

Quarterly Commentary: Factor-Enhanced Quantitative Portfolios (QPs) Large Cap V+Q*

Third Quarter (Q3) 2021

Market Environment

The US economy posted slowing but above-average growth in the quarter, supported by the dual tailwinds of accommodative monetary policy and historic fiscal stimulus. Lockdowns that had defined the early stages of the pandemic have, for all intents and purposes, ended, but supply chain disruptions remain, causing bottlenecks for many goods. Within this context, the Bureau of Economic Analysis released the third estimate of the second-quarter 2021 real GDP, a seasonally adjusted annualized increase of 6.7%, slightly higher than the prior estimate, and an improvement over the 6.3% increase in the prior quarter. The employment situation also improved, but the most recent gains were less than expected. The August report showed that employers added 235,000 jobs in the month, and that the unemployment rate fell to 5.2%. The Federal Open Market Committee (FOMC) maintained its supportive monetary policy response to the pandemic, leaving the federal funds rate target range of 0% to 0.25% unchanged. However, the central bank provided advance notice that it would begin tapering its \$120 billion monthly asset purchases, perhaps starting in December. The FOMC's "dot plot," a forecast of future rate changes, turned somewhat more hawkish, indicating the Committee now expects the first interest rate hike to occur sometime in 2022.

Portfolio Commentary

In the third quarter, the Factor-Enhanced Large Core V+Q strategy generated a gross return of -1.34%, whereas the CRSP US Large Cap Index returned 0.39%. The portfolio's total return of 19.94% has outperformed the index's total return of 15.39% on a year-to-date basis.

US large cap stocks posted their sixth consecutive quarter of gains, albeit with heightened volatility in the latter half of the quarter. Within the large cap segment, growth-oriented stocks were the winners. The CRSP US Large Cap Value Index's quarterly return of -0.94% trailed the 1.39% return for the CRSP US Large Cap Growth Index. The portfolio provides heightened exposure to the value and quality factors. The portfolio's size and value biases were the primary culprits that served as drags on performance. Although the size factor is not explicitly captured in the factor-enhanced strategies, the portfolios tend to have slightly lower weighted-average market capitalizations than the benchmark. On the positive side, the quality factor returned more than 1%, which helped to offset the losses from the value and size factors.

Sector selection has a relatively minor effect on performance, as the QPs are constructed to be sector neutral at rebalancing. Accordingly, the portfolio's relative performance was driven primarily by individual security selection. Sector allocation contributed 11 basis points to performance, whereas stock selection within sectors subtracted 105 basis points during the quarter. The sectors in which positive stock selection occurred included Industrials and Health Care. Sectors that experienced negative stock selection included Communication Services and Information Technology.

The Factor-Enhanced Large Cap V+Q portfolio had no exposure to Amazon.com Inc. (AMZN) during the quarter, which added 15 basis points to performance. The stock returned -4.5%, in part due to regulatory concerns that are on the rise for large technology firms.

The portfolio benefited from having no exposure to PayPal Holdings Inc. (PYPL), which declined 10.7% in the quarter. The digital payments company missed analysts' revenue targets.

An overweight position to The Hartford Financial Services Group Inc. (GRMN) within the Financials sector boosted the strategy's performance by 11 basis points. The stock returned 14% in the quarter, as the company's second-quarter financial results beat expectations on the top and bottom lines.

Portfolio performance suffered during the quarter from having an overweight position to Altice Inc. (ATUS), which declined more than 39%. Investors weighed the communication company's outlook, as stiff competition has required it to invest heavily in network systems.

An overweight to PulteGroup Inc. (PHM) subtracted 30 basis points from portfolio performance. The homebuilder stock's -15.6% return underperformed the -0.12% return for the Consumer Discretionary sector.

The strategy's relative overweight to Lam Research Corp. (LRCX), which fell 12.3%, was a drag on quarterly performance. Although the company's financial results came in ahead of expectations, the stock slid in the second half of the quarter as market volatility increased.

The economy continues to show modest growth, although supply chain disruptions are dampening gains. Inflation remains elevated as a result of the significant amount of fiscal stimulus that is coursing through the economy. With stocks at extended valuations and interest rates on the rise, it is wise for investors to be selective in the types of strategies in which they invest.

*Value + Quality

Model Portfolio Attribution

	Performance Driver	Active Return Contribution	Portfolio Exposure	Average Weight in Model	Comments
Contributors	Amazon.com Inc.	+15 bps	No exposure	0.00%	The stock returned -4.5%, due in part to regulatory concerns that are on the rise for large technology firms.
	PayPal Holdings Inc.	+11 bps	No exposure	0.00%	The digital payments company missed analysts' revenue targets.
	The Hartford Financial Services Group Inc.	+11 bps	Overweight	1.33%	The stock returned 14% in the quarter, as the company's second-quarter financial results beat expectations on the top and bottom lines.
	CF Industries Holdings Inc.	+10 bps	Overweight	0.74%	The stock returned 9.2% in the quarter.
	United Rentals Inc.	+10 bps	Overweight	0.75%	The stock gained 10.1% in the quarter.
Detractors	Altice USA Inc.	-49 bps	Overweight	1.05%	Investors weighed the communication company's outlook, as stiff competition has required it to invest heavily in network systems.
	PulteGroup Inc.	-30 bps	Overweight	1.83%	The homebuilder stock's -15.6% return underperformed the -0.1% return for the Consumer Discretionary sector.
	Lam Research Corp.	-18 bps	Overweight	1.54%	Although the company's financial results came in ahead of expectations, the stock slid in the second half of the quarter, as market volatility increased.
	Qorvo Inc.	-16 bps	Overweight	0.97%	Investors weighed the micro-device company's outlook, given the intense competition in the semiconductor space.
	Alphabet In. Class A	-16 bps	No exposure	0.00%	The stock gained 9.5%, as the company recently beat earnings estimates.



Disclosure

The **Russell 1000 Index** is a market capitalization weighted benchmark index made up of the 1000 largest U.S. companies in the Russell 3000 Index. The **Russell 1000 Value Index** refers to a composite of large and mid-cap companies located in the United States that also exhibit a value probability. The **CRSP US Large Cap Index** includes U.S. companies that comprise the top 85% of investable market capitalization.

Returns displayed represent model returns. Model performance is not based on actual client assets, does not represent actual trading and may not reflect the impact that material economic and market factors might have had on the adviser's decision making if the adviser were actually managing client assets. The actual performance of an actively managed account will not completely mirror model returns, and actual client returns may vary from model returns. The returns shown do not reflect any customized investment screens or other investment restrictions that an investor may place on an investment strategy. The portfolio's current actual performance may be lower or higher than the performance data quoted and these returns should not be considered as indicative of the skills of Envestnet. Model returns are based on data received from the asset manager as reported to Morningstar. Actual investment advisory fees of Envestnet Asset Management, Inc. are described in Part 2A or, Part 2A - Appendix 1 of Form ADV, as applicable. Model performance is shown gross of fees, except for the internal expenses of any investment products and does not reflect the deduction of investment advisory fees or the effect of income taxes on the investment returns. Actual performance results will be reduced by fees including, but not limited to, investment management fees and other costs such as custodial, reporting, evaluation and advisory services. Performance reflects the reinvestment of dividends, income and capital appreciation. Investments in the proposed strategy involve risk including the loss of principal. Intended for advisor use only or with advisor in a one-on-one consultant basis with client. Model returns are calculated by obtaining the weighted monthly returns of the strategy component holdings from the prior month-end to the current month-end. These weighted returns are then added to the prior month's return history and annualized. Performance is calculated based upon the historical asset allocations at the beginning of each month during the periods shown, which may differ from the current allocation. The performance results of the underlying holdings in the model portfolio assume the reinvestment of dividends and other earnings. The holdings comprising the strategies and the allocations to those holdings have changed over time and may change in the future. The historical model performance has not been adjusted to reflect current holding allocations. An investment pursuant to this model portfolio is subject to market risk and an investor may experience loss of principal.

The information, analysis, and opinions expressed herein are for general and educational purposes only. All opinions and views constitute our judgments as of the date of writing and are subject to change at any time without notice. Nothing contained in this brochure is intended to constitute legal, tax, accounting, securities, or investment advice, nor an opinion regarding the appropriateness of any investment, nor a solicitation of any type. All investments carry a certain risk, and there is no assurance that an investment will provide positive performance over any period of time. An investor may experience loss of principal. The asset classes and/or investment strategies described may not be suitable for all investors and investors should consult with an investment advisor to determine the appropriate investment vehicle. Investment decisions should always be made based on the investor's specific financial needs and objectives, goals, time horizon and risk tolerance. **Past performance is not indicative of future results.**

Neither Envestnet, Envestnet | PMC™ nor its representatives render tax, accounting or legal advice. Any tax statements contained herein are not intended or written to be used, and cannot be used, for the purpose of avoiding U.S. federal, state, or local tax penalties. Taxpayers should always seek advice based on their own particular circumstances from an independent tax advisor. Indexes are unmanaged. It is not possible to invest directly in an index.

If interested in the attribution calculation methodology, or for the full list of portfolio contributors and detractors, please e-mail qrg@envestnet.com.