ClarkCapital MANAGEMENT GROUP

Navigator®
Fixed Income Total Return
K. Sean Clark, CFA, Chief Investment Officer

Third Quarter — Portfolio Commentary

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.

TREASURIES REIGN SUPREME

The global markets put in a sloppy performance during the third quarter as economic growth concerns and geopolitical events weighed on stocks and buoyed government bonds. The bright spot in the global economy is the U.S. as Europe flirts with outright recession and the Japanese economy has contracted in two out of the past three quarters. U.S. growth appears to be accelerating as the year progresses. First quarter growth contracted 2.1%, much of it explained away as weather related, while second quarter economic activity surged 4.6%. Labor market conditions remain solid as the economy has averaged 220,000 new jobs per month so far in 2014 and the unemployment rate dropped to 5.9% in September, a six-year low. All told, third quarter GDP is tracking near 3.5%, a respectable pace after 4.6% growth in the second quarter.*

Executive Summary

Risk-off in High Yields: Volatility in the credit markets during the third quarter resulted in quality outperforming and credit suffering losses. High yields declined for the first time in five quarters.

Interest Rates Remain Low: Global rates remain very low, even negative across many European markets' short term bonds markets. This has helped buoy U.S. Treasuries and strengthen the dollar.

The U.S. and Europe are now following different road maps with the U.S. Federal Reserve scheduled to cease their bond buying program in October while the European ECB is trying to stimulate a stagnating economy. In the U.S., the debate has turned to when the Federal Reserve will hike overnight interest rates. A growing consensus among economists is that the FOMC will begin to raise the fed funds rate sometime in the latter half of 2015. Historically, the Federal Reserve has begun hiking rates about twelve months after the end of an easing campaign. However, given the current growth trajectory of the U.S. economy, the rate hike could come sooner and we expect it to happen possibly as early as March 2015, and probably June 2015 at the latest. Even if the FOMC has the urgency to pull the trigger before mid-2015, we believe the earlier schedule would be largely immaterial to the economic environment.

Interest rates have remained very low globally. Short-term rates across many European markets did the unthinkable, with two year rates going negative during the quarter in many countries. Even European 10-year rates have plunged as Europe's economy falters. German and French 10-year rates hit record lows and all of major Europe, and even the peripheral European counties of Spain and Italy, have lower 10-year rates than U.S. Treasuries. Treasury bonds remain buoyed by growth concerns in Europe and demand for U.S. bonds from abroad resulting in U.S. dollar strength. The trade weighted U.S. dollar has risen for 12 straight weeks and was up 7.72% for the quarter. The rising dollar makes U.S. based investments more attractive to foreign investors.

There was a lot of volatility in the credit markets during the third quarter with quality outperforming and credit suffering losses. For the quarter, the Barclays 7-10 Year Treasury index

**Source: Bloomberg; Renaissance Macro Research.*

Past performance is not indicative of future results.

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

gained 0.47%, the Barclays Aggregate Bond index gained just 0.17%, and the Barclays High Yield index lost 1.87%. High yield bonds have performed very well over the past several years and the decline was the first quarterly loss in five quarters. In fact, it was only the second quarterly loss in three years. Credit spreads remain very tight historically and longer-term credit fundamentals remain well supported with a friendly Fed and a strengthening economy. There was a risk-off environment for high yield bonds as retail investors fled on the first hint of weakness, resulting in record outflows from high yield mutual funds and ETFs. However, so far institutions proved willing to buy high yield bonds as retail investors fled.

Q2 Portfolio Analysis & Performance

Top Contributor

- BlackRock High Yield Bond

Top Detractor

- Eaton Vance Income Fund of Boston

Credit markets were under stress during the third quarter of 2014, and returns in the Fixed Income Total Return (FITR) portfolio were therefore negative. The Barclays High Yield Corporate Bond index declined 1.87% for the quarter, while the Barclays Aggregate Bond Index rose 0.17%. Treasuries outperformed credit, as the market took a general risk-off stance. The FITR model was responsive to the market, as our model lost almost all of its strength during August and September. As it is now early October, our model is close enough for just a small amount of market weakness to trigger an exit of our high yield bond position. As a review, the Fixed Income Total Return (FITR) portfolio moved to a 100% fully invested position in high yield bonds nearly a year ago on July 18, 2013. The portfolio's primary evaluation regarding which asset class to own involves comparing the relative strength of high yield bonds versus Treasuries. By that measure, high yield bonds currently have only a very slight edge on Treasuries. Our best forecast for the markets' path this year predicted a more volatile and turbulent third and early fourth quarter – and that has indeed been the case. However, in a matter of days we enter a seasonally very strong time period. Historically the fourth quarter of a midterm election year is the strongest of any quarter in the midterm election cycle. In addition, signs of a short-term bottom and extreme short-term pessimism have begun to appear. While our model remains ready to go on the defensive if there is further weakening in the credit markets, we believe the intermediate term future looks brighter. That being said, as much as we believe in our forecast, the Fixed Income Total Return portfolio is not influenced by any forecast. It is only influenced by its model, and it remains watchful and ready to turn defensive upon further market weakness.

Outlook

Based on the strength of the U.S. economy and macroeconomic research, U.S. interest rates could justifiably be 100 basis points higher than they are today. We feel they have been held lower by a number of factors including foreign inflows, the low rates globally, Federal Reserve bond buying program, and geopolitical turmoil. The U.S. economy is certainly doing well enough to suggest higher interest rates ahead. With quantitative easing ending in the U.S. this month and the U.S. Federal Reserve preparing investors for a higher federal funds rate in 2015, the stage is set for U.S. interest rates to move higher. That seems to be the consensus call, so we will be alert to what may be wrong about that scenario as we move forward.

We view the price weakness in credit over the last quarter was largely due to retail investors fleeing at the first hint of weakness, resulting in record outflows from high yield mutual funds and ETFs, and a record new-issue calendar in September that needed to be absorbed. The credit market handled the influences well and the markets seem to have stabilized. We think that the fundamental backdrop for credit risk remains very favorable from a top-down perspective as the economy continues to grow and corporate balance sheets remain healthy, which should entice those looking to allocate to high yield.

The correlation between credit and equities has been running at fairly high levels, although beta between the two asset classes has remained subdued. This is evident in the market corrections this year. For example, the S&P 500 has had three minor corrections so far this year, -5.72% in January, -3.85% in July into August, and -3.18% in September. High yield bonds corrected each time, but to a much lesser degree, -0.56%, -1.96%, and -2.48% respectively. The markets are now entering the most favorable seasonal period of the 16 quarters in the Presidential Cycle. The fourth quarter of the mid-term year is the strongest of the sixteen quarters, with the S&P 500 averaging a 7.5% gain since 1941. The catalyst to kick off this seasonal strength is the midterm elections, November 4th this year. Given the high level of correlations between stocks and high yield bonds, we expect credit to perform well should the equity markets move higher.

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Second Quarter — Portfolio Commentary

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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.

Clark Capital Management Group, Inc. is an investment adviser registered with the U.S. Securities and Exchange Commission. Registration does not imply a certain level of skill or training. More information about Clark Capital's advisory services and fees can be found in its Form ADV which is available upon request.

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. Clark Capital Management Group, Inc. reserves the right to modify its current investment strategies and techniques based on changing market dynamics or client needs. It should not be assumed that any of the securities transactions, holdings or sectors discussed were or will prove to be profitable, or that the investment recommendations or decisions we make in the future will be profitable or will equal the investment performance of the securities discussed herein.

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