ClarkCapital MANAGEMENT GROUP

Video Transcript
Economic Review & Outlook

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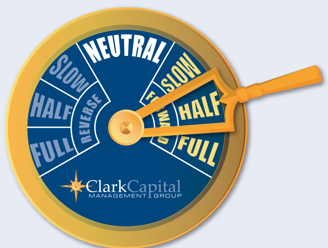
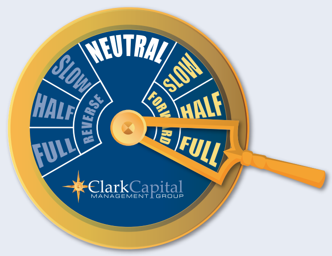
Third Quarter 2020

Thanks for joining me during these challenging times to review our gauges that help shape our view for the overall economic environment. These 5 gauges in turn drive our expectations for the stock market. Recall 12:00 is neutral, anything to the right of 12:00 is positive for stocks, anything to the left of 12:00 is negative.

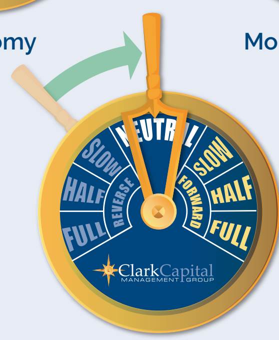


Economy

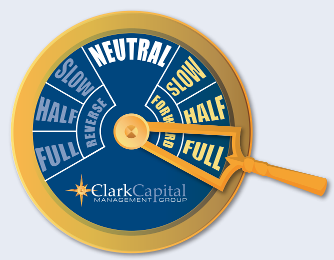


Monetary Policy

Valuations



Investor Sentiment



Interest Rates

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Economy

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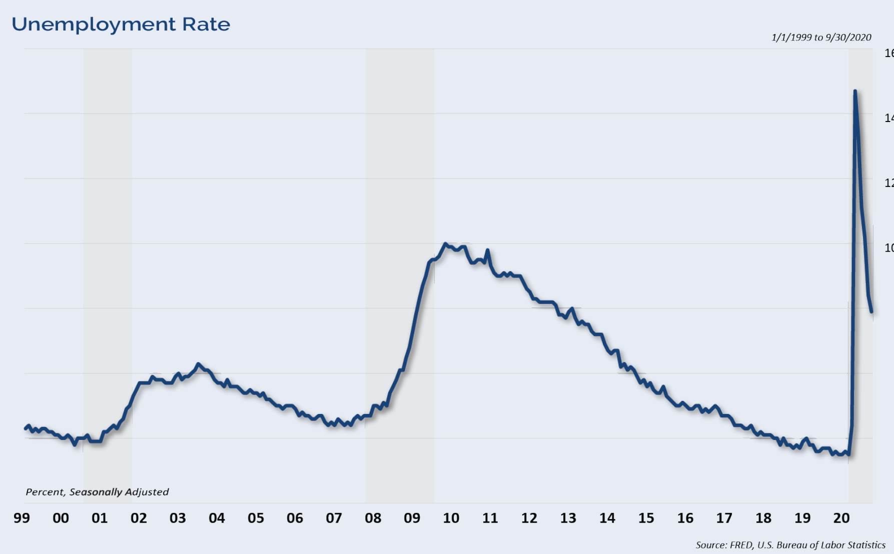
U.S. Economy

Our first gauge is the U.S. economy which we keep at a half forward position heading into the fourth quarter. Third quarter GDP growth will be just as historic in its strength as the drop in economic activity was in the second quarter. As of October 1, the GDP-Now estimate from the Federal Reserve Bank of Atlanta showed third quarter growth was expected to be around 34.6% on an annualized basis. Clearly, an impressive rebound from the annualized drop of -31.4% in the second quarter. Our expectation is that above trend growth will continue in the fourth quarter, though not to the degree we enjoyed last quarter, in what has so far been a V-shaped recovery.

The reopening process continued in earnest in the third quarter and we expect it to continue through the balance of the year. As we have expected all along, the re-opening process will inevitably encounter bumps along the way as COVID-19 cases increase in certain parts of the country. We went through this during the summer as parts of the Sun Belt saw a resurgence in cases, but we continue to believe we will get through those challenges. We acknowledge that the economy will not return to pre-pandemic levels until late 2022 or early 2023, but we do expect the rebound to continue in the fourth quarter.

The job market has bounced back strongly from layoffs early in this pandemic crisis. Without a doubt, it was good news to hear that the unemployment rate went down to 7.9% in September from the high of 14.7% in April. However, it is important to keep in mind that the unemployment rate was at 3.5% at the end of 2019, so we are still more than double that level and need ongoing improvements to occur in the labor market.



Also positive was the news that non-farm employment rose by 661,000 workers in September. Payroll gains have been robust, but the pace of gains has slowed in recent months as we continue to dig out of the hole of more than 20 million jobs lost as the economy was shutdown.

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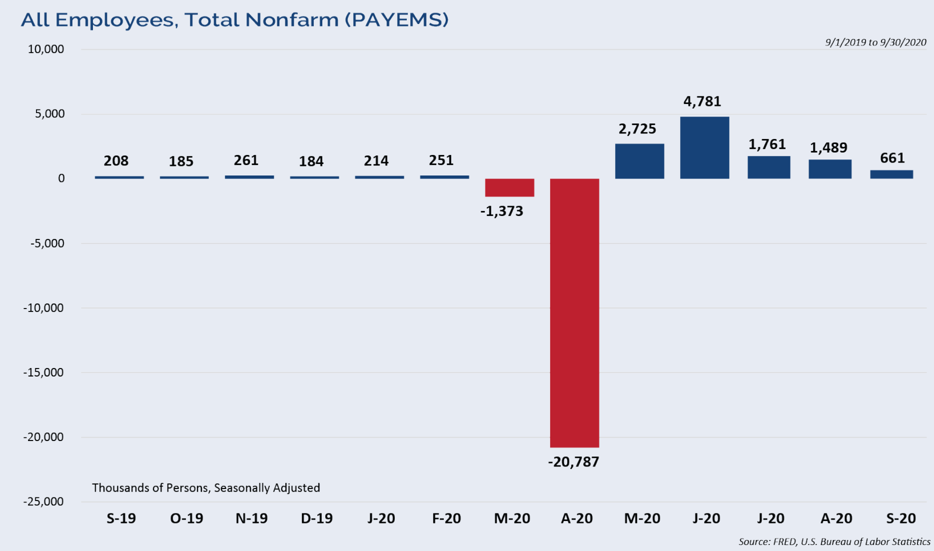

We keep this gauge at the half forward position because we expect strong and above trend growth in the fourth quarter, but the pace of growth will likely slow from what we experienced in the third quarter. As seen in the job market data we just discussed, other economic readings are showing a similar pattern of still strong improvements being made, but not at the pace observed in the early months of the recovery. We believe the economic recovery will take a long and bumpy path, but we would not bet against the resiliency of U.S. economy, corporate America and U.S. citizens to fight their way through this challenging period.

Monetary Policy

Monetary Policy

This leads us to Monetary Policy, which we keep in a full forward position.

There is not a lot of new news to report about the Fed as we go from the third quarter to the fourth quarter. The massive support from the Fed that began in March with unlimited quantitative easing and a whole host of other programs continues with no end in sight. The Fed has reiterated over and over again that it will continue to support the proper functioning of the financial markets and their actions have backed this up. The Fed's balance sheet, which had been slowly declining prior to this crisis, increased by more than $3 trillion dollars in just a matter of months, pushing the total balance sheet to over $7 trillion dollars. The Fed is literally putting its money where its mouth is.

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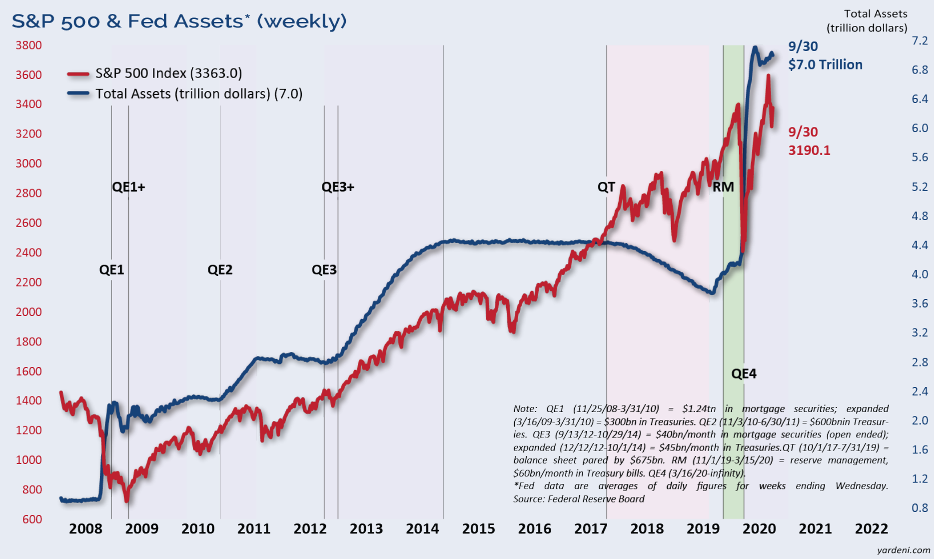

Ultimately, this massive stimulus by the Fed helped support capital markets from the early days of the pandemic crisis period. We have seen over the past decade that when the Fed is increasing its balance sheet, stocks have reacted favorably and subsequently, both stocks and bonds enjoyed a powerful rebound in recent months.

In March, the Fed cut policy rates to a range of 0 to 0.25% as well and Chairman Powell has made it clear that the Fed is not even considering raising rates for the foreseeable future. Moving into the fourth quarter, the Fed shows no signs of letting up on this support. In fact, one piece of news from the Fed came at the annual Jackson Hole Symposium in August, albeit virtual in 2020. The Fed indicated it would look at inflation a bit differently with the broad interpretation they would be willing to let inflation run above 2% for a period of time, meaning a bit hotter, which could push a rate hike even further into the future.

The 5th round of fiscal stimulus has been elusive and although the Democrats and Republicans continue to work on this, nothing concrete has been announced. The market has reacted positively to the ongoing discussions, but that could be a risk as well if another stimulus package fails to materialize.

We know this will be a choppy reopening process, but the Fed is providing unwavering support and we therefore keep this gauge in the full forward position.

Valuations

Valuations

Next are valuations, which we keep in a slow reverse position. The rally in the stock market, which ran almost interrupted until the month of September, has been so strong, that the forward price to earnings or P/E ratio of the S&P 500 is at its highest level in about 20 years.

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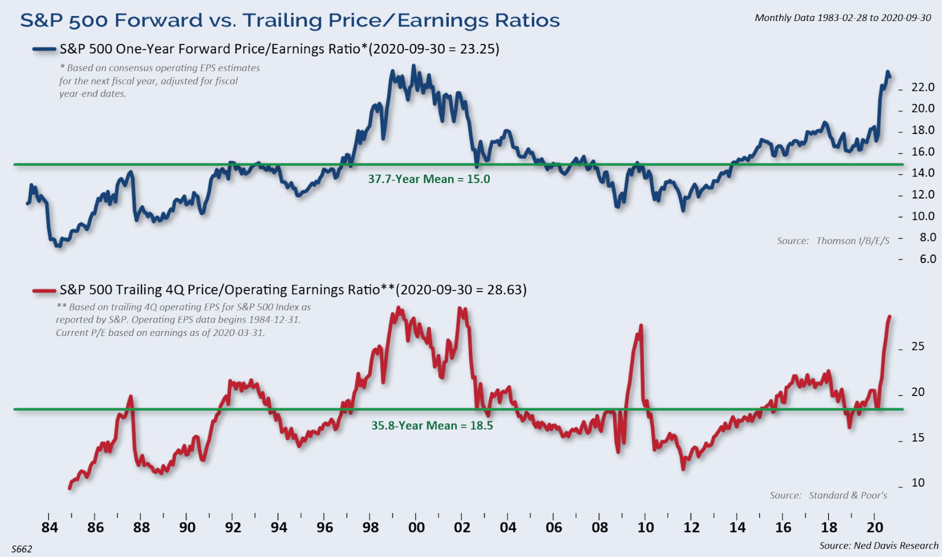

We are in a period where earnings or "E" are down due to the shutdown of the economy and the reopening will take some time for businesses to get operations back up to full speed. So, as we move through this trough period of earnings, the valuation of the broad stock market looks expensive. However, recall that the stock market is forward looking, and investors are looking beyond these shorter-term earnings and at the improvements taking place broadly in the economy and corporate America. In many ways, analysts got too pessimistic about what the impact of the coronavirus would be on corporate earnings and companies have largely exceeded expectations and stocks have bounced back quicker than many expected. Investors have rewarded companies, and the S&P 500 and NASDAQ Indices hit new all-time highs in the third quarter.

So, why not bring this gauge further back into reverse territory with valuations so high? We need to analyze stocks in relation to other asset classes, with the primary alternative asset class for most investors being bonds. With the Fed pushing interest rates down, fixed income yields across most maturities are being suppressed. The 10-year U.S. Treasury yield hit a new all-time closing low of 0.52% in early August. The yield ended the quarter only 3 basis points higher, at 0.69%, than were it closed the second quarter at 0.66%. We can compare the earnings yield of the S&P 500 (which is the inverse of the P/E ratio) to the yield on the 10-year Treasury and it shows on a relative basis, stocks are more attractive than bonds.

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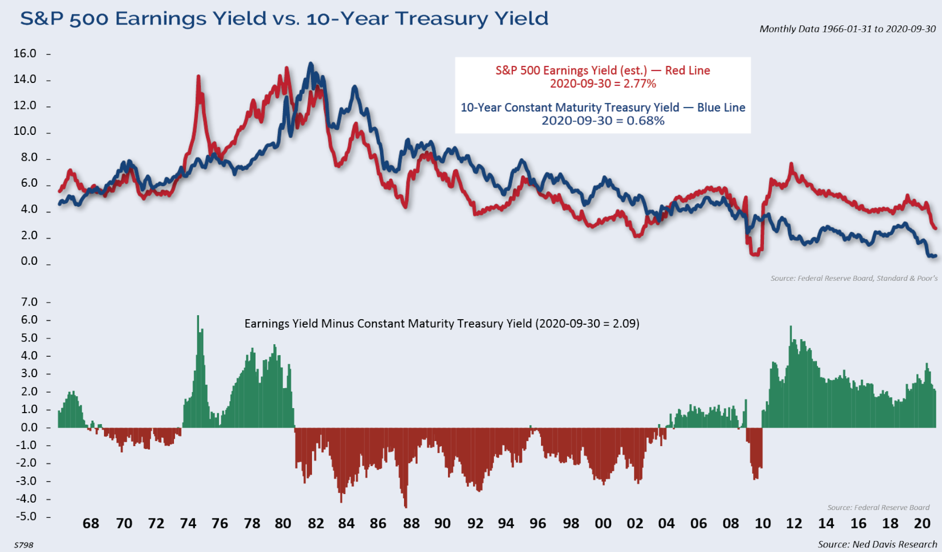

When interest rates are low, it supports higher stock market valuations. Simply said, the low yields of bonds are not providing a lot of competition to stocks. With the Fed focused on keeping rates down for the foreseeable future, this dynamic will likely remain for a while as well.

We continue to believe that volatility will likely increase as we move into the final month before the election. It appears more and more likely that the result of the election might not be known on November 3rd. With that said, we believe the economy and financial markets are heading in the right direction.

And remember, as an active manager, we look at valuations on a company by company basis. Although a few large-cap growth companies have powered index levels to all-time highs and their valuations might be extended, the average stock has not had as strong a rally. So, that provides us at Clark Capital an opportunity to seek out high quality companies at a good price and we continue to make very purposeful investments in both stocks and bonds.

Investor Sentiment

Investor Sentiment

The next gauge is Investor Sentiment, which can be thought of as a measure of speculation or pessimism in the market. This is the only gauge we are changing from last quarter and we bring it back to a neutral position. Recall this gauge is a contrarian indicator, so extreme pessimism is a positive from a market perspective and extreme optimism is just the opposite.

We have had some significant swings in investor sentiment over the course of 2020, but at this point, we believe investor sentiment is more balanced or neutral. Trading sentiment is one indicator we look at and after swinging into extreme pessimism in March, then to extreme optimism as stocks rallied in the later summer and early fall, this gauge is back in neutral territory.

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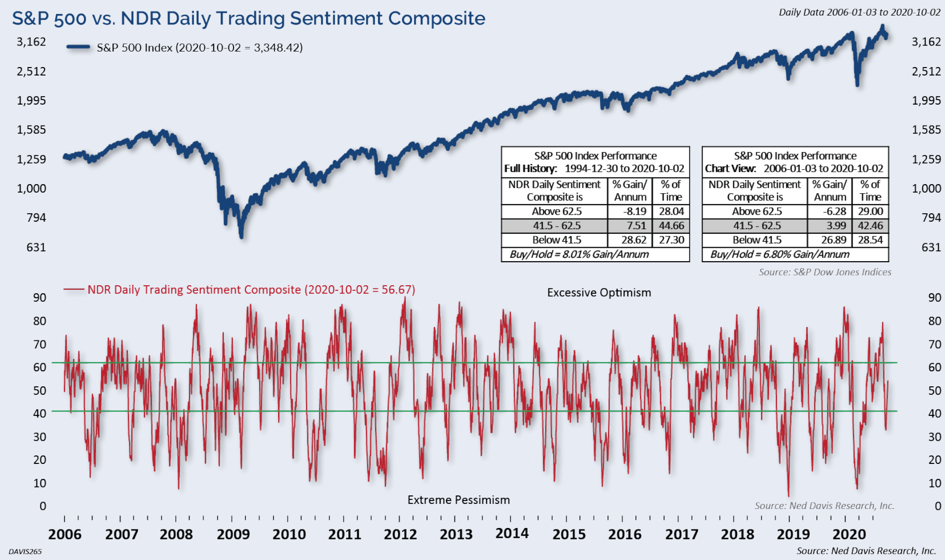
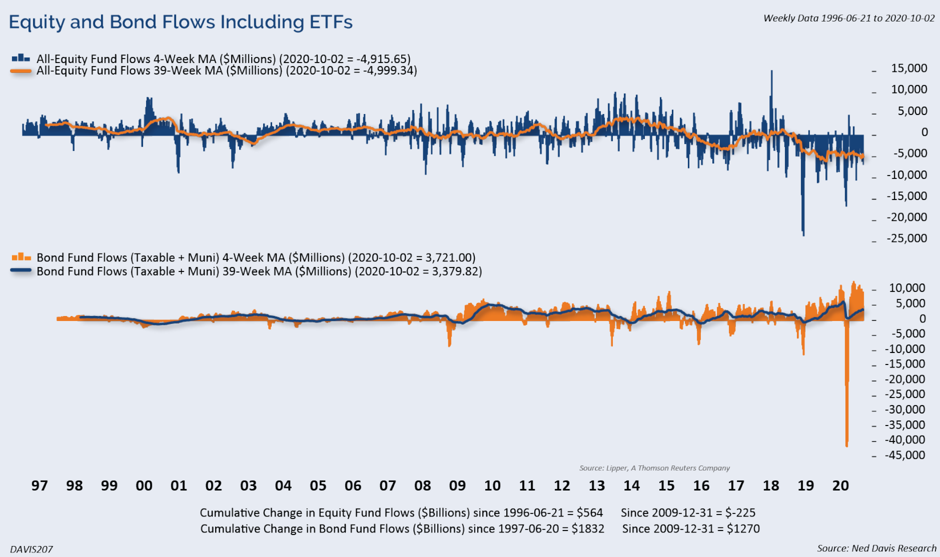


Another indicator we look at to determine investor sentiment is fund flows, which actually track what investors are doing with their money versus simply surveying what they say. We can see that fund flows have still seen a very steady move out of equity mutual funds and ETFs and into bond funds. One would expect to see fund flow going into equities if we were nearing a point of excessive optimism in the market. It might also indicate that there could be some pent-up demand building for stocks as many investors have not participated in this equity rally.



Another indicator, which we have discussed a lot in recent months is the CBOE Volatility Index or VIX Index, which is often referred to as the Fear index. The VIX Index had closed June above the 30 mark – where it historically spends less than 10% of the time – indicating some elevated fear in the market. However, it closed September at just over 26, which is still high from a historical perspective, but out of that unusual above 30 zone. Fear is still elevated, but it's down from the end of the second quarter.

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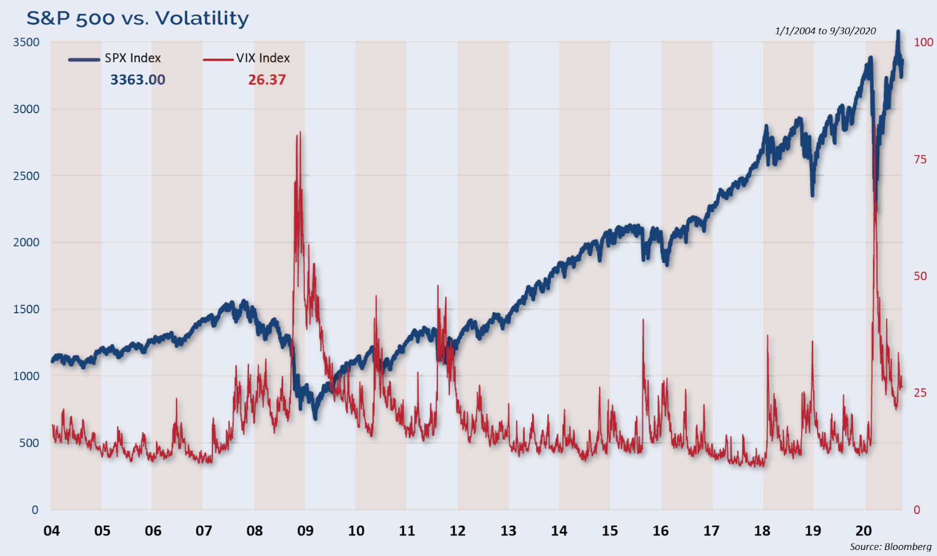
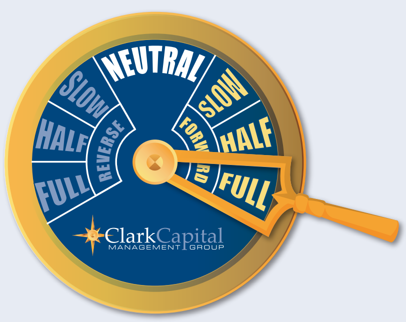


Unlike at the end of the first quarter when excessive pessimism reigned from nearly every indicator, now readings seem to show investor sentiment as more neutral, and we've adjusted this gauge accordingly.

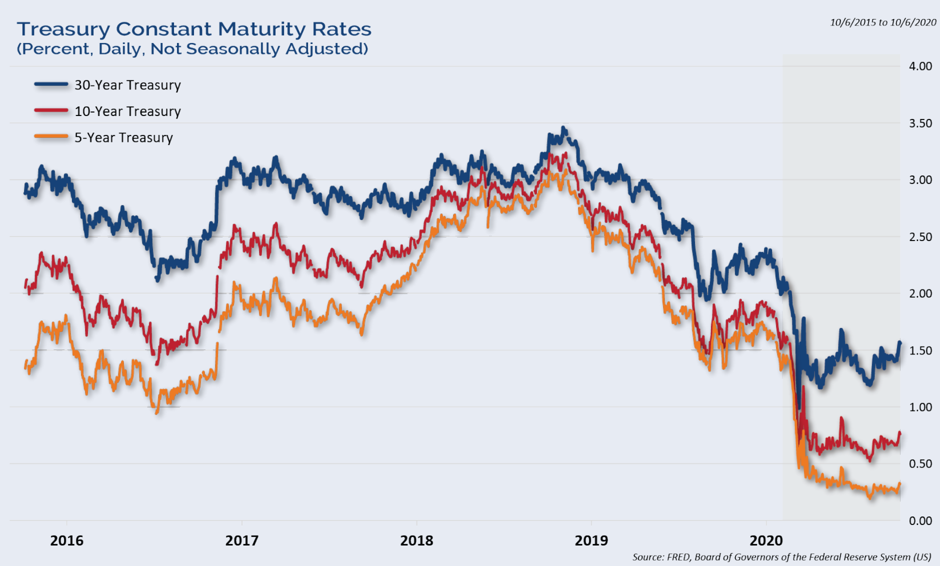


Interest Rates

Interest Rates

Interest rates are the last gauge and we maintain a full forward position. Recent comments by the Fed, along with actions it is taking in the market, lead us to believe we will be in a lower for longer interest rate environment for the foreseeable future.

It might be hard to believe that the yield on the 10-year U.S. Treasury ended 2019 at 1.92%, but driven by the Fed and a flight to quality from nervous investors, rates have hit new all-time lows in 2020 across many parts of the yield curve.



With the Fed's return to its Zero Interest Rate Policy and shorter-term yields anchored so low, the yield curve has steepened. The yield on 30-year U.S. Treasuries

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remains subdued, but increased modestly from their second quarter close to end September at 1.46%. Although U.S. government debt levels are increasing, which is being exacerbated by this pandemic spending, the cost to service this debt remains low.

Ultimately, lower rates should be helpful to the economy as it reduces the cost of capital and it appears rates will remain low for the foreseeable future driven in large part by the Fed. Therefore, we keep this gauge in the full forward position. If consumers can refinance their mortgages and free up some cash for themselves, or if consumers see the interest rates on their credit cards drop, that could be helpful to consumer spending as well.

We know these remain challenging times, but the good news is that the U.S. economy has rebounded strongly from the historic slowdown of the second quarter. We continue to believe that the U.S. economy and corporate America will come through this crisis, although it will take some time. We also anticipate a bumpy road to recovery from both an economic and stock market perspective. As is often the case, the worst periods of market performance, like Q1, are often followed by some of the best times in the market, like Q2 and Q3. That is why we continue to urge clients to stick to their financial plans and not make decisions based on short-term movements in the market.

Please contact your CPM Team or your Investment Consultant to discuss how we can help you during this challenging time. We are here to support you and your clients in any way we can.

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Disclosures

This video was filmed in October 2020

The S&P 500 measures the performance of the 500 leading companies in leading industries of the U.S. economy, capturing 75% of U.S. equities.

The CBOE Volatility Index (VIX) is a measure of expected price fluctuations in the S&P 500 Index options over the next 30 days.

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