



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.

MARCHING TO THE BEAT OF FED LIQUIDITY

The market overcame a myriad of external challenges in the second quarter, including a disastrous report on first quarter economic growth, which had many calling an end to the five-year economic expansion, and more geopolitical strife in the Middle East. The economy contracted at a 2.9% annual pace in the first quarter as consumption plummeted. The combined GDP growth for the last four quarters fell from 2.6% to only 1.5% – lower than the trend of 2.0% for the last five years. Investors appear to have taken the negative news in stride as we have already seen signs that economic activity has rebounded strongly in the second quarter and none of these factors have spoiled investor sentiment. As the quarter came to an end, the major indices were sitting at or near record highs and appear to be primed for further upside. The S&P 500 is just a stone's throw from 2000 and the Dow Jones Industrial Average closed above 17,000 for the first time ever on the last day of the quarter.

Executive Summary

Advances Across the Markets: U.S. and foreign stocks, bonds, and even commodities advanced higher despite geopolitical and economic challenges.

Volatility Remains Low: The CBOE Volatility Index (VIX) fell to 10.61, its lowest level since February 2007.

Outlook for the Remainder of 2014: Investors have become complacent. That is cause of concern given the stretched valuations as we move into the second half of the year.

The advance in the second quarter was broad based with U.S. and foreign stocks higher, bonds up, and even commodities gaining on the back of oil and gold, evidently getting a lift in large part due to the geopolitical tensions in the Middle East and the Ukraine. Global equity markets fared the best with the S&P 500 higher by 5.22%, MSCI EAFE up 4.31%, MSCI Europe gaining 3.64%, and the MSCI Emerging Markets index gaining 6.60%. Both Treasuries and High Yield bonds posted gains. The Barclays Aggregate Bond index gained 2.04%, Barclays 7-10 Year Treasury index was up 2.49%, and the Barclays High Yield index posted a 2.41% gain.

While the gains seem paltry to what investors have become accustomed to over the past several years, the S&P 500 is still up 7.12% total return through the first six months of the year. That is the weakest showing for the first six months since 2011, but it is still better than the median first-half gain of 5% since 1926. In addition, the second quarter's advance pushed the S&P 500's quarterly winning streak to six, something that has only happened seven other times in history. The last stretch of uninterrupted quarterly gains for the index was 14 quarters ending in the second quarter of 1998.

The market is still awash in liquidity fueled by the Federal Reserve (Fed). During the quarter the Fed did taper their bond buying program at each of their FOMC meetings and are now buying \$35 billion of bonds a month, down from a peak of \$85 billion at the end of last year. Even so, the Fed is still purchasing a larger share of treasuries today than at any other time

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Second Quarter — Portfolio Commentary

during Quantitative Easing (QE). The government is issuing debt at a slower pace than the Fed is tapering QE. Over the last two months the amount of outstanding treasuries has been reduced by about \$100 billion while the Fed was in the market buying \$58 billion. The government was reducing debt at the same time the Fed was buying treasuries from the shrinking supply. On a six-month rolling basis the Fed has purchased 73% of new treasury issuance. That leaves very little for normal investors to buy and we believe provides a good reason that yields fell during the quarter. The benchmark 10-year Treasury fell from 2.72% to as low as 2.44%, before settling at 2.52% to end the quarter.

A defining characteristic of the first half was the lack of volatility in the markets. The CBOE Volatility Index (VIX) fell to 10.61, its lowest level since February 2007. The 100-day average volatility of the S&P 500 also hit a seven-year low. We believe investors have become complacent and that is cause for concern given the stretched valuations as we move into the second half of the year.

Q2 Portfolio Analysis & Performance

Key Contributors and Detractors

U.S. Style Opportunity

Top Contributor

- PowerShares S&P 500 High Beta

Top Detractor

- iShares Russell 2000 Growth

The Style Opportunity portfolio has undergone a shift in emphasis from mid and smaller capitalization growth companies towards stable, larger capitalization and value companies. After peaking in price and relative strength in early March, small cap stocks have fallen to the bottom of our relative strength rankings and hence out of the portfolio. Since then, our matrix that ranks the relative strength of style-box oriented U.S. equity ETFs has not changed much. The portfolio now particularly emphasizes mid and large cap value stocks in its top two holdings, the iShares Russell Mid Cap Value and PowerShares S&P 500 High Beta. The PowerShares S&P 500 High Beta ETF was the top contributor for the quarter, while the small cap iShares Russell 2000 Growth was the biggest detractor. The portfolio remains fully invested, as cash is down to a minimal 3%.

U.S. Sector Opportunity

Top Contributors

- iShares NASDAQ Biotechnology
- iShares PHLX Semiconductor ETF

Top Detractors

- Health Care Select Sector SPDR
- iShares U.S. Broker Dealers

During the second quarter many of the biggest headlines came from the Middle East. What had been a relatively peaceful region spiked in violence as events in Iraq and Syria were likely contributors to additional volatility surrounding energy prices. While these events dominated the headlines and probably influenced some portfolio allocations, in our opinion the bigger picture of a slow and steady global economic recovery was more important. Our relative strength driven methodology continues to lead the Sector Opportunity portfolio towards cyclical sectors that would be likely to benefit from global growth returning. The portfolio has maintained a fairly longstanding overweight in the Technology sector, which continues to show relative strength in our rankings. Technology ETF holdings include the NASDAQ 100 (QQQ), broad technology, and Semiconductors. The biggest new addition to the portfolio has been a large weighting to the Energy sector, which appears to have made a major base in relative strength early in 2014. Semiconductors and Biotechnology (IBB) were the portfolio's biggest contributors while Health Care and Financials were the biggest detractors. The portfolio's current sector weightings are as follows: Technology 36.5%, Energy 30.0%, Health Care 14.5%, Industrials 11.0%, Basic Materials 5.0%, and Cash 3.0%.

International Opportunity *(Developed, Emerging & Frontier)*

Top Contributors

- Market Vectors India Small Cap ETF
- WisdomTree India Earnings ETF

Top Detractors

- iShares MSCI Frontier Markets 100
- iShares MSCI Italy

The International Opportunity portfolio shifted away from a multi-quarter emphasis on Europe during the second quarter. While Europe's relative strength has not particularly fallen, the momentum of that relative strength has faded. Thus the portfolio's position in Europe has been reduced to 20%, leaving only previously distressed Italy and Spain as holdings. In an odd dichotomy, both aggressive and volatile emerging markets and the defensive-oriented U.S. and Canada are now the majority of the portfolio's weight. Emerging markets appear to have made a major relative strength bottom in early March as current account financing concerns and the Ukraine crisis both eased at the same time. A resulting return in confidence in Emerg-



Navigator® Global Equity ETF

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ing Markets caused the sector to quickly rise in our relative strength rankings. Brazil, Turkey, Taiwan, and South Africa have been added to the portfolio alongside the U.S. and Canada. Anticipation of the election of a pro-business regime in India – followed by that regime’s big electoral victory – helped make India and India Small Cap top contributors. Italy and Frontier Markets were the portfolio’s largest detractors. The portfolio’s current regional weightings are as follows: Emerging Markets 42.0%, United States and Canada 25.0%, Europe 20.0%, Frontier Markets 8.0%, and Cash 5.0%.

Outlook

With the S&P 500 up over 7% so far this year we still find bullish underlying indications such as the lack of any stress in the credit markets and the low levels of volatility in the market. So, will the second half of the year be a repeat of the first six months with a steady climb higher and record low volatility? Probably not! At some point in the second half of the year we are likely see some volatility. The S&P 500

has gone more than 50 consecutive days without a 1% move and that is the longest stretch since 1995. In addition, it has been over two years without a 10% correction. In our opinion the risks for the market haven’t disappeared; valuations are stretched, escape velocity for the economy is once again being pushed into next year, and sentiment is optimistic. We do have some concern that August and September could be rocky. They normally are in a midterm election year, as the political mudslinging associated with an election cycle can take a toll on investor sentiment. However, the market’s trend is still positive and strong momentum can persist. Many investors have lost a lot of money fighting the Fed and the positive trend. It seems that at this point a big key to keeping the market on solid ground is going to be earnings growth, or more importantly revenue growth, for the second quarter. The earnings over the last several quarters have been engineered from stock buybacks and cost cutting, with revenues barely rising. We believe we need to see the revenue growth pick up to have earnings supportive of the current valuations.

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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 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 U.S. 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.

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 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.

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

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The relative strength measure is based on historical information and should not be considered a guaranteed prediction of market activity. It is one of many indicators that may be used to analyze market data for investing purposes. The relative strength measure has certain limitations such as the calculation results being impacted by an extreme change in a security price.

The CBOE Volatility Index® (VIX®) is a key measure of market expectations of near-term volatility conveyed by S&P 500 stock index option prices and which shows the market's expectation of 30-day volatility. It is constructed using the implied volatilities of a wide range of S&P 500 index options. This volatility is meant to be forward looking and is calculated from both calls and puts. The VIX is a widely used measure of market risk. 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 Barclays U.S. Aggregate Bond Index is a market capitalization-weighted index, meaning the securities in the index are weighted according to the market size of each bond type. Most U.S. traded investment grade bonds are represented. Municipal bonds, and Treasury Inflation-Protected Securities are excluded, due to tax treatment issues. The index includes Treasury securities, Government agency bonds, Mortgage-backed bonds, Corporate bonds, and a small amount of foreign bonds traded in U.S. The Barclays Capital Aggregate Bond Index is an intermediate term index.

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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