Third Quarter 2013

ClarkCapital MANAGEMENT GROUP

navigator® REPORT

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UNBELIEVABLE!

I had just begun to write this Report when the Government shutdown began and I had to stop. I simply did not know what to say about all the foolishness going on in our Capital. As of today, October 12th, resolution seems around the corner and maybe, just maybe, we can begin to breathe again. Can you imagine the damage to this country's reputation if an actual default on the nation's debt was allowed to take place? The shenanigans taking place around the country are simply unimaginable. It seems as if everything is being done to inflict as much pain on the American public as possible during the shutdown. No need to go into details here as I am sure you are seeing and hearing the same things as I am.

> ". . . it was the initial shot across the bow of bond investors that the bull market was over."

So, where do we go from here? The market had reached a new all-time closing high of 1725 on the S&P 500 prior to the shutdown and had declined to 1650 as things became worse and worse. There was a brief respite on October 9th when the President announced his choice of Janet Yellen to succeed Mr. Bernanke as head of the Federal Reserve Bank. On Thursday, October 10th, news seemed to indicate a softening of positions and the market breathed a huge sigh of relief moving higher by almost two percent. The follow through on Friday, October 11th, gave us a level of 1703 on the S&P 500, or just 1.3% below the high.

Believe it or not, the current government shutdown is the 18th since 1976. The longest was for 21 days from December 15, 1996 to January 6, 1997. The market was 4.1% higher three months later in that case. The average gain has been 2.0% over the following three months with the market being positive 59% of the time.

The brinkmanship over our federal deficit and debt ceiling has not gone unnoticed. The total U.S. debt currently stands at $16.747 trillion. The largest single holder of the debt is China with $1.28 trillion invested in Treasury securities. Mr. Yu Yongding, a member of the Chinese Academy of Social Sciences says, "We are angry, but are not panicked. You can't hijack the global economy through political struggles, it's not responsible." In 2009, dollar assets made up 69% of China's foreign exchange reserves. By 2012, the latest data available, they comprised only 49%. It is clear that China is diversifying away from the U.S. dollar because of our political antics. Zhu Guangyao, China's Vice Finance Minister said, "We hope the United States fully understands the lessons of history," referring to the government deadlock in 2011 which led to the U.S. losing its AAA credit rating. Here at home, Fidelity and JPMorgan Chase have dumped all their short-term Treasury holdings.

THE FEDERAL RESERVE BANK

President Obama has appointed Janet Yellen to succeed Ben Bernanke as Chairman of the Fed. It is generally believed that Mrs. Yellen is more dovish than her predecessor which is positive for the investment markets. She prefers to keep rates low to spur economic growth even at the cost of encouraging inflation. She recently said, that with inflation low and unemployment high, "It is entirely appropriate for progress in attaining maximum employment to take center stage." Mrs. Yellen comes with an extensive CV and her husband is also a noted economist. Mrs. Yellen was President and CEO of the San Francisco Fed from 2004 to 2010 and was promoted to Vice Chair of the Federal Reserve Bank in 2010. She has already stated that she would like to keep rates very low into late 2016. There will likely be no taper of the government's $85 billion bond purchases until at least the March 2014 Fed meeting. Still, extracting $3 trillion in monetary stimulus without upsetting the apple cart is going to be a daunting task.

Mrs. Yellen will be the 14th Chair of the Fed since it began in 1916. W. P. G. Harding was the first. While there is great hope for our new chairman the equity market always likes to test the new chairman's mettle by taking a nosedive over the first six months. Yes, there is the usual celebration for the first month or two but then the test begins. The average drawdown over the first six months of a new chairman has been 16.1%. No exceptions! Every new chair saw a market decline with the worst being 38.1% when Mr. Greenspan took office in August 1987. He, by the way, had the longest tenure at almost 20 years. The reign of the chair begins on February 1st and there is the usual celebration following, so can we expect a decent decline to ensue by April or May of 2014? The answer is a resounding YES as you will see as you read on!

Fed Chairperson	First Day	Max Drawdown 1st Six Months
W.P.G. Harding	8/10/1916	-21.0
Daniel R. Crissinger	5/1/1923	-12.7
Roy A. Young	10/4/1927	-9.8
Eugene Meyer	9/16/1930	-33.8
Eugene R. Black	5/19/1933	-23.0
Marriner S. Eccles	11/15/1934	-9.8
Thomas B. McCabe	4/15/1948	-8.9
William McChesney Martin Jr.	4/2/1951	-7.8
Aurthur F. Burns	2/1/1970	-20.4
G. William Miller	3/8/1978	-7.0
Paul Volcker	8/6/1979	-11.2
Alan Greenspan	8/11/1987	-36.1
Ben S. Bernake	2/1/2006	-8.0
Median		**-11.2**
Average		**-16.1**

Source: Ned Davis Research

BOND MARKET

As mentioned in this report over the past several quarters, the great 30-year bull market in bonds that began in 1982 is over. We measure the bond markets by using the 10-year Treasury note as our proxy. **The yield on the 10-year note reached a fifty-year low in July 2012 of 1.39%.** The yield then moved higher to top out at 2.987% on September 6, 2013. This 115% increase is the largest jump in bond yields in the past 50 years, which, conversely, is the largest drop in price over that time. That jump eclipsed the 94% increase in yields which occurred between December 2008 and April 2010. A large part of the current swoon in bond prices and jump in yields was precipitated by a comment in May from Mr. Bernanke about tapering bond purchases which roiled the bond market. As we know, he quickly backed off the idea of tapering at that time. That rapid jump in yields and decline in bond prices took bond investors by surprise and seemed to be a total shock to many. **But it appears to us that it was the initial shot across the bow of bond investors that the bull market was over.** As in any transition from bull to bear or vice versa, a period of adjustment, or back and forth, usually ensues. *This could be considered the first cyclical bear market within the longer term secular bear market in bonds.* This cyclical bear, or decline in bond prices, should then be followed by a cyclical bull market, or rise, in bond price. There were 17 times when yields increased a minimum of 20% over the past 50 years causing cyclical bear markets and occurring during both secular bull and secular bear bond markets, or when bond prices were rising or falling. Over those 17 times the average time from yield bottom to yield peak, or bond price top to bottom, was 420 days. Another way to look at this is to realize that over the past 50 years bond prices were falling on average for 4.66 quarters, or just over one year, at a time while yields were rising. This occurred over 17 times which means that bond prices declined for 20 years of the 50 year period. Remember, for 30 years of that period bonds were generally rising as yields were falling.

What follows a cyclical bear market in bond price is a cyclical bull market in bond price. Sure enough, the current mess in Congress caused bond prices to reverse and start to rise right on schedule or on about 420 days after prices had begun to decline. As I have said here on many occasions, markets (both equity and bond) never are exactly the same but they often rhyme. When yields peak and begin to decline, the average decline has been 35% from the peak. An average decline of 35% would bring yields down to just under 2%! *Some of the above statistics come from "Market Perspectives" written by Scott Minerd of Guggenheim Investments.*

While I believe that the 30-year bull market in bonds is over I also believe that any protracted rise in interest rates will not be forthcoming. Instead I believe that we will see several years of rising and falling rates or several years of cyclical bull and bear markets in bonds. **This will be an exciting time in the bond markets as prices rise and fall giving opportunity for profit.**

NAVIGATOR DURATION NEUTRAL BOND FUND

We have recently introduced a new bond fund called the "Navigator® Duration Neutral Bond Fund." Risk in any bond comes from the length of maturity, or duration, of that bond. The shorter the duration, the less the risk and vice versa. Also, the shorter the duration the lower the yield. So how do you stay low risk to avoid loss and still receive any return? We believe the answer is to hedge away the duration of the bond and hence attempt to hedge away some of the interest rate risk. The fund will utilize interest rate swaps and futures to hedge risk.

The fund is sub-advised to Clark Capital Management Group by Mainpoint Advisors and Jonathan Fiebach. Jon has many years

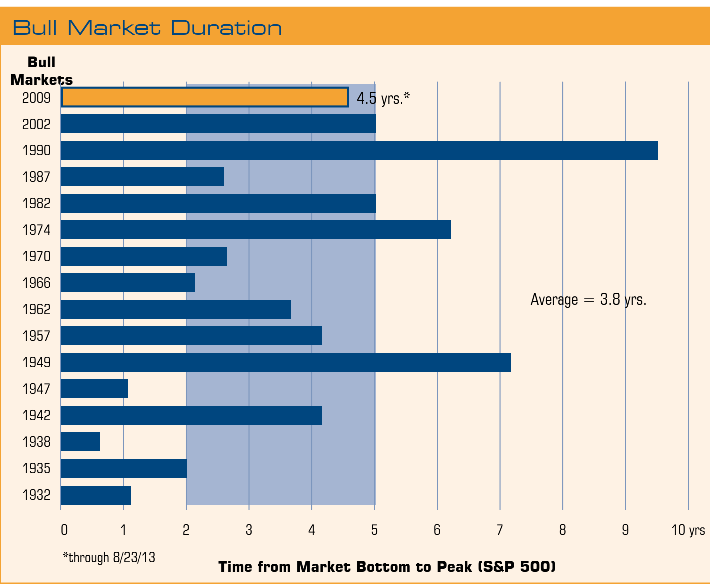
of experience in this area and we feel very fortunate to have him sub-advising on this program. The Fund invests in municipal bonds as the primary bond vehicle. Therefore some or all of the interest on the bonds will be tax-free. We have added a small portion of this new fund to all of our Unified Managed Accounts where bonds are utilized for diversification.

This new bond fund gives us two vehicles by which we seek to manage bond market risk. The other is our Fixed Income Total Return program which is a tactical bond program utilizing high yield bonds, high grade corporate and government bonds and treasury bills. This program has an eight year track record.

Please note that bonds have been, and still are a primary way to diversify any investment program. In our opinion, the above two vehicles give us the tools to actively manage risk inherent in any bond program or portion of an investment account.

HOW FAR CAN THIS RALLY GO?

That, of course is the million dollar question. And, as always, there are arguments to be made on both sides of the equation. This bull market began in March 2009 and is now 4.5 years old. As you can see in the chart it is now the sixth longest bull since 1932. The average bull market lasted 3.8 years. Two bulls ended at the five year mark while two others went on to become super bulls. In any case, when any bull market reached the 4.5 year period, corrections became much more frequent.



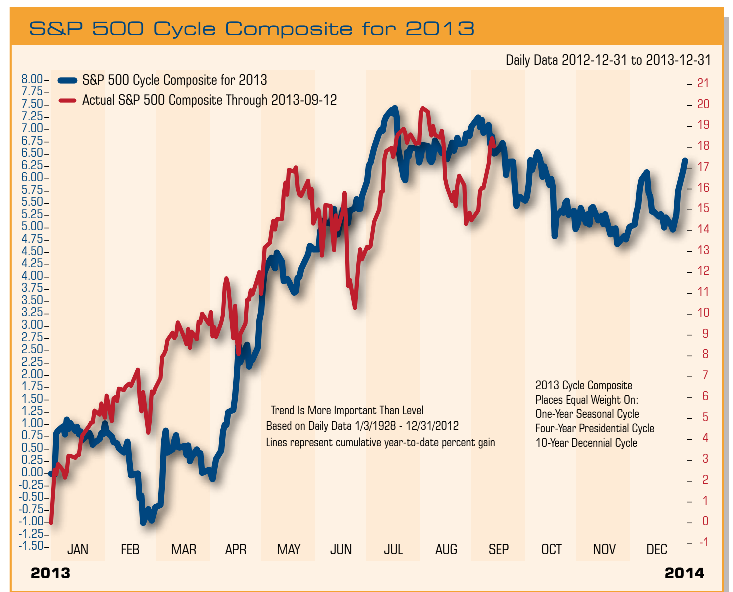
Source: InvestTech Research

Of the six longest bull markets, the current bull has already had more 5% corrections than any other with a total of 11 since it began. The two bulls that lasted five years experienced one more 5% correction before they ended. So if this is any indication, the current bull may have six months or so to run.

FLOW OF FUNDS

The Investment Company Institute tracks fund flows into and out of mutual funds. Positive fund flows have been a good predictor of future market action in the past. The Institute has reported that positive fund flows in August, the latest data available, were $6.6 billion making it the eighth month in a row for positive flows. And this puts the total for the year at $102 billion. This is significant as every time (except once) fund flows reached $100 billion, the equity market continued to move higher for the remainder of the year. The average gain was 9.5% over the next four months. The one loss was in 2000 when the S&P 500 declined by 13.0%. The smallest gain was 7.9% in 1997. Since the fund flow was the smallest of the prior seven this year let's give the 7.9% a haircut to 5.5% which matches the difference in flows. Still a 5.5% gain from here means a year-end S&P 500 of near 1800.

This does not line up very well with the Ned Davis cycle composite for the remainder of 2013. As shown below, the cycle now calls for a correction this fall with a rebound into the end of the year.



Source: Ned Davis Research

Our original projection for this year, which we made in our annual outlook, called for a high of 1700 and a close of 1625 on the S&P 500. How could we get there? A 10% correction is always a possibility which would take the index down to about 1530. A year-end rally of 6% would then bring the S&P 500 to the 1625 target. Is this a possibility?

A potential fly in the ointment for the market on the way to a continuing rally is a divergence in new highs. A market that has continuous new highs is a healthy market. When the number of 52 weekly highs on the NYSE diverges from the price of the S&P 500 it most often signals trouble. As no single indicator is infallible, this indicator also gives an occasional wrong signal but on balance it is

fairly accurate. New highs peaked in late May and have been lower on every peak in the S&P 500 ever since. This may indicate that a correction is imminent and not just a 3% or 4% one either.

SUMMARY

The S&P 500 was up about 20% at the high this year and as mentioned above could still move higher. Even if we do get a further rally into early 2014, we believe we should be prepared for a significant decline following any high in the first half of 2014. This is very typical of a mid-term election year where a peak is followed by a decline. This decline has averaged 21.7% over the past many years. This would actually be very healthy for the market. It would end the current bull market that began in 2009 at about the five year level. A new bull could begin in the second half of 2014 and would, on average, potentially move higher by 48% into a high in the pre-election year of 2015. The rally, from the low in that year to the high the next has averaged 48% since 1932.

If the market closes out this year at the present level, corrects 20% into mid-year 2014 and rallies 48% into 2015 we would be at about 2010 on the S&P 500. At that level in mid-2015 and about a 16.5 multiple, we would need earnings of about $121/share to support that price or about an increase of 10%. We believe this is entirely possible and most likely too conservative.

We will look at the projections for next year in the year-end review and outlook. But, in our opinion, we are in a new Secular Bull market that is likely to last for several more years. The past three secular bull markets lasted for 8 years, 24 years, and 18 years respectively. We are only 4.5 years into this secular bull and judging by history may have lot more to go.

Let's hope that our government in Washington gets its act together and lets our dynamic economy grow as it is very capable of doing.

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