Clark Capital MANAGEMENT GROUP

Navigator® Fixed Income

Jamie Mullen, Senior Portfolio Manager

Fourth 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.

WORLD YIELDS RATCHET LOWER

The Year in U.S. Treasury Interest Rates

	3/31/14	6/30/14	9/30/14	12/31/14
2 year	0.42%	0.45%	0.57%	0.66%
5 year	1.71%	1.63%	1.75%	1.65%
7 year	2.30%	2.13%	2.20%	1.97%
10 year	2.71%	2.53%	2.49%	2.17%
30 year	3.55%	3.36%	3.16%	2.75%

Source: Bloomberg

There Is Still an Argument for Owning Fixed Income in the U.S.

QE ended in the fourth quarter of 2014 and the bull market in bonds continued for another year.

Two year yields increased another 9 basis points in the fourth quarter while five year rates rallied 10 basis points. A strengthening U.S. economy versus Europe and Japan has resulted in a strengthening U.S. dollar. The decline in the euro and the yen has been an added benefit to the higher relative rates of buying U.S. Treasuries.

In previous updates I have said that the unintended consequence of the end of QE and the Fed attempting to raise short term rates could be a flattening yield curve. As we end the year that is exactly what is happening. Besides U.S. interest rates being relatively attractive compared to global alternatives, there is an added benefit of holding treasuries in U.S. dollars versus other currencies that are declining. So the 33 year U.S. bond bull partied again on the trading desks around the world. It looks as if the bull theme will continue in 2015 but perhaps at a more subdued level.

Executive Summary

U.S. Yields Attractive: Commodities prices are falling and keeping inflation low, allowing bonds to rally.

Europe Slows: Interest rates continue to fall in Europe causing the euro to drop in value against the dollar.

Oil Sell-off: Oil Sell-off is the consumers' gain but high yield's pain.

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European Growth Continues to Slow

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

Global Government Bonds as of 12/31/2014

	5 year		10 year	
	9/30	12/31	9/30	12/31
France	0.33%	0.16%	1.28%	0.82%
Germany	0.14%	0.01%	0.94%	0.53%
Italy	1.02%	0.93%	2.33%	1.87%
Spain	0.89%	0.86%	2.13%	1.59%
Portugal	1.71%	1.43%	3.15%	2.65%

Source: Bloomberg

Not shown on this global interest rate chart is that the German two year rates remained negative for the entire fourth quarter of 2014 after turning negative on August 25. The European Central Bank has stated that it wants to bring its balance sheet back up to early 2012 levels, which would be about a 1 trillion euro increase. Draghi needs to bring something to the table in 2015 to stimulate growth or the euro will continue its decline.

The Taxable Portfolios

The fourth quarter was most notable for the collapse in oil prices in December. High yield credit spreads widened out against U.S. Treasuries. As redemptions occur in high yield ETFs, they pretty much sell the whole index basket into the market place regardless of credit quality. This causes valuation spreads to become disrupted and provides opportunities for new security selections in the portfolio.

Energy was the hardest hit sector as that accounts for a large part of the high yield market. Other factors causing weakness in high yield energy were tax selling and lack of liquidity typical for bonds at year-end. Our analysis of some energy credits resulted in sales to pare back our exposure in that sector.

The Tax Free Portfolios

We continued to add to our holdings in AA credits with 4% coupons in 15 to 20 years. There were several notable new issues that came to market in the fourth quarter. New Jersey Transportation Trust Fund and New York State Thruway issues were well received as single A rated credits. The AAA-rated $1.58 billion Texas Transportation deal at the beginning of December was especially well received by investors. The highlighted state general obligation issue was the $575 million Hawaii deal. Hawaii has not come to market very often and is typically a specialty name that trades with a lot of liquidity.

The U.S. economy has steadily, albeit slowly, recovered from the 2009 lows in GDP. During this time, states and local municipalities have made sufficient adjustments to their budgets. We believe this can translate into credit improvement as a continued theme over the next few years.

So looking forward, we could see interest rates that continue to stay lower than people would like, and 10 year bond prices with a "1 handle" on them before we ever move above 2.5%.

TThe 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 freefloat-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.

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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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.

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