Navigator® Fixed Income Total Return

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March 31, 2014 - Commentary & Perspective

Executive Summary

A Good Quarter for Fixed Income: Fixed income benefitted as equities stalled, and credit conditions have remained firm in the face of continued tapering and talks of interest rate hikes.

The Changing of the Guard: New Fed Chair Janet Yellen has the monumental task of reigning in quantitative easing without jeopardizing the markets and economic expansion.

Long Term Outlook: A slow and gradual shift will take place toward inflation as the fight against deflation comes to an end.

3/31/2014 Portfolio Characteristics

Total Exposure:	1615 Holdings
Current 30 Day Yield:	6.16%
Average Duration:	3.88 Years
Average Coupon:	6.83%

48.5%	iShares iBoxx $ High Yield Corp Bond (HYG)	917 Holdings
		30 Day Yield: 5.90%
48.5%	Barclays High Yield Bond SPDR (JNK)	698 Holdings
		30 Day Yield: 6.80%
3.0%	Cash	

Source: Morningstar; iShares; State Street Global Advisors
This is not a recommendation to buy or sell a particular security.

Credit Dominates Again

In our view, U.S. fixed income markets performed well in the first quarter and outperformed their equity counterparts. The equity markets ended the quarter largely mixed as investors seemed hesitant in acting to extend the large gains of last year. Fixed income benefited as equities stalled with the Barclays Aggregate Bond Index and High Yield Index advancing 1.84% and 2.98% respectively.

The biggest event during the first quarter and the one likely to have the longest lasting impact on the economy and markets is the changing of the guard at the Federal Reserve with Janet Yellen stepping into the role of Chair of the Board of Governors. This Fed Chair has the monumental task of reigning in quantitative easing without jeopardizing the markets and economic expansion. So far the market has reacted well to the Fed's tapering activities. In fact, since tapering was announced on December 18, 2013 the 10-year Treasury yield has declined from 2.89% to 2.72%. The Fed has tapered their bond buying program from $85 billion a month to $55 billion a month and they appear on target to end the program by year-end.

The Fed updated their interest rate expectations and they are a bit more hawkish with a target fed funds rate of 1% at the end of 2015 and 2.25% in 2016. As a result of the more hawkish tone coming from the Fed, the yield curve flattened with shorter maturity bond yield rising with the long end of the curve declining. Credit conditions have remained firm even in the face of continued tapering and the Fed's hawkish tone. Investment grade and high yield corporate debt remain well supported and seem to continue to trade with healthy bids and plenty of liquidity under the market.

The budget battles in Washington failed to derail the U.S. economy in the fall, but Mother Nature succeeded this winter. According to the National Weather Service, temperatures from December through February were the coldest in 20 years, and a blizzard prolonged winter's grip on the Northeast through March. The economy suffered a brief soft patch attributed to the weather, but recent data suggests to us that the economy has emerged from winter's chill and is again heating up. That is consistent with our economic outlook as we expect the economy to continue expanding with no real threat of recession on the horizon. Some economic highlights that suggest a pickup in growth are new recovery highs in both the Conference Board's measure of Consumer Confidence and the Index of Leading Economic Indicators (LEI).

We have not been worried about inflation for years, in fact quite the opposite. The real battle has been fought in trying to prevent deflation. The Fed's long-term inflation target is 2.0%. With personal consumption currently running well below the Fed's target and the very low interest rates, the battle against deflation is still raging. However, the Fed wants inflation to pick up, and the Fed usually gets what it wants. While we don't expect inflation to be a problem, we do see signs of a potential shift that suggests we may be nearing an inflection point in the fight against deflation. For example, the unemployment rate has dropped from a peak of 10.0% in October 2009 to 6.7% in March. Meanwhile, average hourly earnings troughed at a record low of 1.3% in October 2012 and has begun to accelerate. Average hourly earnings posted a 2.5% year-over-year growth rate in February, its fastest pace since October 2010. The key point is that wages have risen, albeit from record low levels. While we expect the advance to be slow and gradual, at some point this trend may garner greater attention from both investors and policy makers.

Performance & Analysis

For the quarter, the Fixed Income Total Return composite returned 2.93% gross of fees and 2.40% net of fees. The Barclays High Yield Index returned 2.98% and the Barclays Aggregate Bond Index gained 1.84% for the quarter.

The Fixed Income Total Return (FITR) portfolio moved to a 100% fully invested position in high yield bonds on July 18, 2013. The FITR portfolio's primary evaluation in determining which asset class to own involves comparing the relative strength of high yield bonds versus Treasuries. By that measure, high yield bonds remain very strong. From July 18, 2013 until March 31st of this year, high yield bonds as measured by the Barclays High Yield Bond SPDR (JNK) gained 5.55% while the iShares 7-10 Year U.S. Treasury ETF (IEF) gained 0.81%. Throughout the first quarter, our model continued to make new highs and favor high yield bonds. Our forecast for the markets' path this year calls for a potentially more volatile and turbulent second and third quarters. While we continue to see evidence for that path, we believe the stresses to the credit markets during recent stock market corrections have been minimal to nonexistent. We feel that indicates that stocks are struggling simply due to overbought and overvalued conditions, and that the underlying economy remains on solid footing. While we are always watchful for deterioration in credit conditions that might force us to become defensive, we see no evidence of a need to become cautious at this time.

Outlook

Credit markets remain well supported given continued U.S. economic growth and lack of stress in the financial markets. These characteristics support our preference for high yield corporate debt and suggest the low credit spread environment should continue. Credit spreads (Barclays High Yield Index minus 10-year Treasury Yield) are bumping along at their lowest levels in decades, declining to 251 bp on March 31st. Credit spreads have not been this low since the mid 1990s. In addition, the average high yield bond is trading at about a 4% premium to par, but below its May 2013 peak of a 7% premium. This does suggest that we need to be wary of risks down the road.

We feel lower quality corporate debt should continue to benefit from stronger economic growth. On that front, it is possible that the economy will enjoy two tailwinds from fiscal policy at the federal level: less uncertainty around fiscal policy outcomes, and an easing of the fiscal drag. Some estimates suggest that the fiscal drag in 2013 shaved as much as 1.50% off growth. So, the fading of fiscal drag remains an important source of support this year.

High yield bonds have been in the midst of a normal seasonally strong period from December through April. The seasonal strength has not disappointed as high yields have outperformed Treasuries in three of the past four months, sending the relative total return ratio to a new high. If history is any guide, the second quarter could get off to a good start as historically April has been the best month for high yield outperformance over Treasuries. High yields have outperformed Treasuries in April 72% of the time since 1988 – more than in any other month. In the past, the mean and median excess returns of 153 bp and 81 bp, respectively, have also been better than in any other month.

For now the Fixed Income Total Return portfolio remains overweight in high yields and we expect to see this trend continuing as long as credit remains well supported and stress is absent from the financial markets.

This is not a recommendation to buy or sell a particular security.

[1] Past performance not indicative of future results. Net returns reflect a deduction of 2.10% in advisory and other fees incurred in the management of the account. Please see attached disclosures.

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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 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 free float 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 CBOE Volatility Index (VIX) is a forward looking index of market risk which shows expectation of volatility over the coming 30 days.

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.

Barclays U.S. Government/Credit Bond Index measures the performance of U.S. dollar denominated U.S. Treasuries, government-related & 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 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 comprised 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.

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 U.S. Treasury Bond Index is an issuances-weighted index measuring the performance of the U.S. Treasury bond market, one of the largest and most liquid government bond markets in the world.

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.

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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CCM-14-03-505