Clark Capital MANAGEMENT GROUP

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navigator® REPORT

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A Pause That Refreshes or the Beginning of Something More?

The past quarter was weak in terms of profit while stocks soared, plunged, soared and plunged again as the markets were buffeted by Federal Reserve monetary policy, European Central Bank policy issues, a strong dollar and weak oil. *The S&P 500 moved at least 1% on 33% of trading days in the first quarter compared to 15% of trading days last year.*

The nine quarter run of gains on the S&P 500 is still intact, although barely. The S&P 500 managed to squeeze out a gain of 0.95% total return during the first quarter. Large cap stocks struggled while small and mid caps did best. The Dow Jones gained only 0.33% total return. The worst individual sectors were Financials which lost 2.05%, Energy lost 2.85% as oil declined another 10.6% and Utilities lost 5.17% over interest rate concerns. The **NASDAQ Composite** got within 22 points of its all-time high of March 10, 2000 while gaining 3.48%. After reaching its high, the index, then very tech-heavy, fell 78% from its peak.

> *"And now we can confirm the secular bull, with bullish implications for annualized returns — and performance versus bonds — for the rest of the decade and beyond."*
>
> — Ned Davis Research

Europe was the stand out with the MSCI EAFE index surging 10.9% for its best quarter since the fourth quarter of 2009. This is the most by which the EAFE index has beaten the S&P 500 since the first quarter of 1998. Among individual countries, Russia did best by gaining 19% after losing 29% last year. Greece was the worst losing 30%.

WILL THE DOLLAR CONTINUE HIGHER?

I was part of a meeting last week with the Global Interdependence Center (GIC) hosted by the National Bank of France in Paris. Our host was Christian Noyer, the Governor of Banque de France. In attendance were several economists from various European countries and the President

SUMMARY

Stock Market

Our year-end target for the S&P 500 stands at 2275 for a 10% gain. This is the third year of the Presidential Election Cycle and since 1945 the S&P 500 has gained an average of 16% during the third year. In addition, over the twelve months surrounding the mid-term election (Oct. before to Oct. after), the S&P 500 has risen all 17 times since 1945 by an average of 17.5%. As I mentioned in the last Report, volatility should increase during this year as we have seen in the first quarter. Corrections of 5% may become more the norm as the year progresses and we are way overdue for a 10% pullback.

Bond Market

As of this moment the bull market in bonds, which began in 1981, is still intact. The chart of the 10-year T-bond shows that interest rates are still declining and prices rising. Rates have been declining for over three decades and stand at generational lows. In the attempt to find yield, investors are flocking to bond mutual funds in record numbers. Over $1 trillion has moved into bond funds since 2009. This could prove disastrous when rates inevitably move higher. Investors looking for yield should investigate our High Yield bond program. We offer an individual account with a ten-year track record and a Mutual Fund where we actively manage the risk spectrum of these bonds. We also offer a Neutral Duration Municipal Bond fund.

of one of our Federal Reserve Banks. The discussions centered on economic policy in the coming years, mostly in Europe and Japan. Areas discussed were the U.S. dollar as it relates to the euro, oil pricing, interest rates, especially the negative rates in Europe, and economic stimulus as in Quantitative Easing which was recently initiated by Mario Draghi of the European Central Bank. These Central Bank meetings are always informative and stimulating and the GIC performs a wonderful service in arranging them. As in most meetings with economists, the discussions are always two sided and predictions are not usually forthcoming. So, participants form their own opinions based on the wealth of knowledge disseminated during these discussions, meaning that the following conclusions are my own.

I remember when the euro was first introduced in 1999 and promptly fell to .85 euro cents to the dollar. That was great for Americans traveling to Europe. The euro then proceeded to rise to as high as $1.68 to 1 euro. Not so good! On my recent trip the euro had fallen to $1.06 to 1 euro which is pretty good. **I believe that the currencies will reach parity by the end of 2016.**

The **U.S. dollar** has been very strong recently, which has some benefits and also causes some problems. **Over the past quarter, the dollar has risen 11% and over the past year by 22% against a basket of other widely used currencies.** This rise in the dollar is the fastest in decades. Dollar strength is due to the fact that European and Japanese economies are in the doldrums, China and other emerging markets are slowing, while the U.S. economy is growing. The International Monetary Fund (IMF) expects the U.S. economy to grow by 3.6% this year. **That being said, I do not think the dollar has much further to go on the upside.** The gains we have seen have been very impressive and further gain could have a deleterious effect on earnings and debt payments.

While it is nice to see the dollar stronger, this strength creates problems for American companies doing business abroad.

U.S. Dollar Index (DXY)

About 25% of profits of companies in the S&P 500 are earned in local currencies which means that the strong dollar cuts into their profits. Also, foreign debt is usually serviced in the country's local currency which, due to dollar strength, has depreciated thereby making the debt service more difficult. This includes China which has more than $1 trillion in dollar denominated debt.

As an aside, massive Quantitative Easing in Japan is finally having an effect. The Japanese index, the nikkei, is about to close above 20,000 for the first time in fifteen years. Talk about longevity, Japan has more than 50,000 businesses that are more than 100 years old, including a 900-year-old sake brewer and a 1300-year-old inn. They are doing something right!

HIGH-YIELD BONDS

We have been positive on High Yield Bonds, sometimes called "junk bonds" for quite some time. These are bonds that do not have an investment quality bond rating of BBB or better. Some say that a High Yield Bond is Equity in bond clothing. There is some truth in this as these bonds tend to

10 Year T-Bond Yield

move more in step with equities than with other bonds. Interest rates have been very low for a very long time as the Fed (Federal Reserve Bank) has kept them low as the economy recovered from the last massive recession. It is inevitable that the Fed will raise interest rates at some time in the future. Most Analysts were initially expecting a rate increase at the June Fed meeting. It is now believed that a recent disappointing new jobs number has delayed that increase until at least September, and I believe it will not be this year at all. In general, bonds have been in a bull market since 1981 when interest rates peaked at about 16% on the 10-year T-bond. In other words, bond prices have been moving higher since 1981 as rates have declined. The chart above shows the decline in bond yields over this time frame. At some point that bull market in bond prices should come to an end and a bear market will begin.

We believe this decline will eventually reverse, and investment grade bonds will suffer losses. But will High Yield Bonds suffer the same losses? There have been four times since 2005 when the yields on the 10-year Treasuries have risen more than 1%. That equates to a decline in Treasury bond prices. **The average return of the Barclays Corporate High Yield Index was 20.76% positive while the 10-year Treasury bond declined an average of -6.95%.** So, as you can see, not all bonds react the same to interest rate change.

It is inevitable that rates will move higher in the near future. In our opinion, most bonds, especially longer term bond mutual funds, will suffer losses while High Yield Bonds will have positive returns.

K. Sean Clark, our Chief Investment Officer, has written a report titled "Five Reasons to Hold High Yield in 2015." This report is available on our website blog (blog.ccmg.com). Just scroll down to the article.

A SECULAR STOCK MARKET

For some time this Report has been discussing "secular" and "cyclical" bull market terminology.

Ned Davis, of Ned Davis Research has formally classified the current market as "secular" in a report titled *"A Secular Bull for Six Years — Many More to follow?"* The report provides extensive reasoning behind his opinion. The Merriam-Webster dictionary defines the adjective "secular" as "relating to a long term of indefinite duration."

As you know from this report, all secular (longer term) bull markets are made up of cyclical (shorter term) bull and cyclical bear markets. There has been one cyclical bear market so far in this secular bull market as discussed in the fourth quarter 2014 *Navigator Report*. It occurred from May to October in 2011 and the S&P 500 lost 22%.

There have been three prior long term, or secular, bull markets since 1900. They began in 1921, 1942, and 1982.

The 1921 secular bull lasted for eight years ending in 1929. There was one cyclical bear where the market declined by 19% in 1923. Following that short term bear, the cyclical bull appreciated by 345% to become the largest cyclical bull market of the 35 since 1900. Of course, the panic of 1929 ended that Bull Run.

The 1942 secular bull was to become the longest in history and lived for 24 years but not without some serious scares. There were six short-term bear markets during the 24-year reign. Four of these corrections, or short-term cyclical bears, were less than 20%, but two were between 20% and 31%. I believe that a 31% decline today would scare the pants off many investors.

The most recent, except for the current bull market, began in 1982 and lasted until 2000. This Bull Run included three short term bears with the most memorable being the 1987 one day crash. That cyclical bear caused a 36% decline. That entire decline occurred in 55 days and other short term declines during that 18 year run were 16% and 21%.

One common thread runs through all four secular bull markets including the present one which began in 2009 and is now six years old. That thread is a double digit return for the first six years. Those returns are 19.7%/year, 11.7%/year, 17.4%/year and today's 18.3%/year.

By historical standards our current bull market could potentially run many years if it follows the three prior bull markets, which lasted 8, 24, and 18 years.

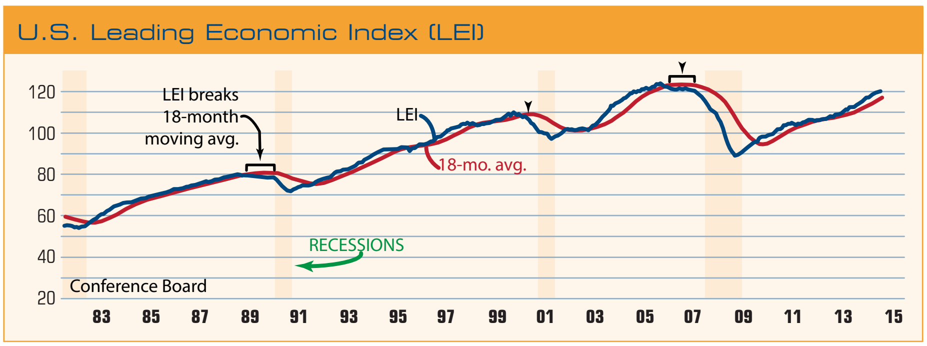
But this is no time for complacency. We could, and most likely will, have a short term bear at any time and while most cyclical bears are less than 20%, some reach the 30% level. In addition, 10% corrections come along quite regularly, usually every 18 months. It has been 42 months since the last 10% correction so one is expected at any time now. A buying opportunity?

If you are wondering what happened between the three long-term bulls, the answer is long-term secular bear markets. They lasted 13 years, 14 years, and 9 years.

You also might be wondering what factors cause a new secular bull to begin as well as what causes a new secular bear to begin? The easy answer is fear and greed. New bull markets are born of a transition from panic level valuations and economic fear to the realization that economic growth is resuming. Long-term bear markets are born of greed, in which every investor is involved, valuations are through the roof and expectations are that the good life will go on forever. The key today is that no one believes that the current bull can or will continue. **The public is still not even looking at the market as the place to put their money.** Retail investors have actually pulled $429 billion out of stock mutual funds since the rally began in 2009. The bubble mentality that has been present at all other major market tops has not even begun to develop yet. Does this mean we are safe? No! Caution is always advised and a short-term bear could develop at any time.

THE ECONOMY

The economy appears to be on solid footing as shown in the chart below from Jim Stack and InvesTech Research. Since the late 60s the lead time from when the Leading Economic Indicators (LEI) peak to a recession has been at least eight months. Yes, the stock usually leads recessions by several months but in our opinion, there is absolutely no sign of recession anytime soon.



Overall, the job market is strong even with the disappointing 126,000 jobs added in March[1]. The economy is creating jobs at an average of more than 250,000 per month. Employment growth is the best it has been in 15 years and there are signs that wage growth is on the horizon.

Corporate earnings are expected to fall for the first time since the third quarter of 2009 for several reasons. The strong dollar is causing many multinationals to lose money on business abroad while the drop in the price of oil is wreaking havoc on the Energy industry. The Energy sector is expected to post a 63% year-to-year decline in earnings. Overall estimates for S&P 500 earnings are for a decline in the second quarter of 0.6% before picking up to gains of 2.2% in the third quarter and 6.3% in the fourth. Without Energy the S&P 500 should show growth of 5.4% in the first quarter. Annual profit growth, excluding Energy has been running at 8.5%. A temporary slowdown in corporate earnings should not derail the current bull market but potentially could lead to the 10% correction that is way overdue.

1. Bureau of Labor and Statistics

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