Clark Capital MANAGEMENT GROUP

# Navigator® Unified Solutions

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## Fourth Quarter 2013 - Commentary & Perspective

### Executive Summary

**U.S. Equities:** U.S. stocks enjoyed another quarter of stellar gains during the fourth quarter, with the S&P 500 and large cap stocks leading the way.

**International Equities:** International equity markets have displayed unusual concentration in their relative strength recently. The U.S. continues to lead global markets along with Europe, and only China can even try to come close to keeping pace with the two regions.

**Fixed Income:** Fixed income investing in 2013 was difficult and in the end was not very profitable.

**Commodities:** Commodities performed poorly with the S&P GSCI Index down 2.21%. Gold declined 28.3%, its first losing year in 13 years and its worst percentage loss in more than 30 years.

### Optimism Reigns

The global equity markets experienced a year to remember in 2013 with the major developed markets gaining more than 20 percent. The global equity markets were led higher by the U.S. and Japan. The S&P 500 gained 32.36% and the MSCI Japan Index in dollars gained 27.16%. Reflecting European markets, the MSCI Europe Index in dollars was up 25.23%. Among the laggards in 2013 were the emerging markets, whose performance in our opinion suffered greatly due to currency weakness and rising interest rates. The MSCI Emerging Markets Index in dollars was down 2.60%. Fixed income also suffered losses with the Barclays Aggregate Bond Index down 2.02%. It was the biggest yearly loss for the bond market since 1994! Treasuries yielded losses across the yield curve with the Barclays 7-10 Year Treasury Index down 6.04% and the Barclays 20+ Year Treasury Index down 13.88%. The bright spot among the fixed income asset class was below investment grade credit, with the Barclays High Yield Index posting a solid 7.44% gain. Commodities performed poorly with the S&P GSCI Index down 2.21%. Gold declined 28.3%, its first losing year in 13 years and its worst percentage loss in more than 30 years. Industrial metals also suffered losses with the S&P GSCI Industrial Metals Index down 9.3%. Oil was the only major commodity to post gains, up 7.5%. By this brief summary of performance, it is apparent that equities did best, and the usual asset classes used to build robust diversified portfolios detracted from performance.

We feel the major drivers of returns for the market in 2013 were an improving economy and continued stimulus from the Federal Reserve. The U.S. economy gained momentum throughout the year and allowed the market to rally in the face of taper concerns. In fact, the economy accelerated in each quarter from the fourth quarter of 2012 through the third quarter of 2013. In the fourth quarter of 2012 the economy stalled and grew at just 0.1% before accelerating to 1.1%, 2.5%, and 4.1% for the next three quarters. The 4.1% growth in the third quarter of 2013 was the second highest quarterly reading since the expansion began in 2009.

### Q4 Portfolio Analysis & Performance

**Sentry Strategy** (Hedge/Volatility)

| Level | Current Weight* |
|---|---|
| Level 1 | 9.0% |
| Level 2 | 12.0% |
| Level 3 | 15.0% |
| Level 4 | 17.0% |
| Level 5 | 17.0% |

Clark Capital's Investment Committee continues to maintain a modestly bullish stance on equity markets and, as a result, our equity hedge is as focused on containing costs as it is on protecting against the downside. With the S&P 500 gaining over 30% in 2013, hedging was a difficult and costly proposition. Hedging produced sizeable losses on the year and, as a result, in December 2013 we engaged in tax-loss selling within the hedged portion of our portfolios. We sold the S&P 500 Dynamic VIX ETN (XVZ) and also the 2x inverse UltraShort S&P 500 ETF (SDS). The losses from these positions should help offset some of 2013's sizeable taxable gains. Looking into 2014, we may to increase our equity hedge sometime in the first or second quarter, and for much of the middle of the year to be fully hedged, as we expect market turbulence during the second and third quarters. We do believe a year-end rally during 2014 is possible, so we would expect to reduce our hedges at that time. As always, our real-time indicators and market analysis will determine our investment decisions throughout the year.

### Core

**U.S. Equity Core**

Top Contributors

- JPMorgan Large Cap Core Plus Select
- iShares S&P 500 Growth Index

Top Detractors

- Artisan Mid Cap Value Inst'l
- JPMorgan Small Cap Growth Select

| Level | Current Weight* |
|---|---|
| Level 1 | 0.0% |
| Level 2 | 20.0% |
| Level 3 | 20.0% |
| Level 4 | 20.0% |
| Level 5 | 17.0% |

U.S. stocks enjoyed another quarter of stellar gains during the fourth quarter. The equity market evidently was fueled by Fed-driven liquidity and an improving economic landscape. The year turned out better than even the most bullish expected. The S&P 500 and large cap stocks led the way. Mid and small cap stocks trailed by very modest margins. During the quarter, the Equity Core sleeve made one mutual fund change, replacing American Century Mid Cap Value (which closed) with Artisan Mid Cap Value. Both funds have high quality biases and would be expected to outperform during times of market turbulence. Recent growth and mid-cap purchases performed ably during the rally. For the fourth quarter, the portfolio's holdings of JPMorgan Large Cap Core Plus and iShares S&P Growth were standout performers. Our expectation for this year is that it will be a good year overall. However, there are a lot of risks and historic trends that suggest there may be a cyclical decline in the middle of the year. Nonetheless, looking out longer term, we are positive on the markets and think we may be in the early stages of a secular bull in stocks.

### U.S. Equity Income Core

Top Contributors
- Nuveen Santa Barbara Dividend Growth
- JPMorgan Large Cap Growth Select

Top Detractors
- AllianceBernstein High Income
- Loomis Sayles Strategic Income

| Level | Current Weight* |
|---|---|
| Level 1 | 23.0% |
| Level 2 | 0.0% |
| Level 3 | 0.0% |
| Level 4 | 0.0% |
| Level 5 | 0.0% |

The Equity Income Core Sleeve for some time has allocated 70% of the portfolio to equities and 30% to fixed income. Given the strong equity market during all of 2013 it comes as no surprise that JPMorgan Large Cap Growth and the Russell 2000 were the portfolio's strongest performers on the year. Nuveen Santa Barbara Dividend Growth lagged behind its benchmark on the year due to its high quality bias, but the fund's fourth quarter performance was very solid. In our opinion, the portfolio's fixed income funds performed relatively well in the fixed income category, but their raw performance could not match that of equities during a strong bull market. We continue to be willing to be patient with these fixed income funds, believing that their aggressive nature towards credit will be rewarded as bond and stock market confidence returns. Looking forward into 2014, we expect to at some point slightly reduce this portfolio's equity exposure during the middle of the year, as we expect more volatile markets are possible during the middle of the year.

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*Allocations will vary according to client account guidelines and restrictions.

### International Equity Core

Top Contributors
- Artisan International
- Artisan International Small Cap

Top Detractors
- JPMorgan Emerging Markets Equity
- MFS International Value Inst'l

| Level | Current Weight* |
|---|---|
| Level 1 | 10.0% |
| Level 2 | 10.0% |
| Level 3 | 10.0% |
| Level 4 | 11.5% |
| Level 5 | 10.0% |

International equities trailed behind U.S. equities by some eye-popping margins in 2013. While the S&P 500 was up by over 30%, Europe gained between 10 and 20%, and most Emerging Markets were lower on the year. The International Equity Core sleeve contains a strong lineup of mutual fund managers, including two managers and three mutual fund holdings in the portfolio that were nominated to be Morningstar's International Stock Fund Manager of the Year for 2012 (George Evans of Oppenheimer International Growth and Mark Yockey of both Artisan International and Artisan International Small Cap). The portfolio's top performing funds for the quarter were Artisan International and Artisan International Small Cap, both of which benefited from strong returns in Europe. Later in the year the portfolio sold JPMorgan Emerging Markets Select, which had underperformed its benchmark and replaced it with Vanguard Emerging Markets ETF (VWO) and iShares Core MSCI Emerging Markets (IEMG). Going forward, the portfolio will use ETFs for emerging markets exposure, as they offer both lower costs and greater tactical flexibility.

### Fixed Income Core

Top Contributors
- Loomis Sayles Investment Grade Bond
- Navigator Duration Neutral Bond

Top Detractors
- Legg Mason Brandywine Global Opportunities Bond
- Aberdeen Asia Pacific Income

| Level | Current Weight* |
|---|---|
| Level 1 | 30.0% |
| Level 2 | 19.0% |
| Level 3 | 7.50% |
| Level 4 | 0.00% |
| Level 5 | 0.00% |

Fixed income investing in 2013 was difficult and in the end was not very profitable. The iShares Core Total U.S. Bond Market ETF (AGG) was down almost 2.0% in 2013. The worst of those losses were contained within U.S. Treasuries and longer duration bonds, both of which the Fixed Income Core portfolio actively avoided. The portfolio's focus on credit spread narrowing paid off, as our corporate bond slice performed very well. The portfolio's struggles were focused in the international fixed income area, which offers higher yields but also currency risk. A strong dollar and tremendous currency weakness in Emerging Markets and Australia took its

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toll on that portion of the portfolio. At the end of the year, we sold the fund's positions in international fixed income closed end funds at losses as part of tax loss harvesting. It is our goal to increase our international and emerging markets debt exposure near the end of 2014 but will be more cautious until then. We may repurchase the Legg Mason Brandywine Global Opportunities Fund (GOBIX), which was sold for tax loss harvesting reasons, sometime in late January as we continue to like the fund's longer term prospects. The portfolio's commitment to credit spread narrowing among corporate bonds continues as a longer term play, as we would rather take on credit risk than interest rate risk.

## Explore

**U.S. Style Opportunity**

Top Contributors

- iShares S&P 500 Growth Index

Top Detractors

- iShares Russell Midcap Growth

| Level | Current Weight* |
|---|---|
| Level 1 | 0.0% |
| Level 2 | 7.0% |
| Level 3 | 8.0% |
| Level 4 | 11.0% |
| Level 5 | 15.0% |

Globally, U.S. equities have been the best spot to be for any equity investor. The S&P 500 enjoyed a banner year in 2013, and the strength was such that any corrections that occurred were both small and uniform. There has been very little difference between large, mid, and small cap stocks' performance during declines. One cannot help but look at this development as intermediate-term bullish, as normally small caps underperform before and during a market decline. We have seen very little evidence of small cap weakness so far, only a flattening of their relative strength. While any further weakness may produce some changes in our models, right now the strength of the trend favors small caps. The portfolio's latest trades changed the portfolio's emphasis entirely towards growth stocks, which are heavily weighted in Technology, Consumer Staples, and Health Care. The portfolio remains fully invested, as cash is down to only 3%.

**U.S. Sector Opportunity**

Top Contributors

- iShares Dow Jones U.S. Broker Dealers
- S&P Regional Banking SPDR

Top Detractors

- PowerShares Dynamic Entertainment & Leisure
- S&P Retail SPDR

| Level | Current Weight* |
|---|---|
| Level 1 | 0.0% |
| Level 2 | 7.0% |
| Level 3 | 8.0% |
| Level 4 | 11.0% |
| Level 5 | 15.0% |

The Sector Opportunity portfolio continues to be positioned heavily in economically sensitive sectors such as Financials, Consumer Discretionary, Industrials, and Technology. Recent additions to the portfolio include Industrials (XLI), Transportation (IYT), Pharmaceuticals (IHE), Insurance (KIE), and Medical Devices (IHI). We also added to our NASDAQ 100 (QQQ) and Broker Dealers (IAI) positions. Our relative strength rankings show persistent strength in the Consumer Discretionary sector; the relative strength trend has been impressively smooth and consistent. With the onset of Fed tapering in December, we are watching the sector closely for a breakdown, but one has yet to even begin. Technology's relative strength is also recently on the rise, reaching its highest point since May. We continue to like the Internet and NASDAQ 100 ETFs within technology, and we are avoiding semiconductors. We continue to avoid defensive and interest rate sensitive sectors such as Utilities, Telecommunications, and Consumer Staples. Basic Materials appear to be making a relative strength base, so they could be an addition in the coming weeks. The portfolio's current sector weightings are as follows: Technology 24.0%, Financials 24.0%, Consumer Discretionary 20.0%, Health Care 15.0%, Industrials 14.0%, and Cash 3.0%.

**International Opportunity** (Developed, Emerging & Frontier)

Top Contributors

- iShares MSCI Spain
- iShares MSCI Germany

Top Detractors

- S&P China SPDR
- Guggenheim China Small Cap ETF

| Level | Current Weight* |
|---|---|
| Level 1 | 0.0% |
| Level 2 | 7.0% |
| Level 3 | 8.0% |
| Level 4 | 11.0% |
| Level 5 | 15.0% |

International equity markets have displayed unusual concentration in their relative strength recently. The U.S. continues to lead global markets along with Europe, and only China can even try to come close to keeping pace with the two regions. Changes to our portfolios reflect this. Our portfolio gives Europe an impressive 62.0% weight, and the U.S. garners another 20.0%. As the maximum weight that the U.S. can hold in our international portfolios is 25%, we are already near a maximum. A strong and resurgent dollar along with a remarkable weakness in emerging markets has made international investing treacherous in recent months, so our positioning is largely defensive in this area. At this time, we don't see any changes to these relative strength trends on the horizon. We look forward to a brighter day for international equities, but we see no light as of yet.

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The portfolio's current regional weightings are as follows: Europe 62.0%, U.S. 20.0%, Asia Emerging Markets 13.0%, and Cash 5.0%.

**Alternative Strategy** (Commodities, Currency, Real Estate, Absolute Return)

Top Contributors
- Neuberger Berman Long-Short Inst'l
- iShares DJ U.S. Basic Materials

Top Detractors
- iPath Goldman Sachs Crude Oil ETN
- Pioneer Strategic Income

| Level | With Sentry Current Weight* | Without Sentry Current Weight* |
|---|---|---|
| Level 1 | 3.0% | 13.0% |
| Level 2 | 3.0% | 13.0% |
| Level 3 | 6.0% | 16.0% |
| Level 4 | 8.0% | 18.0% |
| Level 5 | 3.0% | 13.0% |

The Alternative Opportunity Sleeve contains a well-diversified mix of themes which are broken down as follows: Alternative-Oriented Mutual Funds 38.0%, Tactical Global Equity 33.0%, Fixed Income 15.0%, Commodities 8.0%, and Cash 6.0%. The most recent trades in the Alternative portfolio aligned the portfolio more closely with our relative strength models. Sales included the Pioneer Strategic Income Fund (STRYX), which both struggled performance-wise and was a tax-loss sale, Vanguard Emerging Markets ETF (VWO), and iShares Australia (EWA). The largest addition to the portfolio was the S&P 100 Index (OEF), which was added to increase our U.S. equity exposure but minimize the risk and volatility that mid or small caps might present at this late stage of the bull market cycle. We also added to our position in Basic Materials (IYM), which has shown a stable and slowly increasing relative strength trend. Within the portfolio's core mutual fund holdings, we added to the Neuberger Berman Long-Short (NLSIX) and Neuberger Berman Absolute Return Multi-Manager (NABIX).

**Global Macro** (Unconstrained)

Top Contributors
- SPDR S&P 500 ETF

Top Detractors
- iShares S&P Europe 350

| Level | Current Weight* |
|---|---|
| Level 1 | 7.0% |
| Level 2 | 10.0% |
| Level 3 | 13.0% |
| Level 4 | 15.0% |
| Level 5 | 15.0% |

U.S. stocks have occupied the top of our relative strength rankings for some time now, and thus the Global Macro portfolio continues to emphasize U.S. equities. However, continued relative strength in Europe has enabled international equities to finally earn a small allocation (now 25%) in the Global Macro portfolio. Our relative strength models still favor U.S. equity over international, and after a pause in U.S. relative strength in October and November, the U.S. is once again resurgent. Within U.S. equities, we are now neutral with relation to large cap versus small cap, as we have seen the relative strength of small caps flatten out but not yet decline. Bonds and cash rank far behind equities in our relative strength ranks, and they have little chance of being added to the portfolio over the short-term.

**Fixed Income Total Return**
(Low Quality, High Quality, Short Term Cash)

Top Contributors
- Barclays High Yield Bond SPDR
- BlackRock High Yield Bond

Top Detractors
- Pioneer High Yield Bond Fund
- JPMorgan High Yield Bond Select

| Level | Current Weight* |
|---|---|
| Level 1 | 17.0% |
| Level 2 | 10.0% |
| Level 3 | 7.5% |
| Level 4 | 0.0% |
| Level 5 | 0.0% |

In mid to late June, the Fixed Income Total Return (FITR) portfolio reduced the risk in its portfolio by paring back its high yield bond position by half. Our models are designed to react when raw price losses in high yield bonds exceed a certain threshold, and that threshold was exceeded on June 21st. However, distressed conditions in the credit markets did not last long. Prices recovered, and as a result we quickly returned to a full allocation to high yield bonds on July 18th. Since then, high yield bond prices have declined slightly, but they have not made new lows. In the meantime, yields on high yield bonds have returned to over 6.2%, making them considerable competition for stocks. The FITR quantitative models continue to be bullish on high yield bonds, particularly in comparison to Treasuries. Our model evaluating high yield bonds vs. cash remains modestly bullish as well. While high yield prices remain weak overall, we are content to wait for optimism to return to the markets while collecting a coupon in excess of 6% in the meantime. Looking forward, we believe interest rates have made an intermediate-term peak as the fear and hysteria surrounding the Fed's tapering action peaked in mid-September. All of the fear surrounding tapering had been built into the market, and the Fed's lack of action in tapering has made it quite clear that they are very dovish over the longer term.

## Outlook

We believe we are in the early stages of a new secular bull market in stocks. Relative valuations and comparisons to other secular advances support the case for higher stock performance over the long-term. From a fundamental viewpoint, we see a strengthening economy providing a solid measure of support for stocks and, consequently, this bull market deserves the benefit of doubt even as concerns grow

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about its technical strength. Trends throughout developed equity markets remain strong, cyclical stocks are outpacing defensive stocks, credit spreads remain tight, with yields and the curve discounting improving economic prospects. Our baseline expectation for 2014 is for the market to post additional gains but not without a long overdue correction, which we think has the potential to be quite sharp.

History suggests that good years tend to follow great years. On average the S&P 500 rose 10.0% in the year following a 20% or greater advance (versus an average gain of 8.7% for all years since 1945) and increased in price nearly 80% of the time versus the more normal 70%. So, this suggests that the strong momentum experienced in 2013 may carry over to 2014. In addition, the S&P 500 posted a 10.50% gain in the fourth quarter, one of its best fourth quarter performances of the past 85 years. A big question many are asking as we enter 2014 is if the strong momentum will carry through to the new year or if a first quarter pullback is in order. History suggests that momentum should be respected. Following the top twenty fourth quarters since 1928 (return of 8% or greater), markets have rallied well in excess of the longer-term averages to start the new year, with median returns of 3.6% and 5.9% in January and the first quarter respectively. Simply using history and momentum as a guide suggests the markets will likely have additional upside early in 2014.

Even though the economy is accelerating as we turn the calendar to the new year and the market has a tremendous amount of momentum behind it, there is no shortage of concerns that cause us to expect a sizeable correction in 2014. 2014 is a mid-term election year and they tend to follow a very reliable pattern of returns. Some of the concerns we have are raised by the Ned Davis Research (NDR) Cycle Composite, that warns of some weakness in the second and third quarters, the longevity of the current bull run, a new Fed chairman, overly optimistic investor sentiment, stretched valuations, cash in money market funds that has slipped to levels that may suggest a lot of bull market fuel has been expended, record earnings and expectations that we believe are a little too robust, and record high profit margins. It is our view that none of these concerns by themselves are enough to stall the market, but taken together they suggest the market may be vulnerable to a valuation and sentiment driven correction to relieve the excesses.

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

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 Barclays U.S. Government and Credit Bond Index measures the performance of U.S. dollar denominated U.S. Treasuries, government-related, and investment grade U.S. corporate securities that have a remaining maturity of greater than 1 year. In addition, the securities have $250 million or more of outstanding face value, and must be fixed rate and non-convertible.

The Barclays U.S. Corporate High-Yield Index covers the USD-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.

The Barclays 30-Year U.S. Treasury Bellwethers Index is a universe of Treasury bonds, and used as a benchmark against the market for long-term maturity fixed-income securities. The index assumes reinvestment of all distributions and interest payments.

The Barclays 10-Year U.S. Treasury Bellwethers Index is a universe of Treasury bonds, and used as a benchmark against the market for long-term maturity fixed-income securities. The index assumes reinvestment of all distributions and interest payments.

The Barclays 5-Year Municipal Bond Index is the 5 Year (4-6) component of the Municipal Bond index. It is a rules-based, market-value-weighted index engineered for the tax-exempt bond market. The index tracks general obligation bonds, revenue bonds, insured bonds, and pre-refunded bonds rated Baa3/BBB- or higher by at least two of the ratings agencies.

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 B of A Merrill Lynch U.S. High Yield Index tracks the performance of below investment grade U.S. dollar-denominated corporate bonds publicly issued in the U.S. domestic market.

The Barclays 7-10 Year Treasury Index tracks the investment results of an index comp rised of the U.S. Treasury bonds with remaining maturities between seven and ten years.

The Barclays 20+ Year Treasury Index tracks the investment results of an index comprised of the U.S. Treasury bonds with remaining maturities greater than twenty years.
The Barclays Long-Term Year Treasury Index tracks the performance of the long-term U.S. government bond market.

Index returns include the reinvestment of income and dividends. The returns for these unmanaged

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The volatility (beta) of a client's portfolio may be greater or less than its respective benchmark. It is not possible to invest in these indices.

Returns are presented gross of investment advisory fees and include the reinvestment of all income. Gross returns will be reduced by investment advisory fees and other expenses that may be incurred in the management of the account. For example, a 0.50% annual fee deducted quarterly (.125%) from an account with a ten year annualized growth rate of 5% will produce a net result of 4.4%. Actual performance results will vary from this example. The Firm's policies for valuing portfolios, calculating performance, and preparing compliant presentations are available upon request.

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