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Clark Capital Management Group

navigator REPORT

Harry J. Clark, CFP® Chief Executive Officer, Editor in Chief

Aging, Raging Bull and the Seven Year Stretch

On one hand, the current bull market is about to become the third longest of the past 85 years and by most standards is getting pretty old. **On the other hand, we are entering the third year of the Presidential cycle, which historically has seen the best results of the four-year cycle and bodes well for the bull to stretch.**

Most bull markets last from two to five years before they expire. The average bull of the past 85 years has lived 3.8 years. The two longest bulls were the 1949 bull which lasted just over seven years and the 1990 bull which lasted over nine years. Could our current bull stretch into its seventh year and become the second longest of the past 85 years? I believe the answer to that question is YES and we will explore the reasons why.

The average broadly diversified portfolio was up about 5%. Hedged portfolios did even less as the Equity Hedged Index (HFRXEH) only gained 1.42%. *The average stock in the Russell 3000 was up only 4.89% while the median stock was actually down!*

There is some debate at the moment about the duration of the current bull. During May to October 12, 2011, the NASDAQ fell 20%, the NYSE composite fell 26% and the S&P 500 fell 22%. This meets the definition of a bear market, a 20% decline, which would have ended the bull market that began in 2009. A new bull would have begun in October 2011 and there has not been a correction of greater than 13% since. But the pundits say that the May-October decline was only a technical decline with no real economic reasons behind it. However during that time there was a raging debate on the debt ceiling and a resulting downgrade of U.S. debt. Based on this, the current bull is only three years old! And, the bull that began in 2009 lasted two years. Both time frames qualify as bull markets. We will show why we believe that this bull has legs whether it's three or six years old.

2014 REVIEW

Among the world's major developed markets, the U.S. stock market was Top Dog for the year. The Dow Jones rose 10% while the S&P 500 rose 13.7%, both total returns include dividends. The largest Dow gainer

SUMMARY

Economy

The US economy should grow by 3.0% this year. The second and third quarters of last year grew at a 12-year high which is encouraging. U.S. employment in the private sector has increased for the 58th month. Japan has slipped back into recession while the Eurozone seems to be heading that way also. China should grow at 7.0% but double digit growth there may be a thing of the past. World growth appears to be headed to between 3.25% and 3.5% which is essentially where the world grew between 1980 and 2013.

Bonds

It is expected that the Fed will raise rates for the first time in several years at the June FOMC meeting. This is expected and we don't believe it will cause a problem with the stock markets. We expect high yield bonds to recover as the shock of the oil decline wears off. The 10-year Treasury should trade in a range of 1.6% to 3.00% and we look for 2.5% for the end of the year. Municipal bonds seem to be the most attractive segment here.

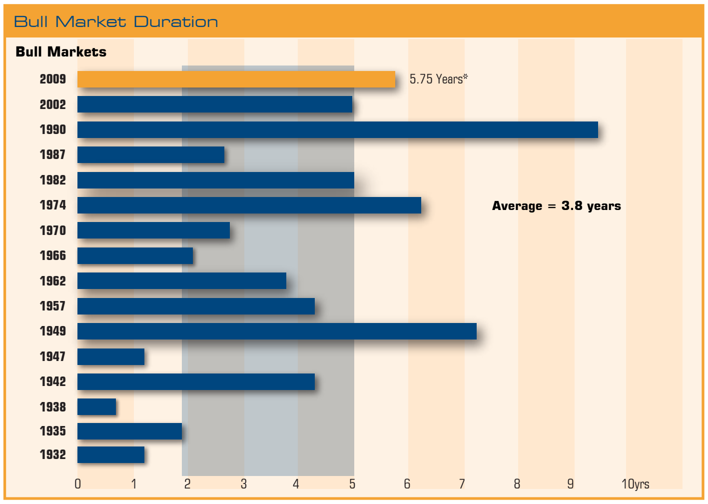
Equities

This year has very bullish stock market tendencies based on the Presidential Election Cycle, which includes last year's mid-term elections. There are also bullish tendencies around initial Fed rate hikes which should take effect mid-year.

We expect small cap stocks to catch up to large cap stocks during the first half. Our range for the S&P 500 is 1800 to 2500 with a year-end target of 2275 for a 10% gain.

Commodities

Commodities have entered a long-term secular bear market and we believe they will continue to fall during the first half of 2015.



*Through 12/31/14 Source: InvesTech Research

was Intel, up almost 40%, while the worst was IBM which lost 14.5%. IBM has been the worst Dow stock for the past two years. Southwest Airlines was the best performer in the S&P and rose 125%. The airline group was the second-best industry rising 95%. The reason airlines did so well was the same reason that energy did so poorly. Six of the bottom ten stocks in the S&P were in the energy sector as oil had its worst decline since 2008. Energy was the worst sector for the first time since 1991.

The S&P 500 was up over 10% for a third year for the first time since 1995-1999 and had the fewest declines of three days or more on record. **The U.S. stock market has only registered double digit gains for three consecutive years six times in the past 150 years.** Large cap stocks (Russell 1000) outperformed small cap stocks (Russell 2000) by the largest margin since 1998, 8.35%. The S&P 500 outperformed the MSCI EAFE (foreign index) by 18.59%, the most since 1997.

The MSCI World ex U.S. index lost 4.52% and emerging markets lost 2.11% in dollar terms. The US dollar had its best year since 1997. As mentioned, the U.S. was the Top Dog in 2014.

Commodities, oil in particular, plunged. The S&P GSCI (commodity index) dropped 33.9%, the worst year since the super recession of 2008 **and the second worst decline since data began in 1971.** West Texas Intermediate Crude Oil futures fell by 44.5% for their second largest yearly loss ever and the largest since 2008 (see more on oil later).

REALITY

The market return numbers above seem, and are, very attractive. But the reality is that if you did not own the several large cap stocks, or a cap-weighted index, your returns were most likely disappointing. Most investors believe that it is prudent to be diversified among, and within, asset classes. **The average broadly diversified portfolio was up about 5%. Hedged portfolios did even less as the Equity Hedged Index (HFRXEH) only gained 1.42%. *The average stock in the Russell 3000 was up only 4.89% while the median stock was actually down!*** Does this mean that you should abandon diversification or hedging? NO! It means that investors should be evaluating their individual situations as to tolerable risk compared to the reward that they are seeking. Assets invested for a near-term need most likely should be broadly diversified or even hedged while those invested for the longer term can be more targeted, less diversified, and not hedged. Please see our performance section.

The U.S. markets have become the most popular in the world. Maybe too popular! In September (latest data) investors, from all over the globe, poured $164.3 billion into U.S. assets, a record. The S&P Global Broad Market Index (includes 48 country markets) gained 4.4% for the year. Without the U.S. the index lost 1.6%. Over the past three years that index has gained 44% but if you remove the U.S. the gain is only 26%. U.S. stocks now account for over one-half of the S&P Global Broad Market Index which includes all the worlds' free-floating stocks measured in dollars. In 2009 the U.S. accounted for only 40% of that index and today's level is the highest in the history of the index since formation in 1989. **Is it time to start looking to other markets for future gains?**

A DIVERGENT MARKET

Results in 2015 were, more than ever, about where you were invested. While the S&P 500 returned 13.66% and the Dow Jones returned 10.02%, the average stock, as measured by **the Russell 3000 index of all stocks, returned 4.89% (the same as small-cap stocks) and the median stock in this index lost money in 2014.**

Concentrated portfolios did well while diversified portfolios, which most investors own, performed as expected. **The average diversified portfolio returned about 5%**. Hedged equity portfolios returned even less with the HFRXEH (Hedged Equity Index) returning 1.42%. **International stocks (ex U.S.) lost almost 5%.**

As an example, the Navigator High Dividend Equity portfolio, (Maira Thompson as lead manager), which invests mostly in large-cap dividend paying stocks **retuned 10.37%** net of 2.35%. Compared to the Navigator UMA level 3 (a broadly diversified portfolio) which returned 3.09% net of 2.40%. This portfolio when hedged retuned 0.78% net of 2.40%. The Navigator Tax Free Income portfolio (Jamie Mullen as lead manager), a concentrated portfolio which invests in municipal bonds, **returned 7.75%** net of 1.00%. The Navigator Fixed

Income Total return portfolio (which invests in a broad range of high-yield and U.S. Treasury bonds), experienced its first loss of the past ten years and returned -0.083% net of 2.10%. This loss was partly due to the drastic decline in the price of oil as very many high-yield bonds are from the energy sector.

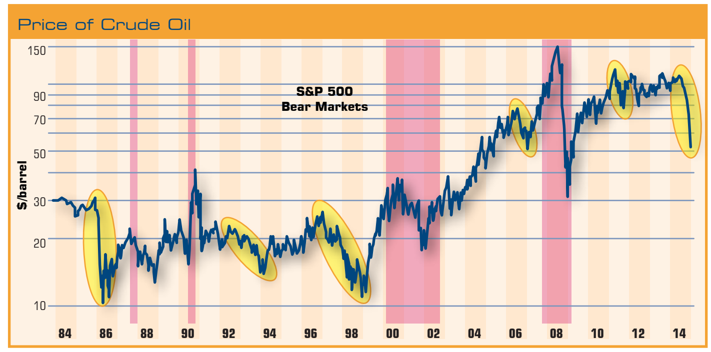
Of particular interest is the Navigator International Equity/ADR portfolio (Tony Soslow as lead manager) which **returned 6.84.%** net of 2.35%. This compares to the MSCI World ex U.S. Index which **returned -4.89%**. Tony's' small/mid-cap portfolio **returned 10.98%** net of 2.35%.

If you believe that you should be in a different portfolio please contact your financial professional and see what else might be appropriate as we manage many other portfolios. The portfolios discussed above are for illustrative purposes only in the context of the market conditions during the period. There were some portfolios that performed better or worse than the examples above. For information on the performance of portfolios not discussed above, please contact us or your financial professional.

OIL WHAT IN THE WORLD IS GOING ON?

I am sure everyone has been watching the price of oil, and hence gasoline, decline over the past several months. We hear all sorts of reasons but do you, as I, wonder what the real reasons are? Some say that there is an oil glut. Some do say that world economic activity is slowing so demand is down. And some insist that Saudi Arabia is waging war on U.S. shale oil producers. The fact is that all the above reasons are most likely true. But it is also true that the price of oil can be, and has been, very volatile. The chart in the top right corner is from Jim Stack and InvesTech Research. As expected, oil declines during bear markets and recessions are largely due to shrinking demand. But, as Mr. Stack shows, it is not unusual for oil to decline in price during bull markets as well and this is the sixth time this has occurred over the past 32 years.

As you can see from the chart, the price of oil does not stay down for long. But before a rebound I do expect oil to at least test the bottom of about $35/barrel reached during the severe recession from 2008-09. That decline was on the order of 75% as oil declined from $148/barrel to $35/barrel during that worldwide great recession. As you can see from the chart, the largest decline during a bull market occurred in the 1985-86 time period when oil declined by 67%. If the oil price does decline to $35/barrel the current decline will equal that decline of 67%. If nothing else it will be very nice for a while as gasoline prices will probably decline to under $2/gallon. That would equate to about a $1200 per year bonanza to every family in America.



Source: InvesTech Research

Some contributing factors to today's oil price decline are a slowing economy in China, which consumes about 10 million barrels a day; a desperate Russia which basically depends on oil revenue to survive; an expected European recession, or at the minimum restricted growth; and U.S. resurgence in oil production due to the shale oil and fracking boom.

The U.S. is now producing 12.4 million barrels a day which is 3 million barrels more than Saudi Arabia production. U.S. production accounts for 20% of the production of the top 10 countries. During the oil crisis of 1985-86, the U.S. did not produce any oil from shale and now 49% of U.S. production is from shale. At the recent meeting of the Organization of Petroleum Producing States (OPEC), Saudi Arabia said that it would not reduce supply to meet current demand effectively sabotaging U.S. shale producers. Saudi production costs are said to be less than $20 a barrel and some insist it is under $10 a barrel. Many U.S. shale producers can produce oil, once found, at about the current price of $50 a barrel. But initial production from these wells can be short lived and new exploration can cost over $100 a barrel. This is about the same as Saudi Arabia's fiscal cost of $80 to $100 a barrel as their oil revenue basically supports the country. They can sustain a low price for quite some time as their fiscal reserves are quite large. Saudi Arabia is simply protecting their future by allowing oil price to decline to limit new production in the US. Talk about free markets at work! An ancillary effect of the oil decline might be to reign in Mr. Putin's desire to expand Russia's footprint since their major source of revenue is from exporting oil.

2015

So here we are with the current bull celebrating its sixth birthday in March. This bull will shortly, we hope, stretch into year seven and join only two other bulls in length. The only two longer bulls, as mentioned earlier, averaged gains of 28% during year seven.

In addition, this is the third year of the Presidential cycle which typically means a solid performance year. Since 1945, the S&P

500 has gained an average of 16% during the third year of the cycle and rose 88% of the time. The market was flat the other 12% of the time which was in 1947 and 2011. Another favorable trend is that for the months surrounding the mid-term elections (Oct. before to Oct. after the mid-term election) the S&P 500 has risen all 17 times since 1945, and the gain averaged 17.5%.

In our opinion this does not mean that market corrections are things of the past. The market has gone for 39 months without a correction of 10% or more. The average time between 10% declines has been 18 months. Over the past many years the S&P 500 has endured 30 declines of 5% or more during the third year of the cycle. So we expect volatility to increase dramatically during the year.

Besides this being a third year and historically very positive for the market, there are other factors that may help this bull extend during 2015. Our economy is in a "Goldilocks" environment. GDP growth is now running at about 3% which is neither too hot nor too cold. The past two quarters have exhibited the strongest economic growth in 12 years. And thanks to the strong U.S. dollar and favorable (albeit low) interest rates foreign capital is pouring into our country. Yes, the Fed very well might raise rates mid-year but we believe that is not a negative or an impediment to either economic growth or stock market returns.

The cycle composite is a combination of the market's historical one-, four-, and ten-year cycles combined into a single composite and serves to provide a framework or possible roadmap of how the market may trade. In the past it has served us well in formulating our outlooks and by this chart you can see that the market (in blue) has tracked the cycle composite (in red) very closely since the beginning of 2009. It not only forecasted the broad trends correctly, it also called many of the important turning points over the past couple of years. So, you can see why we give this composite so much weight when we formulate our outlooks. This year the cycle composite shows the market continuing its advance with strong gains, especially in the first half of the year.

Source: Ned Davis Research

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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 Russell 2000® Index measures the performance of the 2,000 smallest companies in the Russell 3000 Index.

The Russell 1000 Index measures the performance of the large-cap segment of the U.S. equity universe.

The MSCI EAFE Index (Europe, Australasia, Far East) is a free float-adjusted market capitalization index that is designed to measure the equity market performance of developed markets, excluding the US & Canada.

The MSCI World ex US Index is a market capitalization-weighted index designed to measure equity performance in 22 global developed markets, excluding the United States.

The S&P Global Broad Market Index (also known as the S&P Global BMI) is a widely encompassing, rules-based index that measures global stock market performance.

The Russell 3000 Index measures the performance of the 3000 largest U.S. companies based on total market capitalization, which represents approximately 98% of the investable U.S. equity market.

HFRXEH is an equally weighted equity hedge fund performance index produced by Hedge Fund Research.

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Investment Advisory ❖ One Liberty Place ❖ 53rd Floor ❖ 1650 Market Street ❖ Phila, PA 19103
(215) 569-2224 ❖ (800) 766-2264 ❖ Fax (215) 569-3639 ❖ navigator@ccmg.com ❖ www.ccmg.com