Clark Capital MANAGEMENT GROUP

Navigator®
Fixed Income Total Return

K. Sean Clark, CFA, Chief Investment Officer

Second Quarter 2015 — Portfolio Commentary

K. Sean Clark, CFA
Chief Investment Officer

As Clark Capital's Chief Investment Officer, Sean oversees all of the Firm's investment activities and heads the Firm's portfolio team. Sean joined the Firm in 1993 and is responsible for asset allocation and investment selection for Navigator Investment Solutions as well as directing ongoing market research and contributing to the development of proprietary products. Sean is a member of the Clark Capital Board of Directors, the Investment Committee and the Management Committee. He graduated from the University of Delaware, earning a B.S. and an M.A. in Economics. Sean is a Chartered Financial Analyst and a member of the CFA Institute (formerly AIMR) and the Financial Analysts of Philadelphia, Inc. Sean is considered an industry expert and is often asked to appear on CNBC and Bloomberg television to share his views on the market. In addition, Sean has been featured in a number of articles in nationally distributed business journals and newspapers.

STAY WITH CREDIT

Executive Summary

Setting Sights on Rate Hikes: The Federal Reserve has signaled a desire to hike rates in the second half of the year and an improving economic landscape in the U.S. supports the view that rates are set to rise.

Credit Spared During June Volatility: Bonds with any duration risk got hit hard in mid-June while credit exposure, in particular lower credit quality bonds, held up quite well.

Credit with a Caveat: As an asset class, high yield bonds are experiencing stronger fundamentals and less leverage, except in the energy sector which is clearly under stress.

The U.S. and global stock and bond markets faced several obstacles in the first half of the year. We entered the year with the U.S. market overvalued and earnings expectations a bit aggressive. The plunge in oil prices and its impact on capital expenditures and oil company earnings sent earnings expectations plunging throughout the first six months as analysts were forced to look reality in the face given a 60% drop in oil prices, a 12-year high in the U.S. Dollar Index, and a 0.2% contraction in U.S. real GDP. The flow of negative news came on top of the uncertainty over if and when the Federal Reserve would raise short-term interest rates for the first time since 2006, over whether or not Greece would default, and over gyrations in Chinese equities and policy responses.

The global markets turned volatile in the second quarter as the Greek crisis hit another boiling point and the bubble that was Chinese stock prices got deflated. Up until now we have seen volatility in commodities, currencies, and fixed income. The next logical spot for volatility to land was in equities, and it began to be a factor just as the quarter was closing and most of Wall Street was hoping for a relaxing vacation. The relaxing vacation was not to be as global markets became uneasy at the prospect of Greece defaulting and leaving the euro and Chinese investors seeking the exit door at the same time.

Bond investors that have not focused on high yield debt haven't fared so well this year. The Federal Reserve has signaled a desire to hike rates in the second half of the year and an improving economic landscape in the U.S. evidently supports the view that rates are set to rise. Yields have risen as it became apparent that the Federal Reserve will lift interest rates this year for the first time since 2006. The 10-year Treasury yield bottomed in early February at 1.67% and rose to a high of 2.48% in mid-June, before settling at 2.34% on June 30th. Bonds with any duration risk got hit hard while credit exposure, in particular lower credit quality bonds, held up quite well. The Barclays Capital Long-Term Treasury Index plunged 8.30% for the quarter and lost 4.67% for the first six months, its worst pre-election year start since 1999. The Barclays Aggregate Bond Index fell 1.68% during the quarter and is down 0.10% through the first six months. Meanwhile, lower quality debt, with its higher yield and economic sensitivity has performed well. The Barclays High Yield Index was unchanged for the quarter and is up 2.53% year to date.

Past performance is not indicative of future results.

This is not a recommendation to buy or sell a particular security. Please see attached disclosures.

Q2 Portfolio Analysis & Performance

Top Contributors

- Lord Abbett High Yield Bond
- BlackRock High Yield Bond

Top Detractors

- iShares iBoxx $ High Yield Corporate Bond
- Barclays High Yield Bond SPDR

Early in 2015, on January 12th, the Fixed Income Total Return portfolio allocated 100% to high yield bonds using a combination of high yield mutual funds and ETFs. Since then our models have remained positive on high yield bonds and indeed made new highs for most of the second quarter. Lately, while headlines have focused on Greece and China-related volatility, within high yield the volatility has been centered around energy stocks. The collapse in oil prices has put the focus on oil and gas drillers and explorers, many of whom have financed via high yield debt. Their bonds continue to decline and indicate severe stress. However, we have found the market's fears to so far be isolated within the energy sector. Other sectors are not showing signs of severe stress, and in fact, the recent U.S. economic strength indicates that fundamentals and leverage are improving. Thus, while we are watching the energy situation closely, our overall view on high yield bonds remains a bullish one. During the second quarter, high yield enjoyed strong performance in relative terms. While high yield bond prices were largely unchanged, interest rates increased and most bonds declined. The iShares Barclays Aggregate Bond ETF (AGG) declined 2.4% and the iShares Barclays 7-10 Year Treasury ETF (IEF) declined 3.1%. Past history has indicated that high yield bonds outperform during times of rising interest rates, and the second quarter provided an example of just what that can look like. High yield bonds, despite their credit risk, can be quite defensive during bond bear markets. Two bond mutual funds, Lord Abbett High Yield Bond (LAHYX) and BlackRock High Yield Bond (BRHYX) were the top contributors on the quarter, while high yield bond ETFs (HYG and JNK) were the largest detractors.

Outlook

We believe the U.S. economy is set to accelerate from the first quarter slowdown in which it declined at a 0.2% annual rate. Employment growth has been solid with the economy adding jobs for 57 consecutive months. Over the past year and a half the economy has created an average of 242,000 jobs per month[1]. In addition, leading indicators of the economy continue to advance, with the Conference Board's Index of Leading Indicators soaring to new highs. That suggests continued economic growth with no recession on the horizon. Of course, we need to be vigilant in watching for signs of weakness. The Federal Reserve will likely begin hiking interest rates this Fall. When the Fed does finally hike rates, it will have been the most telegraphed move in Federal Reserve history. The mantra out of the Fed had been "lower for longer" but that now seems to have changed to "slower but sooner." Fed Chair Yellen recently told the House Financial Services Committee that "If we waited longer, it certainly could mean we have to do [hikes] more rapidly." She also said, "An advantage of moving earlier may be that we can have a more gradual path of rate increases." And that moving slowly after nearly seven years of near-zero rates "strikes me as a prudent approach to take." [2]

While Fed-speak is always changing with current economic events, we think investors should stay focused on the moderate GDP growth in the U.S. economy as it's beneficial for high yield companies. As company earnings grow, default risk falls, leading to tighter credit spreads. The continued strength in U.S. corporate balance sheets should support the credit-related sectors over time. Given this fundamental health, we believe that the income advantage provided by high yield bonds remains relatively attractive. We shouldn't fear the Fed raising rates — history suggests high yield bonds can perform well in rising rate environments — as much as we should fear the potential for a slowing economy. The current economic expansion is aging, but the fundamental signs we see from companies are still robust. A good economy leads to better corporate earnings and tighter credit spreads, which benefits high yield returns. Fund flows around the credit sectors of fixed income have been volatile. We view this volatility in investment flows to be driven more by investor emotions than changing fundamental factors.

Our models continue to favor high yield bonds, and they strengthened thier position toward high yield bonds throughout the quarter. While our analysis indicates that, as an asset class, high yield bonds are experiencing stronger fundamentals and less leverage, that does not appear to the case in the energy-related high yield bonds, which are clearly under stress. As of now, the global collapse in oil prices does not appear to be affecting the broader U.S. economy, and we believe that our position in high yield bonds will remain firm in the near future.

1. U.S. Bureau of Labor Statistics.
2. Mullaney, Tim. Yellen Defends 'Soon and Slow' Approach to Rate Hikes in Congress. The Street, July 15, 29015. (Retrieved from http://www.thestreet.com/story/13219615/1/yellen-defends-soon-and-slow-approach-to-rate-hikes-to-congress.html)

Past performance is not indicative of future results. This is not a recommendation to buy or sell a particular security. Please see attached disclosures.

The opinions expressed are those of the Clark Capital Management Group Investment Team. The opinions referenced are as of the date of publication and are subject to change due to changes in the market or economic conditions and may not necessarily come to pass. There is no guarantee of the future performance of any Clark Capital investment portfolio. Material presented has been derived from sources considered to be reliable, but the investment singular accuracy and completeness cannot be guaranteed. Nothing herein should be construed as a solicitation, recommendation or an offer to buy, sell or hold any securities, other investments or to adopt any investment strategy or strategies. For educational use only. This information is not intended to serve as investment advice. This material is not intended to be relied upon as a forecast or research. The investment or strategy discussed may not be suitable for all investors. Investors must make their own decisions based on their specific investment objectives and financial circumstances. Past performance does not guarantee future results.

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 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 free float 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 CBOE Volatility Index (VIX) is a forward looking index of market risk which shows expectation of volatility over the coming 30 days.

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.

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 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 B of A Merrill Lynch U.S. High Yield Index tracks the performance of below investment grade U.S. dollar-denominated corporate bonds publicly issued in the U.S. domestic market.

The Barclays 7-10 Year Treasury Index tracks the investment results of an index comprised of the U.S. Treasury bonds with remaining maturities between seven and ten years.

The Barclays 20+ Year Treasury Index tracks the investment results of an index comprised of the U.S. Treasury bonds with remaining maturities greater than twenty years.

The Barclays Long-Term Treasury Index tracks the performance of the long-term U.S. government bond market.

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 U.S. Treasury Bond Index is an issuances-weighted index measuring the performance of the U.S. Treasury bond market, one of the largest and most liquid government bond markets in the world.

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.

Returns are presented gross of investment advisory fees and include the reinvestment of all income.

Gross returns will be reduced by investment advisory fees and other expenses that may be incurred in the management of the account. For example, a 0.50% annual fee deducted quarterly (.125%) from an account with a ten year annualized growth rate of 5% will produce a net result of 4.4%. Actual performance results will vary from this example. The Firm's policies for valuing portfolios, calculating performance, and preparing compliant presentations are available upon request.

Clark Capital Management Group, Inc. is an investment adviser registered with the U.S. Securities and Exchange Commission. Registration does not imply a certain level of skill or training. More information about Clark Capital's advisory services and fees can be found in its Form ADV which is available upon request.

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. Clark Capital Management Group, Inc. reserves the right to modify its current investment strategies and techniques based on changing market dynamics or client needs. It should not be assumed that any of the securities transactions, holdings or sectors discussed were or will prove to be profitable, or that the investment recommendations or decisions we make in the future will be profitable or will equal the investment performance of the securities discussed herein.

CCM-505