ClarkCapital MANAGEMENT GROUP

navigator REPORT

First Quarter 2014

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Do Things Really Ever Change?

Spring has finally sprung in Philadelphia and the snow is gone. As in a lot of places in our country, this past winter has had its share of challenges. I believe that it was the second snowiest here on record and while I do love the snow, enough was enough. Many people that I speak with around the country echo the same sentiment. This winter reminded me of my time at university, Villanova University, where I was an engineering student. I recall walking the campus in snow most of the winter. It is hard for me to believe that I left there 50 years ago this year. It is also hard for me to believe that I have spent the past 43 years in the investment arena. My ramblings here might have been prompted by the passing of a very close friend of 42 years. Funny what things trigger our minds to remembering the past. This gentleman, who was to become my long-term friend, walked into my office when I was just new in the industry and since I was "man of the day" was sent to see me. In those very early days I was a retail stock broker with the firm Hornblower & Noyes, Hemphill Noise. Thus began a 42 two year friendship that, as all friendships must, ended two days ago.

While it may not seem so, the above rambling does actually have some connection to the stock market and some of the challenges that we are facing today. Remembering the past is actually a very good clue in the attempt to discern where things are going in the economy and the investment markets. As I have stated on many occasions, the investment markets rarely repeat in the same way as before but they do closely rhyme in a very many ways.

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FIRST QUARTER

Not much happened during the first quarter of 2014. Even world news was quiet except for Mr. Putin's land grab of the Crimean section of the Ukraine. Other than Malaysian Flight 370 being lost there was not much happening. I do wish they would find the lost airplane, not just to put the relatives minds of those lost to rest, but to get the story off the air. Just shows how little news there was. Even with the lack of news, the markets still exhibited strong volatility with the Dow Jones advancing more than 100 points or more in a day13 times and declined by 100 points or more in a day 10 times.

During the quarter the S&P 500 gained all of 1.3%, the NASDAQ edged up 0.5% and the Dow Jones lost 0.7%. The only excitement was provided when the S&P 500 suddenly dropped 5.8% during the last two weeks of January. **That was the largest correction, believe it or not, since April 2012, almost two years ago.** That shows how persistent the current bull market has been. During the quarter most of the well performing, hot sectors had their comeuppance as one after the other of the high flying sectors stumbled. This rotation could be good or it could be bad. Markets that are getting ready to move higher will rotate among the strong sectors as a way to relieve stress without a major correction. On the other hand, rotation sometimes means that a rotational top is being formed before a major correction.

The first quarter was disappointing in that it followed a very strong fourth quarter of 2013 when the S&P 500 advanced 10.5%. Historically, big fourth quarters, median returns during January have been 3.6% and for the quarter have been 5.9%. But we did not get those returns this year. I hope these returns are just delayed until later in the year.

Foreign markets performed much better during the quarter with most European markets doing well. The traditional PIIGS of Europe did especially well with Italy advancing 14.57%, Portugal 9.70%, Ireland 13.09%, Greece 18.09% and Spain 4.57%. Might be hope there yet! And Russia fell by 9.7% (no comment).

BULLS & BEARS

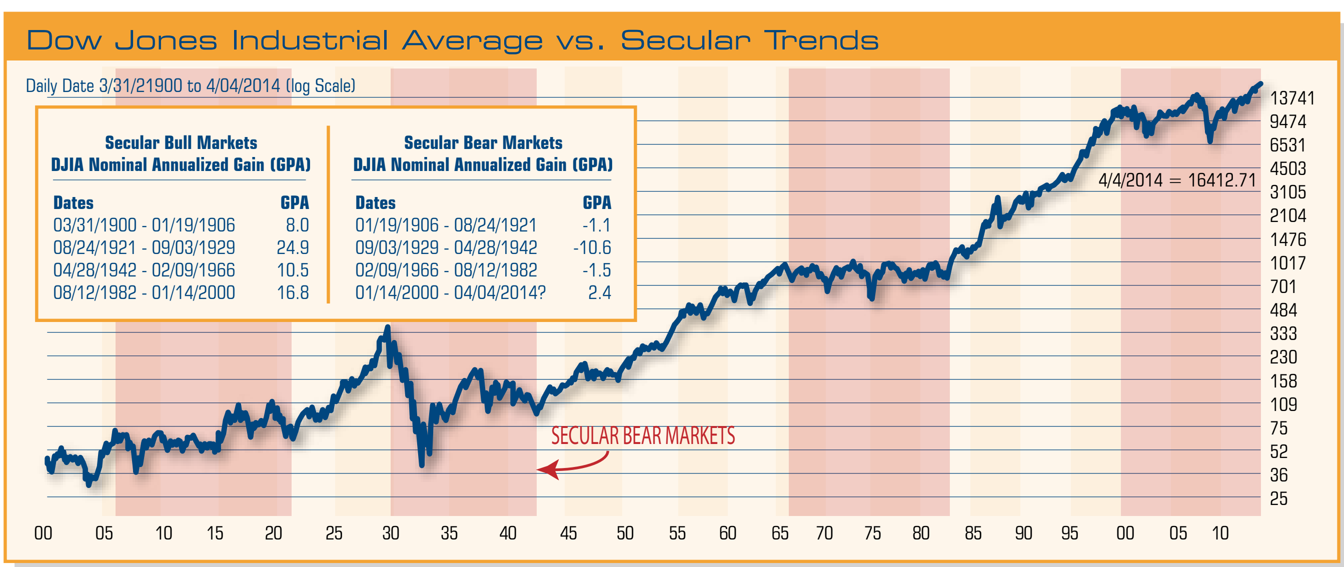
The current bull market was born of the worst disaster in the equity markets since the great depression. The decade plus, from 2000 through 2013, has been called the lost decade since the equity markets did not eclipse the high of 2000 until just this past year (please see the prior Navigator Report). History shows us that there have been three large sustained "secular" bull markets in the U.S. over the past century. The great long-term "secular" bull and bear markets are shown in the chart below.

Each of these long-term bull markets were comprised of several shorter up (bull) markets and down (bear) markets. These shorter up and down markets are referred to as "cyclical" bull and bear markets.

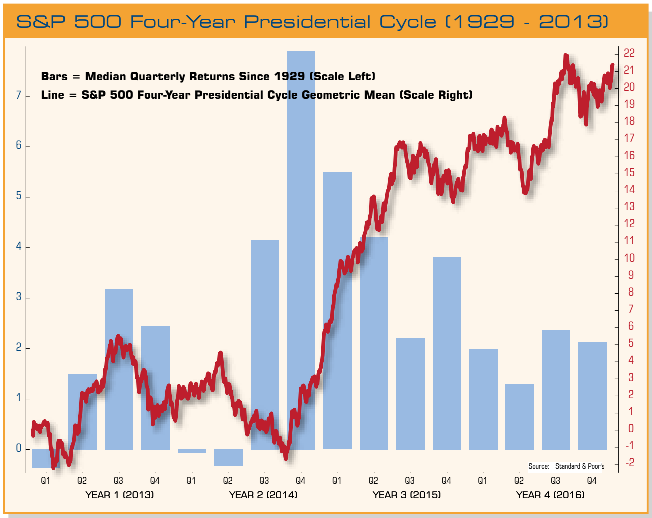
I believe that we are again experiencing a long-term "secular" bull market in this country that, potentially, will last for many more years. *The chart below shows that we are still in a secular bear market that began on 1/14/2000. I believe that a new secular bull began in March 2013 when the market eclipsed the old highs.* This "secular" up market will be comprised of several shorter "cyclical" up and "cyclical" down markets. The present bull market, which I believe to be a "cyclical" up market, began in the spring of 2009 and has just passed its fifth anniversary. The average length of a "cyclical" bull market since the era of the great depression has been 3.8 years. The longest bull market of this type began in 1990 and ended in 1999 having longevity of 9.4 years. The two next in terms of longevity were 6.2 years and 7.2 years. This means that the current bull is the fourth longest, of what I believe to be "cyclical" bull markets over the past eighty years. Can this bull continue? Are things in the country and economy so good that it may keep on going or is there a "cyclical" bear market approaching that will end the current Bull Run? Remember, any short term "cyclical" bear (down market) that may develop will lead to the next "cyclical" up market in the longer term "secular" bull market.

THE PRESIDENTIAL ELECTION CYCLE

There is a very persistent and well recognized cycle in the U.S. equity market referred to as the "Presidential Cycle." The cycle, of course, is four years in length and each year has its own distinct characteristic. We will only delve into the mid-term election year here and it is the only year of the cycle that has consistently had two declining quarters, the second and third quarters.



Source: Ned Davis Research



Source: Ned Davis Research

In the last (fourth quarter 2013) Navigator Report, I showed that the average decline during a mid-term election year since 1934 was 21.7%.

In more recent times, since 1974, there has only been one mid-term election year where the equity market experienced two consecutive down quarters in the second and third quarters. That was during the secular bear market of 9/24/2000 to 10/09/2002 where the declines were 13.7% and 17.6%.

Other than those two quarters the largest decline during one of these quarters, was a 14.5% decline during the third quarter of 1990 which was when a bear market was coming to an end. There was an 11.9% decline in the second quarter of 2010 as the current bull market was getting under way. The chart below, from InvesTech, shows the average mid-term election year activity since 1942

Source: InvesTech Research

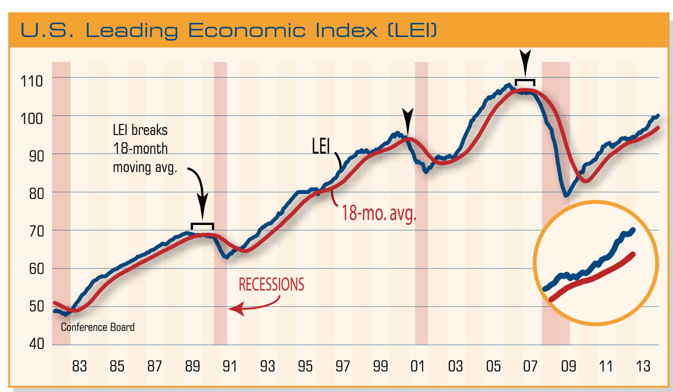
and how the market has done so far this year. Will the 5.9% correction of the first quarter suffice?

What does this all mean? It means that we might be able to escape this mid-term election year without the two quarter decline.

And here is the rub, so to speak. The current secular bull market is aging. It will take a bear market to put the current bull to sleep. A bear market is generally one where the decline is 20% or greater. Therefore this bull market will just keep getting older until we have that 20% correction. I just do not see how things are so good that this bull market will become the second or third longest in the past 85 years. Only time will tell.

THE ECONOMY

The extreme cold and snowy weather during the past winter has not seemed to have had a drastic effect on the economy. In fact the U.S Leading Economic Index (LEI) increased by 0.5% during February. The chart below shows this index over the past 30 years and it looks pretty strong at the moment and looks as if it may be strong for the next several months. While this data comes from the Government Conference Board, it is reproduced here from an excellent publication that I have utilized many times in this Report, *InvesTech Research* from James Stack.



Source: InvesTech Research

A recession in the economy has never begun until several months after the LEI has declined below its moving average. The average lead time has been twelve months with the shortest time being 4 months and the longest time 21 months. In other words, it does not appear that any recession is in our near-term future.

Corporate profits hit new all-time highs last year and stand at 11.2% of total U.S. Gross Domestic Product. After tax corporate profits rose to a record $1.9 trillion in the last three months of 2013. Consumer spending, which accounts for two-thirds of economic output, rose 3.3% during the fourth quarter. The jobs report, due out in a couple of days, is expected to show that the labor force has recovered to the level of before the last recession.

All in all, the U.S. economy seems to be firing on all cylinders which is always good news for the equity markets.

SUMMARY

While it has been disappointing that the market could not follow through with the momentum of the fourth quarter of 2013, recent new all-time highs have been encouraging. I feel fairly confident that we will get some sort of correction during the next two quarters but with the economy looking solid I hope that any correction will be shallow and short lived. Again, only time will tell.

We expect the Federal Reserve Bank to continue removing stimulus by cutting back their bond buying activities over the course of the year. Ms. Yellon gave the market quite a start with her comment on raising interest rates sooner rather than later. Her comments were initially thought to be a mistake but she is too smart to make mistakes of that type. She knows exactly what she is doing and saying. In any case, her comments indicated raising rates after the tapering slowdown is complete which means sometime next spring or so. Bonds will trade higher in price, lower in yield, in any market correction. **Otherwise we expect interest rates to rise as bond prices fall over the intermediate term.** We have stated for the past many months that the bond market is in transition from a bull to a bear market. Interest rates on the 10 Year Treasury note had already doubled at one point recently before settling down a bit. If you must be in bonds, you should be in high yield bonds.

We have just launched our Tactical Fixed Income Bond Fund. The fund tracks our Fixed Income Total Return program which has a nine-year track record. Please ask you financial advisor about this new fund.

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