Clark Capital Management Group

Navigator® Fixed Income

Jamie Mullen, Senior Portfolio Manager

Second Quarter — Portfolio Commentary

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Senior Portfolio Manager

As Senior Portfolio Manager, Jamie developed and manages the Navigator Global Opportunity portfolio and manages the Premier Fixed Income Strategies. In addition, Jamie manages covered call options deployed on individual stocks and exchange traded funds in the Premier Portfolio Group and implements collar strategies on individual blocks of stocks. He is a member of the Clark Capital Investment Committee. Jamie has over 25 years of experience with fixed income securities. He began in municipal credit research and worked in public finance before moving to a position in trading where his experience included trading municipal bonds and employing fixed income futures and futures options. He has extensive experience in dealing with mutual funds, and trust departments and money managers. He received his degree from St. Joseph's University.

THE RACE TO ZERO?

The bond market continued its march to lower interest rates as first quarter GDP was revised to -2.9%. Many pundits say, "It's the weather stupid." The bond market counters saying, "Something's amiss with growth."

U.S. Treasury Interest Rates

	3/31/14	06/30/14
2 year	0.42%	0.45%
5 year	1.71%	1.63%
7 year	2.30%	2.13%
10 year	2.71%	2.53%
30 year	3.55%	3.36%

Source: Bloomberg

The Shawshank Redemption

The Fed continued to pair back on QE II, reducing the purchase of bonds again, and it now stands at $35 billion a month. Fed Chairman Yellen continues to tell the markets the Fed will be accommodative.

The process to extricate the Fed from this massive money printing reminds me of Andy Dufresne who in the movie, slowly, patiently worked on his tunnel to freedom, sprinkling dirt from his pants onto the ground in the prison yard. The Fed slowly walks into the markets and sprinkles their intentions on the market floor day after day and hopefully they will see freedom someday. It took Andy 19 years to escape. In my opinion the bond market is seeing much the same thing; it may be a long slog accompanied by low rates until we reach higher territory.

Executive Summary

The Flight to Fixed Income Continues: The Fed continued to reduce their bond buying program. I believe it may be a long process accompanied by low rates until we reach higher territory.

Global Interest Rates Move Lower: Rates declined across the globe in the second quarter, providing further gains in the fixed income markets.

Portfolio Outlook: For any new taxable holdings, the steepness of the yield curve will likely be used as a guide. Tax-free portfolios will likely be guided by seasonal demand in the muni markets.

Where Would You Invest?

Here is a snapshot of global interest rates at the end of the second quarter 2014:

Global Government Bonds as of 6/30/2014

	5 year	10 year
France	0.64%	1.69%
Germany	0.34%	1.24%
Italy	1.35%	2.84%
Spain	1.27%	2.66%
Portugal	2.36%	3.64%
Greece	4.22%	5.95%

Source: Bloomberg

The U.S. five year interest rate at 1.71% falls above Italy and below Portugal. This seems hard to believe based on where we were a few years ago when Greece was basically bailed out by the European Union. So the flight to fixed income continues.

Navigator Taxable Fixed Income

Volatility was low and taxable credits remained stable during the quarter. The treasury rally in the second quarter provided the impetus for further gains in the taxable portfolios.

For any new holdings, the steepness of the yield curve will likely be used as a guide. For example, we like buying bonds in the six and a half year area and let the spread narrow to its five-year treasury benchmark though time.

Navigator Tax-Free Fixed Income

Like a ship on calm seas, it was steady as she goes in the municipal market. New issue supply was absorbed easily during the quarter. We bought bonds of states that we believe have some scarcity value that can trade well in all market conditions. Oregon, Idaho, Nebraska and Wisconsin bonds were added during the quarter.

A possible problem overhanging the municipal market is Puerto Rico. During the first quarter of the year a $3.5 billion financing was well received. However by the end of the second quarter the government of Puerto Rico introduced legislation that would allow the Electric Power Authority, The Highway Authority and the Aqueduct and Sewer Authority to negotiate a re-structuring of their debt with existing bond holders.

Evidently this coupled with an article on the issues facing Puerto Rico in the June 30th issue of *Barron's*, brought in sellers of these three entities on the last day of the quarter. This could be a long drawn out affair and one that at some price may offer us trading opportunity.

In the municipal market, July sees large coupon and maturity payments come due which in the past has kept demand firm for muni bonds for a few weeks. In August the market generally slows to a crawl as fixed income desks head for vacation.

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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.

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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.

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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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CCM-655