spending, as well as for the seeming lack of concern in the markets that stocks can ever do anything other than appreciate.

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Best performers/worst performers

In a representative account in the Special Equity strategy (01 Jan 2021 - 31 Mar 2021)

Best performing securities	Average weight (%)	Security contribution to portfolio return (%)
TripAdvisor, Inc.	2.74	1.85
ViaSat, Inc.	3.10	1.25
Teradata Corporation	2.21	1.25
American Eagle Outfitters, Inc.	2.43	1.02
General Motors Company	2.97	1.02

Worst performing securities	Average weight(%)	Security contribution to portfolio return (%)
ADMA Biologics, Inc.	0.49	-0.39
T-Mobile US, Inc.	1.08	-0.10
RenaissanceRe Holdings Ltd.	1.48	-0.06
Walmart Inc.	2.09	-0.06
GlaxoSmithKline plc Sponsored ADR	2.06	-0.04

Source: FactSet. The exposure and performance contribution information presented herein is based on the holdings of a fully seasoned institutional representative account that we believe is reflective of the separately managed accounts strategy. The reader should not assume that the securities identified were or will be profitable. Such securities do not represent all of the securities purchased, sold or recommended over the past year and the reader should not assume that the securities identified necessarily were or will be profitable. Holdings and performance of individual accounts will differ based upon, among other things, timing of transactions and market conditions at the time of investment, account restrictions, and corresponding investment management fees. In addition, holdings of an institutional account may differ from those in a separately managed account.

Representative account data excludes cash; positions have been equitized on a pro rata basis. This may materially impact the results presented. Exposure and performance contribution are calculated by applying daily closing prices rather than the account's actual transaction prices for the respective time period. Accordingly, the information presented herein will differ from an account's actual exposure and performance contribution. Such differences can be material when there is a significant difference between the trade price and the closing price of a given security. In addition, account data may not reflect reconciliation of all activity during the respective period. For additional information regarding the methodology used to select these holdings or to obtain a list showing the contribution of every holding in the representative account to the overall account's performance, please contact Nuveen at 800.752.8700. NWQ's Form ADV Part 2A is available on the SEC's website at www.adviserinfo.sec.gov or upon request via email at compliance@nwq.com.

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Index definitions

Purchasing Managers' Index (PMI) is an index of the prevailing direction of economic trends in the manufacturing and service sectors. It consists of a diffusion index that summaries whether market conditions, as viewed by purchasing managers, are expanding, staying the same, or contracting.

Russell 1000® Growth Index measires the performance of those Russell 1000 companies with a greater-than-average growth orientation.

Russell 1000® Value Index measures the performance of those Russell 1000® companies with lower price-to-book ratios and lower forecasted growth values.

Russell 2000® Index measures the performance of the small cap segment of the U.S. equity universe which includes approximately 2000 of the largest securities based on a contribution of their market cap and current index measurement.

Russell 3000® Value Index measures the performance of the largest 3000 U.S. companies representing approximately 98% of the investable U.S. equity market with lower price-to-book ratios and lower forecasted growth values.

S&P 500® Index is widely regarded as the best single gauge of large-cap U.S. equities. The index includes 500 leading companies and captures approximately 80% coverage of available market capitalization.

Clients should consult their financial professionals regarding unknown financial terms and concepts.

Endnotes & disclosures

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