Navigator®
Opportunity Update

Mason Wev, CFA®, CMT®, Portfolio Manager

Fourth Quarter — Portfolio Commentary

# WILL THE U.S. LEAD THE WORLD TOWARDS A RECOVERY?

**Mason Wev, CFA®, CMT®**
Portfolio Manager

Mason joined Clark Capital Management Group, Inc. in 2005 as a Portfolio Manager He is a member of the Clark Capital Investment Committee, contributing to asset allocation policy and security selection. Mason has more than a decade of experience in the investment industry. He is responsible for quantitative investment analysis, security selection, and communicating the firm's investment policy to wealth advisors and consultants. He participates in the research and product development efforts of the Portfolio Team. A graduate of Dickinson College, Mason earned an M.B.A. in International Management from the Garvin School of Management at Thunderbird (the American Graduate School of International Management) and holds the CMT and CFA designations.

## Executive Summary

**Summing Up 2014:** The impressive performance of the S&P 500 Index and U.S. Treasuries overshadowed the fact that investing in most other equity styles, countries, regions, or other asset classes was a frustrating and often money-losing endeavor.

**Looking Ahead:** International equities are where we expect most of the volatility and opportunity to be this year.

Two of the most prominent asset classes delivered strong returns in 2014, but if an investor did not own the S&P 500 Index or U.S. Treasuries, their returns did not look nearly as rosy. The S&P 500 Index gained 13.7% on the year, and while the iShares 7-10 Year Treasury ETF (IEF) was up a solid 8.9%, long term Treasuries as represented by the iShares 20+ Year Treasury (TLT) were up a noteworthy 27.4%. It is not normal circumstance for U.S. long-term Treasuries to outperform the S&P 500 by over 10% while the S&P 500 itself is up over 10%. Strong Treasury bond performance usually occurs during economic weakness, and that was not the situation, at least in the U.S. In the rest of the world it was a very different story, however. European economies have become stagnant, and the region is amok in deflation. Emerging markets do have economic growth, but they were slammed by the collapse of energy prices during the second half of the year. So while the S&P 500 gained 13.7%, the Russell 2000 was up only 4.9%; thus investors saw the biggest gap between U.S. large and small cap stocks since 1998. The U.S. dollar was a winner as well, gaining 12.7% itself on the year. International investments, when translated into U.S. dollar terms, were a disaster. The S&P 500 outperformed the MSCI EAFE Index by an eye-opening 18.6%; emerging markets did not fare much better as the S&P 500 outperformed the MSCI Emerging Markets Index by 15.9%. Lastly, we should not forget commodities and energy, which suffered a collapse in 2014. The U.S. Energy Sector SPDR (XLE) fell 11.3% on the year, and oil prices themselves fell 44.5%. To sum up 2014, the impressive performance of the S&P 500 Index and U.S. Treasuries overshadowed the fact that investing in most other equity styles, countries, regions, or other asset classes was a frustrating and often money-losing endeavor. The question going forward is: will the deflationary malaise that affected Europe and emerging markets drag the U.S. down, or will the strong U.S. economy lead the rest of the world towards a recovery?

To answer that question, the broad economic picture in the U.S. has become more positive as we enter 2015. The Leading Economic Indicators continue to rise and make new highs, and job growth remains solid and growth has if anything accelerated. Extremely low interest rates, and now very low oil prices will provide a much needed boost to U.S. consumers. From a cycle perspective, we know that the third year of the president's term is typically the strongest for stock market gains, particularly the first half of the year. Valuations in the U.S., however, are fairly rich and could be said to be at the high end of the fair value range. Such valuations mean that while we expect to see gains in U.S. equities, they should be fairly muted. International equities are where we expect most of the volatility and opportunity to be this year. Right now, relative strength and valuations are pointing us towards the fast growing Asia Pacific region. Major risk factors we are watching going into 2015 are the political and economic turbulence in Europe and the fiscal health of individual energy companies and major energy exporting nations.

## Sector Opportunity Portfolio

| SECURITY | TICKER | WEIGHT |
|---|---|---|
| Health Care Select Sector SPDR | XLV | 19.00% |
| PowerShares QQQ | QQQ | 17.50% |
| iShares Transportation Average | IYT | 12.50% |
| PowerShares Dynamic Food & Beverage | PBJ | 10.00% |
| iShares U.S. Technology ETF | IYW | 9.00% |
| S&P Retail SPDR | XRT | 7.00% |
| iShares NASDAQ Biotechnology ETF | IBB | 6.00% |
| iShares U.S. Health Care Providers ETF | IHF | 6.00% |
| Financial Select Sector SPDR | XLF | 5.00% |
| DJ Wilshire REIT SPDR | RWR | 5.00% |
| Cash | | 3.00% |

In following relative strength trends, the Sector Opportunity portfolio continued to emphasize Health Care and Technology during the fourth quarter. During most of 2014, we saw very tame equity markets, but the volatility tiger came out of the cage during the fourth quarter. We saw a collapse in oil prices and energy stocks and a dramatic move lower in interest rates. Despite that, the S&P 500 posted a gain for the quarter. Steady growth and defensive sectors such as Health Care and Technology, along with interest rate sensitive sectors such as Real Estate and Utilities, showed the most relative strength. While the U.S. economy has been strong and seems to be still on the rise, investors across the globe are starved for companies that can grow, and they are willing to pay up. The portfolio's relative strength driven methodology has tracked and then allocated towards the market's hunger for growth. As a result, on a trailing basis the P/E ratio of the Sector Opportunity portfolio is 26.0 while by comparison the S&P 500 is at 18.2. On a 12 month forward basis, the comparison looks better but as expected remains rich, as the portfolio's P/E is 18.3 vs. the S&P 500 at 16.4. Given the market's hunger for companies that deliver stable earnings, it is not surprising that though the portfolio is expensive, its beta versus the S&P 500 is 0.93. Health Care, Technology, and Consumer Staples companies deliver that much-hungered-for growth, and these sectors' relative strength has made them mainstay holdings. For the quarter, contributing sectors included Health Care, Energy, and Technology. Health Care was the portfolio's biggest sector weight, and investor appetite for pharmaceuticals and biotechnology was rewarded. Within the technology sector, we allocated to stable large cap technology ETFs such as iShares Technology (IYW) and the PowerShares QQQ (QQQ). Of greatest importance from a risk management perspective, the portfolio did not own energy during the quarter and entirely avoided the losses in the sector amidst a collapse in oil prices and energy sector stocks. This highlights one of relative strength's greatest attributes: the potential to capture and/or avoid trends with large magnitude. Detracting sectors included an under allocation towards Financials, poor timing of trades in the Consumer Discretionary sector, and an under allocation to Utilities. Looking forward, our relative strength matrix shows that Financials are a sector currently most on the rise. The portfolio's current sector weightings are as follows: Health Care 31.0%, Technology 26.5%, Industrials 12.5%, Consumer Staples 10.0%, Financials 10.0%, Consumer Discretionary 7.0%, and Cash 3.0%.

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### International Opportunity Portfolio

| SECURITY | TICKER | WEIGHT |
|---|---|---|
| S&P China SPDR | GXC | 22.00% |
| SPDR S&P 500 ETF | SPY | 20.00% |
| WisdomTree India Earnings ETF | EPI | 15.00% |
| iShares Japan | EWJ | 10.00% |
| iShares Taiwan | EWT | 9.00% |
| iShares Turkey | TUR | 7.50% |
| iShares Philippines | EPHE | 6.00% |
| iShares Singapore | EWS | 4.50% |
| WisdomTree Japan Hedged Equity ETF | DXJ | 3.00% |
| Cash | | 3.00% |

While relative strength has driven our Sector Opportunity portfolio towards comparatively expensive stable growth stocks in the U.S., the International Opportunity portfolio has found relative strength in areas of comparative value. The portfolio allocates towards country and regional ETFs that display relative strength within our ranking matrix. Given the deflation that is vexing Europe and the volatility of the energy-heavy Emerging Markets nations, it has been a very good thing that the portfolio considers the U.S. an investable part of its universe. The S&P 500 itself ranks near the very top of our relative strength rankings, and we have allocated our maximum weight of 20% for this portfolio to it. The Asia Pacific region dominates most of the rest of the portfolio, particularly China. China ranks very highly in relative strength, and with reasonable P/E ratios of ten times forward earnings, valuations are supportive of a further rally. Taiwan, the Philippines, Japan, and India round out the portfolio's Asia-Pacific exposure. Only Turkey, which we feel is quite reasonably valued with a forward P/E of 12, is not from the Asia Pacific region. In aggregate, we see the International Opportunity portfolio as attractively valued. On a 12-month forward earnings basis, the portfolio's P/E ratio is 12.7 versus a 13.1 P/E for its benchmark, the MSCI World ex-U.S. Index. To be clear, the portfolio's methodology is agnostic with regard to valuations and favors owning countries and regions that have relative strength. Having said that, as managers we prefer to own securities that are both attractively valued and have relative strength because logically the appealing valuations mean that the relative strength can both continue into the future and have magnitude. Given the overall attractive valuations for the international equities, we are optimistic about this portfolio's opportunity to add value in 2015. For the quarter, the portfolio's top contributors were the U.S. via the S&P 500 ETF (SPY) and China (GXC). From a risk management point of view weakness in France and more broadly Europe were avoided. The top detractors were Thailand (THD), Mexico (EWW), and Japan (EWJ and DXJ). The portfolio's current regional weightings are as follows: Asian Emerging Markets 52.0%, United States and Canada 20.0%, Developed Asian Markets 17.5%, Middle East & Africa 7.5%, and Cash 3.0%.

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### Style Opportunity Portfolio

| SECURITY | TICKER | WEIGHT |
|---|---|---|
| iShares S&P 500 Growth | IVW | 42.00% |
| SPDR S&P 500 ETF | SPY | 40.00% |
| iShares MSCI USA Minimum Volatility ETF | USMV | 15.00% |
| Cash | | 3.00% |

The Style Opportunity portfolio emphasized large cap, steady growth stocks during the fourth quarter of 2014. The slow but steady economic growth that we have seen since 2009 has led equity investors to place more and more value on those companies that have the potential to deliver persistent growth. Such companies' earnings are not volatile but stable and steady. Pharmaceuticals, Consumer Staples, and large Technology companies are prime examples. The portfolio's relative strength ranking methodology has seen large cap stocks and large cap growth in particular top our equity style rankings for much of 2014, and thus the portfolio was heavily weighted towards the S&P 500 (SPY) and the iShares S&P 500 Growth ETF (IVW). With growth companies displaying clear relative strength and selling at a premium, it is not surprising that the Style portfolio is modestly more expensive than the broad S&P 500. The portfolio's 12 month forward P/E is 17.5, while the S&P 500 is at 16.4. Given what we believe to be high quality of the portfolio and correspondingly lower beta of 0.94, such a modest premium above the S&P 500 does not seem unreasonable. While we construct the portfolio by looking at the relative strength rankings of a number of U.S. equity style ETFs, we do look at what the portfolio looks like as a whole. In aggregate, the portfolio overweights the Technology, Health Care, and Consumer Discretionary sectors, while underweighting financials and energy, traditional value sectors. One recent new entrant to the portfolio, the iShares MSCI U.S. Minimum Volatility ETF (USMV), was a top contributor for the quarter as interest rate sensitive companies in particular tend to fare well. The SPDR S&P 500 ETF (SPY) was the other top contributor. The top detractors included the S&P 500 High Beta ETF (SPHB) and the iShares S&P 100 Index (OEF). Looking forward to 2015, we expect relative strength of small cap companies to rise, and we may soon add them to the portfolio. Small cap stocks were expensive in comparison to large caps at the beginning of 2014, and that overvaluation contributed to a very poor year for small caps. However, that valuation gap has largely been closed and small cap relative strength returned in the fourth quarter.

### Global Tactical Portfolio

| SECURITY | TICKER | WEIGHT |
|---|---|---|
| SPDR S&P 500 ETF | SPY | 35.00% |
| iShares Russell Midcap | IWR | 20.00% |
| iShares Russell 2000 | IWM | 20.00% |
| iShares Barclays 7-10 Year Treasury | IEF | 22.00% |
| Cash | | 3.00% |

The philosophy for the Global Tactical portfolio is to use our proprietary matrix ranking the relative strength of various asset classes, and then allocate to those asset classes with the highest rankings. Stocks have occupied the top of the portfolio for well over a year now, and they have received the lion's share of allocation. Early during the fourth quarter, a U.S. Treasury ETF (IEF) entered the portfolio for the first time in many months, and it has been favored as Europe's struggles and a collapse in energy prices led to falling interest rates and a general risk-off tone in the markets. Count us among many market observers that are perplexed that the S&P 500 can enjoy a strong 2014 with gains over 10% and be outperformed by long-term U.S. Treasuries by another 10%. Strong U.S. Treasury performance usually coincides with economic and stock market downturns, but that was not the case in 2014. A Europe battered by deflation and collapsing energy prices boosted both U.S. stocks and bonds. Looking forward into 2015, our expectations are that both Treasuries and U.S. stocks should enjoy gains during the first half of the year. We would still expect to overweight equities in the portfolio, as bonds continue to have a poor risk-return profile. For the quarter, the iShares Barclays 7-10 Year Treasury ETF (IEF) and a new entry to the portfolio, the iShares Russell 2000 (IWM), were the top contributors. Small cap stocks underperformed the S&P 500 for all of 2014, but they enjoyed a strong fourth quarter. The top detractors were the SPDR S&P 500 ETF (SPY) and the iShares Russell Midcap (IWR).

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### Alternative Opportunity

| SECURITY | TICKER | WEIGHT |
|---|---|---|
| Neuberger Berman Absolute Return Multi-Manager | NABIX | 10.00% |
| Neuberger Berman Long Short Inst'l | NLSIX | 10.00% |
| BlackRock Global Long/Short Credit Instl | BGCIX | 10.00% |
| iShares S&P 100 Index ETF | OEF | 8.00% |
| iShares Core S&P Mid-Cap ETF | IJH | 8.00% |
| 361 Managed Futures Fund I | AMFZX | 6.00% |
| S&P Oil & Gas Exploration & Production SPDR | XOP | 5.00% |
| Barclays High Yield Bond SPDR | JNK | 5.00% |
| iShares iBoxx $ High Yield Corp Bond | HYG | 5.00% |
| iShares MSCI EMU | EZU | 5.00% |
| iShares Russell 2000 | IWM | 5.00% |
| iShares Barclays 20+ Year Treasury | TLT | 5.00% |
| Barclays Convertible Securities SPDR | CWB | 4.00% |
| VelocityShares Inverse VIX Short-Term | XIV | 4.00% |
| iPath DJ-UBS Grains ETN | JJG | 3.00% |
| iPath DJ-UBS Livestock ETN | COW | 2.00% |
| Cash | | 5.00% |

The Alternative Opportunity portfolio contains a well-diversified mix of themes which breaks down as follows: Alternative-Oriented Mutual Funds 36.0%, Tactical Global Equity 35.0%, Fixed Income 19.0%, Commodities 5.0%, and Cash 5.0%. The portfolio's mutual fund holdings are longer-term allocations that target proven and respected managers that have disciplined approaches toward a number of areas: long/short U.S. equities, long/short global fixed income, alternative asset manager selection, and managed volatility. Each of these managers are conscious of managing volatility and potential downside in their methodologies. Within the rest of the portfolio, we take a targeted and tactical approach to managing equity, fixed income, and commodity exposure. The fourth quarter of 2014 was a difficult one for Alternative assets, as the market's shunning of risk led to more losses than gains. The portfolio's U.S. equity components produced gains, but its credit-oriented fixed income allocation struggled when energy bonds in particular were hit hard. Commodities in particular were simply crushed by a collapse in oil prices and fears of deflation in Europe. Though the portfolio underweighted commodities as an asset class, we did wade unsuccessfully into the commodity equity space a few times. The portfolio's top contributors were among U.S. equities, highlighted by the iShares Russell 2000 ETF (IWM) and the iShares S&P 100 ETF (OEF). Detractors included the JPMorgan Alerian MLP ETN (AMJ) and iPath Bloomberg Cocoa ETN (NIB). Looking forward into 2015, we expect to continue to emphasize U.S. equities and credit-oriented fixed income, areas which we believe should fare well if the Fed does raise interest rates at mid-year, as many expect.

## Fixed Income Total Return

| SECURITY | TICKER | WEIGHT |
|---|---|---|
| iShares Barclays 7-10 Year Treasury | IEF | 17.00% |
| iShares Barclays 3-7 Year Treasury | IEI | 16.00% |
| BlackRock High Yield Bond | BRHYX | 16.00% |
| Invesco High Yield Y | AHHYX | 6.00% |
| Lord Abbett High Yield Y | LAHYX | 6.00% |
| Neuberger Berman High Income Inst'l | NHILX | 6.00% |
| Cash | | 33.00% |

Weakness in the fixed income credit markets that began to manifest in the third quarter continued into the fourth quarter. On October 10th the Fixed Income Total Return (FITR) model became fully defensive, and the portfolio has taken a generally defensive stance since then amidst some increased market volatility. Overall the defensive stance has served investors well as two thirds of the portfolio has been in U.S. Treasuries or cash since October. Since our exit of High Yield Bonds on October 10th, High Yield prices have continued to weaken amidst volatility, largely due to the collapse in oil prices and fears about the fiscal capacity of energy companies. The portfolio had an overall cautious stance because we never saw enough sustained High Yield price strength and thus watched largely from the sidelines. However, one third of the portfolio did alternate between U.S. Treasuries and High Yield Bonds, moving into U.S. Treasuries and then back to High Yield bonds twice during the quarter. Certainly our portfolio team was concerned with the FITR model struggling with volatility during the fourth quarter, moving a portion of the portfolio in and out of high yield more than has been its usual pattern. We were reassured, however, that the portfolio remained at least two thirds out of the high yield bonds for most of the quarter during a time when volatility was elevated. The primary goal of the FITR model has always been to capture and/or avoid large moves in relative strength between High Yield Bonds, U.S. Treasuries, and cash. A generally defensive stance during the quarter certainly appears justified, and thus we believe that our model is successfully fulfilling its mission. The top two contributors to return for the quarter were two High Yield Bond funds: Lord Abbett High Yield (LAHYX) and Eaton Vance Income Fund of Boston (EIBIX). The primary High Yield ETFs used in the portfolio, the iShares iBoxx High Yield Corporate Bond ETF (HYG) and the Barclays High Yield Bond SDPR (JNK), were the top detractors.

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## Sentry Managed Volatility Portfolio

| SECURITY | TICKER | WEIGHT |
|---|---|---|
| Navigator Sentry Managed Volatility Fund | NVXIX | 95.00% |
| Cash | | 5.00% |

Hedging equity exposure during a bull market when the S&P 500 is up over 13% on the year is difficult and ultimately a losing endeavor – all one can do is responsibly manage the cost of hedging while maintaining a minimal hedge required to safeguard client assets. Under these circumstances, the Navigator Sentry Managed Volatility fund is a net loser in client portfolios, waiting for its day when protection will shine.

Our strategy and tactics towards managing volatility changed during the quarter, and we believe for the better. The core of our protection strategy will be using S&P 500 put spreads, usually putting on spread trades that are 2% and 7% or 3% and 8% below the S&P 500's price level at the time of execution. By both owning puts and then writing puts at a lower level, we are able to greatly reduce the cost of equity portfolio protection. During the quarter, we then moved in and out of these put spread trades, attempting to cash in on what are most often fleeting gains in volatility. Our policy in this portfolio continues to be to maintain a core protective position for client assets at all times, and we intend to use put spreads as this protective vehicle going forward. Maintaining a constant protective position of course has a cost, and much of the portfolio's other activity is devoted to attempting to minimize the cost of hedging. To do that, the portfolio has placed put spread trades on the iPath S&P 500 VIX Short-Term ETN (VXX), looking to slowly and gradually earn profits by taking advantage of the huge cost of owning volatility when markets are up or even flat. Finally, when volatility has spiked up and we sense extreme pessimism and panic have taken over the markets, the portfolio will attempt to monetize the portfolio's cash and tactically short volatility using the VelocityShares Inverse VIX Short Term ETN (XIV). During the quarter, we executed such a trade once, between October 15th and October 21st.

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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 U.S. & Canada.

These portfolio holdings and weightings reflect portfolio models that may or may not have changes since publication. Actual client holdings and weightings may or may not differ. Performance since position initiated reflects the performance of security from the closing price of the day before the initial purchase date. This performance does not reflect actual performance of any actual client position or account. In addition, performance does not reflect total performance of a specific position as allocations are often reduced or increased. This performance does not reflect the deductions of any fees. For information on fees see the Form ADV Part 2A Appendix 1 Wrap Fee Brochure for Unified Solutions. This research has not been reviewed by FINRA. The S&P 500 Index is an unmanaged market capitalization weighted index of 500 common stocks chosen for market size, liquidity, and industry group representation to represent U.S. equity performance. It represents approximately 75% of the U.S. equities market. Index returns do not reflect fee deductions. Benchmark index performance provided by Bloomberg and includes dividends. It is not possible to make an investment directly in any index.

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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.

CCM-508