ClarkCapital MANAGEMENT GROUP

Navigator® Market Update
K. Sean Clark, CFA, Chief Investment Officer

December 19, 2013 - Market Commentary

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 Board of Directors, the Investment Committee and the Management Committee. 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 has been featured in a number of articles in nationally distributed business journals and newspapers.

TAPER RALLY

The taper of 2013 finally happened, and the market didn't tank. In fact, the market had a banner day on the news as a great deal of uncertainty overhanging the market was lifted. Consensus had been split about whether the Fed would announce a taper at the December meeting, with only about 60% believing they would not announce tapering until January or March. We were in the "later" camp and didn't think they would announce tapering before Christmas. However, everybody knew that a taper was coming, so even though it was a little surprising it was expected to happen soon anyway.

The FOMC now sees risks "nearly balanced" instead of tilting to the down¬side. As a result of the "cumulative progress" and "improving outlook" in labor markets, the Fed decided to reduce its asset purchases by $10 billion per month to $35 billion in mortgage-backed securities (MBS) and $40 billion in Treasuries beginning in January. Very dovish forward guidance on keeping the fed funds rate low for longer than previously expected was offered, and the inflation language was upgraded. As for the pace of tapering, the Fed said reductions would be made at a gradual and measured pace and that cuts would be split evenly between Treasuries and MBS going forward. In our opinion, the market should expect a similar $10 billion reduction at each of the Fed's scheduled meetings next year if all goes as forecast. The Fed did offset the tapering with the very dovish language regarding the forward guidance of the fed funds rate. They said, *"it likely will be appropriate to maintain the current target range for the federal funds rate well past the time that the unemployment rate declines below 6.5%, especially if projected inflation continues to run below the Committee's 2% longer-run goal"*[1] and Chairman Bernanke emphasized this new pledge during the press conference. The Fed did mention their concern over the low level of inflation, specifically: *"The Committee recognizes that inflation persistently below its 2% objective could pose risks to economic performance, and it is monitoring inflation developments carefully for evidence that inflation will move back toward its objective over the medium term."*[1]

The Fed is largely sticking to the forecast for 2014 that it laid out in September, forecasting a modest improvement in growth next year, continued declines in unemployment and a modest pickup in inflation. It sees growth in gross domestic product next year between 2.8% and 3.2%, the jobless rate falling to between 6.3% and 6.6% and inflation as measured by the personal consumption expenditure price index between 1.4% and 1.6%. The growth and inflation forecasts are slightly lower than they were in June when Fed chairman Ben Bernanke said that if the economy evolved in a way that was "broadly consistent" with the Fed's forecasts it would be-

[1]Source: Text of the Federal Reserve's Statement Wednesday, ABC News, Washington, December 18, 2013.

gin reducing its bond buying program before year end. With today's action, he and his colleagues appear to think the economy cleared that hurdle.

The markets responded very favorably to the taper news, indicating that the actual taper is of secondary importance to the economic improvement globally. The equity markets rallied to new all-time highs, the dollar strengthened versus the other major world currencies, and gold broke through support to retest long term lows. December is one of the strongest months of the year historically. The seasonal strength tends to begin on the twelfth trading day of the month, which this year was Tuesday, December 17. The Santa Claus rally came right on schedule and now, with the uncertainty lifted, the seasonal strength is likely to dominate for the next few weeks into early January.

The sentiment landscape of the market is of concern but it appears seasonal strength will trump sentiment concerns through year end. One such survey that urges caution is from *Investor's Intelligence*. The Investor's survey of investment advisors showed the percentage of advisors that are bearish has been below 15% for four straight weeks. According to *SentimenTrader* that is the first time since 1987 and only the fifth time since 1969. The others were 1/30/76, 1/21/77, 11/25/83 and 2/6/87. In the year following each of those occurrences, the S&P 500's maximum gain at its best point averaged +3.9%. Its maximum loss at its worst averaged –12.0%. The sample size is woefully small, but that's a negatively skewed risk/reward ratio.

For now though, the market appears headed higher into year end.

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 Dow Jones Industrial Average is a stock market index that shows how 30 large publicly owned companies based in the U.S. have traded during a standard trading session in the stock market.

The NASDAQ Index is a market-weighted index of all common stocks listed on the NASDAQ exchange.

The MSCI EAFE Index is a free float-adjusted market capitalization index that is designed to measure the equity market performers of developed markets outside the U.S. and Canada.

The MSCI World Index is a free float-adjusted market capitalization index that is designed to measure global developed market equity performance.

The MSCI World Index ex. U.S. is a free float-adjusted market capitalization index that is designed to measure global developed market equity performance excluding the U.S.

The MSCI Emerging Markets Index is a free float-adjusted market capitalization index that is designed to measure equity market performance in the global emerging markets.

The MSCI All Country Europe is a free float-adjusted market capitalization index that is designed to measure the performance of European equity markets.

The Russell 2000® Index measures the performance of the 2,000 smallest companies in the Russell 3000 Index.

The Russell 3000® Index measures the performance of the 3,000 largest U.S. companies based on total market capitalization, which represents approximately 98% of the investable U.S. equity market.

The VIX Index is a forward looking index of market risk which shows expectation of volatility over the coming 30 days.

Barclays U.S. Government/Credit Bond Index measures the performance of U.S. dollar denominated U.S. Treasuries and government-related and investment grade U.S. corporate securities that have a remaining maturity of greater than one year.

The Barclays U.S. Aggregate Bond Index covers the U.S. investment-grade fixed-rate bond market, including government and credit securities, agency mortgage pass-through securities, asset-backed securities and commercial mortgage-based securities. To qualify for inclusion, a bond or security must have at least one year to final maturity, and be rated investment grade Baa3 or better, dollar denominated, non-convertible, fixed rate and publicly issued.

The Barclays U.S. Corporate High-Yield Index covers the dollar-denominated, non-investment grade, fixed-rate, taxable corporate bond market. Securities are classified as high-yield if the middle rating of Moody's, Fitch, and S&P is Ba1/BB+/BB+ or below.

Index returns include the reinvestment of income and dividends. The returns for these unmanaged indexes do not include any transaction costs, management fees or other costs. It is not possible to make an investment directly in any index.

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