ClarkCapital MANAGEMENT GROUP

Navigator® Global Opportunity

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First Quarter 2015 — Portfolio Commentary

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John serves as a Portfolio Manager on the Navigator Global Opportunity management team, focusing on trend and risk analysis, and is a member of the Clark Capital Investment Committee. John has over 20 years of experience in the investment advisory business. Prior to joining Clark Capital in 2011, John spent 15 years at Wachovia Securities and its predecessor firm Wheat First Butcher Singer, where he spent his last two years managing the Absolute Return ETF portfolio. John holds a degree in Economics from Millersville University and pursued graduate studies in economics at Lehigh University, with an emphasis in Econometrics. He is a Certified Financial Planner (CFP®) licensee and a Chartered Financial Consultant (ChFC) with the American College. He is also an Affiliate of the Market Technicians Association, a professional organization of market analysts, and is currently studying for Level III of the Chartered Market Technician's examination.

EQUITY MARKETS GOING NOWHERE FAST

Executive Summary

- In the last four months, the U.S. equity markets have been trading in wide 5 to 7% swings with virtually no gains since Thanksgiving.
- The Global Opportunity portfolio experienced a negative divergence in relative performance from the S&P 500 for the quarter. However, we have been here before. In 2014, we experienced a similar negative divergence and subsequently outperformed the S&P 500 for that year.
- Increasing currency volatility remains a major source of macro risk in global markets today.
- The market may be about to test Chairman Yellen for the first time.

It's hard to believe the equity markets have gone nowhere since Thanksgiving. One must consult a chart to see the S&P 500 was trading at 2075 the day after Thanksgiving, yet only closed the first quarter at 2068. In the interim, we experienced multiple 5 to 7% trading ranges. Now that is going nowhere fast.

In our last commentary, we went into depth describing our two-step investment process:

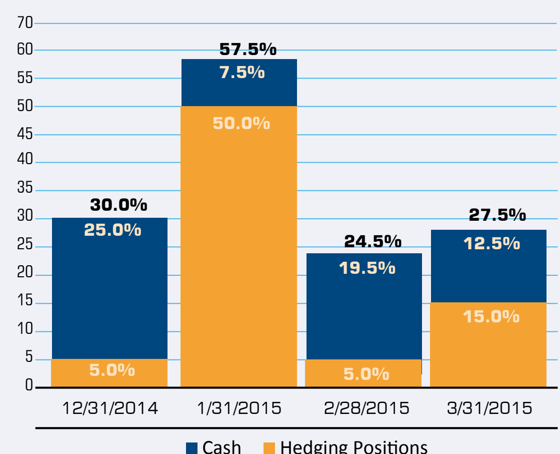
- **Step 1:** Evaluate and establish the level of macro risk in the broad market and set the portfolio's overall allocation to risk based and defensive positions accordingly.
- **Step 2:** Select risk based assets based upon relative strength analysis, comparing all investable ETFs against one another.

Step 1 of the Global Opportunity process begins to adjust defensively to early warning signs, while a relative strength only process (Step 2) will give you defensive signals but generally later in the drawdown. As we had said, this is good and bad depending on the nature of the trend.

The sideways trending movement since Thanksgiving has presented to our process the most challenging set of trend characteristics. Over this time, we have had five swing ranges of 5 to 7%, with two false breakouts. A false breakout is a move to a new daily high that subsequently fails and trades back into the prior range. (Often fast trend reversals begin with false breakouts.) Consequently, we have been whipsawed by our pattern of trend analysis and internal market data.

These conditions have created a neg-

Defensive Positions (Last Four Months)



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ative divergence in our performance relative to the S&P 500 for the quarter. However, we have been here before. Last year during August through September, we had a similar negative divergence in performance versus the S&P 500; but we continued to follow our process. By the end of 2014, we had outperformed the S&P 500.

One might ask: Why follow this risk management process, and engage in this defensive positioning when the Federal Reserve has been "managing markets"? Given the Fed's implicit put, why subject the portfolio to the disruptions from repositioning?

The best answers to these questions came in a CNBC interview with Kevin Warsh, a former Federal Reserve Board Governor (March 31, 2015). During his interview he made the following points:

- The Fed has made lavish accommodation to the financial markets since 2009.
- Markets are exhausted but the markets still believe that monetary stimulus is important.
- The Fed has been reluctant to roil markets and has kept language and benchmarks for tightening vague. For example, the unemployment rate target has been continuously moved down from 6 ½ to 6 to 5 ½%.
- Therefore, according to Warsh, "the markets think they have the Fed's number, and that is a very dangerous development."

Mrs. Yellen, since becoming Chairman early in 2014, has not been tested yet. This may be the time markets do so.

Mr. Warsh made an additional point regarding the Fed's concern over the fast rise of the U.S. dollar. Although the Fed officially states that the dollar is not a problem to the economy, they have broken one rule that has been followed by the Federal Reserve and the Treasury for the last thirty years. Namely, the Treasury doesn't talk about interest rates, which are the purview of the Federal Reserve; and the Federal Reserve doesn't talk about the U.S. dollar, the purview of the Treasury. The Fed has been actively speaking about the dollar and thereby violating this agreement for the first time in 30 years. According to Mr. Warsh, it demonstrates their deep concern.

We have been stating for over a year that currency issues could become the spark that begins a corrective action in the markets. It's the one fat tail risk the Fed cannot control. Remember, we have not seen a 10% correction since June 2012. A very long time by historical standards.

To conclude, we must continue to follow the data and the process. There is a possibility we could revisit the old highs (S&P 500 target: 2200), but the equity markets will have to begin trending now. However, the underlying technical data is weak and not supportive of further substantial gains from this point in the trend. We will continue to follow our data and process. We will not outsource our risk management responsibilities to the Federal Reserve.

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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 NASDAQ Index is a market-weighted index of all common stocks listed on the NASDAQ exchange.

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 World Index is a freefloat-adjusted market capitalization index that is designed to measure global developed market equity performance.

The MSCI World Index ex. U.S. is a freefloat-adjusted market capitalization index that is designed to measure global developed market equity performance excluding the U.S.

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 MSCI All Country Europe is a freefloat-adjusted market capitalization index that is designed to measure the performance of European equity markets.

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

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 VIX Index is a forward looking index of market risk which shows expectation of volatility over the coming 30 days.

Barclays U.S. Government/Credit Bond Index measures the performance of U.S. dollar denominated U.S. Treasuries and 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 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.

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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