ClarkCapital MANAGEMENT GROUP

Navigator® Fixed Income

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First Quarter 2014 - Commentary & Perspective

Executive Summary

A surprise to the upside in Q1: The bond market did exactly what it is supposed to do – provide income, lower volatility and provide diversification in balanced portfolios.

Taxable bond outlook: We are expecting a pullback in the equity markets over the coming months, which could result in a selloff in high yield bonds.

Tax free bond outlook: In past years, investors have sold muni bonds to pay their taxes. If that is the case this year, we will use the opportunity to invest the cash in our portfolios.

You Can Make Money in Bonds? Who Knew?

The Quarter in Interest Rates

	12/31/13	3/31/14
2 year	.382%	.42%
5 year	1.743%	1.719%
7 year	2.452%	2.30%
10 year	3.029%	2.719%
30 year	3.969%	3.559%

Source: Bloomberg

The year began with all eyes bullishly focused on equities after a 32.38% return for the S&P500 in 2013. Equities had a brief selloff in January, evidently due to the political issues in the Ukraine and Russia, and staged a rally that managed to grind out a positive return for the S&P 500 of 1.81% for the quarter.

The bond market surprised a lot of people who were expecting higher interest rates. The 10-year Treasury bond was up 2.93% and the 30-year up 7.71% for the quarter. The bond market did exactly what it is supposed to do: provide income, lower volatility and provide diversification in balanced portfolios.

The Fed cut back their QE II program by another $10 billion and it now stands at $55 billion a month. The most generally anticipated result is that yields may rise as a result of bond purchases being reduced as QE is removed by the Fed. But what if interest rates don't rise? People speak of the law of unintended consequences. One unintended consequence, in our opinion, would be a flattening yield curve and a slowing economy, neither of which is good for the banks.

A look at the table shows that as QE has been reduced the curve has in fact flattened. At year-end, the spread between 5- and 30-year Treasuries was at 222 basis points. By quarter end the spread had decreased to 184 basis points. In our view, right now the bond market is pointing toward slow growth in the economy as QE is reduced. In our view, there is nothing in the interest rate charts that points to a different outcome as of quarter end so we will continue to position the portfolio for a slow growth scenario.

Past performance is not indicative of future results.

Q1 Portfolio Analysis & Performance

Taxable Fixed Income

We are anticipating a pullback in the equity markets over the coming months. In the past few equity corrections, high-yield bonds have sold off with equities. We believe Treasury bonds in the 7-10 year range have performed well in the first quarter and we have been a buyer of investment grade corporate paper in the 2021 to 2023 maturities and selective sellers of taxable munis and some BB corporate credits.

The taxable portfolios have several issues that will be either called or mature in early April which will raise cash levels a bit as we begin the new quarter.

Tax Free Fixed Income

Correlation, Correlation, Correlation. That continues to be the theme in municipal bonds — correlation in the structure of new deals, the liquidity of new deals, and the overall credit concerns at the municipality level.

For the quarter, with Treasury bonds rallying, and global credit markets behaving calmly the market was able to digest what could have been its only possible hiccup. That was the $3.5 billion Puerto Rico general obligation deal that could have had a negative impact on the market. We believe the deal was priced perfectly in a one term bond that created demand from non-traditional muni buyers. The deal was priced, traded up nicely and became a non-event credit wise for now.

In our view, after the Puerto Rico deal the market just re-focused on the low supply and really provided little opportunity except to sit back and enjoy the tax free income. In the past, during the months of April and May the muni market has experienced some selling pressure as people pay their income taxes. We are hopeful with higher tax brackets in 2013 that this will be the case again and we will get some of our cash invested.

This is not a recommendation to buy or sell a particular security. Please see attached disclosures.

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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.

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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