Duration Neutral Fund

A discussion with Sean Clark, CIO of Clark Capital Management Group, Inc.

K. Sean Clark, CFA
Chief Investment Officer

As Clark Capital's Chief Investment Officer, Sean oversees all of the Firm's investment activities and heads the Firm's portfolio team. Sean joined the Firm in 1993 and is responsible for asset allocation and investment selection for Navigator Investment Solutions as well as directing ongoing market research and contributing to the development of proprietary products. Sean is a member of the Clark Capital Management Committee and the Board of Directors. He graduated from the University of Delaware, earning a B.S. and an M.A. in Economics. Sean is a Chartered Financial Analyst and a member of the CFA Institute (formerly AIMR) and the Financial Analysts of Philadelphia, Inc. Sean is considered an industry expert and is often asked to appear on CNBC and Bloomberg television to share his views on the market. In addition, Sean was featured in an article in Barron's and has been quoted in a number of articles in nationally distributed business journals and newspapers.

What is the goal of the strategy?

The strategy aims to take advantage of opportunities in the municipal markets while minimizing interest rate risk. The primary objective is to maximize total return, which is comprised of income and capital appreciation, while hedging interest rate exposure. The effective duration target is –1 to +1 years with a potential total return goal of 3 to 5%, of which the income component is roughly 2.5% currently

What is Clark Capital's approach to the fixed income markets in the Navigator Duration Neutral strategy?

The portfolio utilizes a four step investment methodology including a debt structure review, credit review, risk/reward analysis and hedging using U.S. Treasury futures. A thorough risk analysis of each security and the overall portfolio in aggregate is performed in an effort to maintain the optimal hedged versus long bond allocation.

The municipal bond allocation research process is focused on a quantitative model that measures the relative value of a particular municipal bond versus other issues with similar characteristics. This process leads us to invest in deeply undervalued issues in an effort to exploit supply and demand inefficiencies and credit spread trends between credit qualities.

Securities held will generally range from 25 to 75 high grade (a or better) municipal holdings. The duration of the long municipal bond holdings will generally be between 5 and 10 years; however, our hedge process effectively reduces the effective duration targeted to between -1 to +1 years with a target of zero. Vehicles used may include ETFs, closed end funds and U.S. Treasury futures contracts[1].

Why is the strategy appropriate in today's climate?

For the last 30 years fixed income has been in a bull market as interest rates have steadily declined, and we believe investors have become conditioned to expecting bonds to provide both risk mitigation, capital appreciation and income. Interest rates are near all-time lows and the bull market for bonds will possibly end and along with it the added benefit of capital appreciation. Fixed income may revert to its historical benefits — volatility mitigation and income. Over the next decade, as a result of rising interest rates, we believe investors may see portfolio valuation decreases in their bond portfolios. In a rising rate environment, this strategy seeks to minimize the risks of interest rates rising and can potentially protect investors' capital.

Where does this portfolio fit in a diversified asset allocation?

The Navigator Duration Neutral strategy can be a complement to a core fixed income strategy; it can also be the core holding in an alternative fixed income allocation. Potential benefits include:

- Low volatility exposure to the municipal bond market
- Opportunistic, value-oriented investing with a constant hedge against rising interest rates
- Protection of capital alongside conservative income generation
- The potential for tax advantaged interest income

What are the major risks associated with the portfolio?

Our investment philosophy holds that it is not possible to systematically predict interest rate direction. For that reason, the portfolio holds a consistent allocation to the hedge strategy. The unique structure of this fund carries the following risks that should be considered:

- A dislocation of the historically high correlation[2] between municipal bonds and treasuries
- A dislocation of the historically high correlation between 1 to 2 year treasuries and 3 month treasuries
- Changes to the tax exempt status of municipal bonds
- Leverage is used for hedging purposes

What is the portfolio's process for hedging?

The portfolio's interest rate risk is hedged utilizing short positions of Treasury futures and options. Each short position is customized to individual issues and their characteristics. The hedge methodology is consistently applied to a constant ratio based upon a quantitative model. It seeks to preserve capital while providing absolute return and income. The hedge lowers the volatility by shortening the effective duration of the portfolio.

How much leverage is allowed in the portfolios and why is leverage used?

The portfolio purchases primarily high quality, investment-grade municipal bonds. Up to 33% leverage may be used to manage the balance between the assets and the interest rate hedge. Leverage is also used in order to take advantage of short term opportunities.

Important Disclosures

Investors should carefully consider the investment objectives, risks, charges and expenses of the Navigator Duration Neutral Bond Fund. This and other important information about the Fund is contained in the prospectus, which can be obtained by calling 800.766.2264 or from the website www.navigatorfund.com. The prospectus should be read carefully before investing. The Navigator Duration Neutral Bond Fund is distributed by Northern Lights Distributors, LLC, member FINRA.

Important risk information. An investment in the Fund(s) is subject to risks, and you could lose money on your investment in the Fund(s). There can be no assurance that the Fund(s) will achieve its investment objective. Your investment in the Fund(s) is not a deposit in a bank and is not insured or guaranteed by the Federal Deposit Insurance Corporation (FDIC) or any other government agency. The Fund invests primarily in bond instruments such as municipal bonds and U.S. Treasury bonds and notes. The Fund(s) has specific principal risks, which are described below. More detailed information regarding these risks can be found in the Fund's prospectus. The principal risks of investing in the Navigator Duration Neutral Fund include: correlation risk, derivatives risk, fixed income risk, inflation-indexed securities risk, interest rate and bond maturities risk, issuer-specific risk, leverage/volatility risk, liquidity risk, management risk, municipal market risk, non-diversification risk, non tax exempt risk, turnover risk, U.S. government securities risk. The Fund invests in exchange traded funds (ETFs), closed end funds and other mutual funds ("Underlying Funds"). Such Underlying Funds are subject to investment advisory and other expenses, which will be indirectly paid by the Fund. As a result, the cost of investing in the Fund will be higher than the cost of investing directly in the underlying funds and may be higher than other mutual funds that invest directly in stocks and bonds. Each of the Underlying Funds is subject to its own specific risks, but the sub-advisor expects the principal investments risks of such Underlying Funds will be similar to investing in the Fund.

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1. An **ETF** is a Regulated Investment Company that tracks an index, a commodity or a basket of assets like an index fund but trades like a stock on an exchange. A **Closed End Fund** is a publicly traded investment company that raises a fixed amount of capital through an initial public offering. The fund is then structured, listed and traded like a stock on a stock exchange. **U.S. Treasury Contract** is a futures contract in which one agrees to buy a U.S. Treasury security at a certain price at some stated date in the future, regardless of what the price is on that date.

2. **Correlation** is a statistical measure of how two securities or asset classes move in relation to each other. Positive correlation explains the degree to which a security or asset class will move in the same direction as another security. Negative correlation explains the degree to which a security or asset class will move opposite another security.