Clark Capital MANAGEMENT GROUP

Navigator® Global Opportunity

John E. Clark, IV, CFP®, Portfolio Manager

Second Quarter 2015 — Portfolio Commentary

THE PRICE OF PRESERVING THE STATUS QUO

"There are economic laws like there are physical laws and, as with physical laws, economic laws do not yield to political will . . . . It does not follow that governments can bring about economic outcomes they prefer by fiat."

Lawrence Summers, former U.S. Treasury Secretary

This statement by Larry Summers, from a recent *Financial Times* commentary,[1] caught us by surprise. Not only because Mr. Summers is the consummate political operator, who should believe in the power of governmental fiat, but because he questions the wisdom of our current problem solving approach. Not a position one would expect from one of the political elite. His message: Incremental actions to preserve the status quo, which do not correct fundamental problems will ultimately fail. To further paraphrase Mr. Summers, when the arithmetic doesn't add up and confidence leaves, then financial problems ensue.

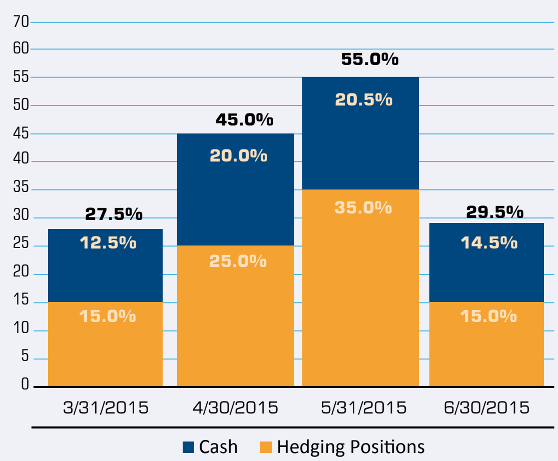
Executive Summary

- Global crisis solutions (especially Greece) continue to follow an incremental "band-aid" approach rather than addressing fundamental causes of imbalances.
- Increasing currency volatility persists in global markets today.
- For the last thirty weeks, the U.S. equity markets have been trading in a struggling sideways pattern with virtually no gains since last Thanksgiving. There is a possible alternative path for US equity markets.

We live in a world where central banks still enjoy the confidence of investors. Some have called this the "Age of the Central Bankers." They've created ZIRP (Zero Interest Rate Policy), and so many QEs (Quantitative Easings) that we need numbers to track them. They have become the de facto economic policymakers in our world. But what fundamental problems have been solved?

A Greek debt deal: what fundamental problems can be solved by debt restructuring and imposing additional austerity? Notwithstanding whether Greece is a victim of its own bad economic policies, if Greece is precluded from loosening monetary policy and devaluing its currency, what chance do they have of resurrecting their economy? After more than a 20% decrease in Greek GDP, austerity policies could conceivably push Greece into depression.

Defensive Positions (Last Four Months)



Past performance is not indicative of future results.

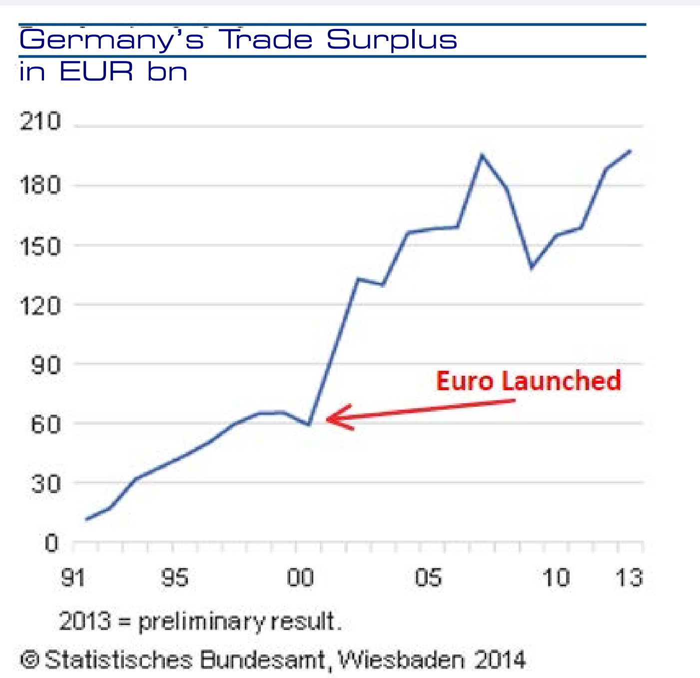
This is not a recommendation to buy or sell a particular security. Please see attached disclosures.

John E. Clark, IV, CFP®
Portfolio Manager

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.

1. Summers, Lawrence. "Complacency and incrementalism are traps to avoid." Financial Times, July 12, 2015

Aside from some short term eurozone prosperity, the euro has primarily helped German industry through the currency depressing effect of the weaker eurozone countries (i.e., Portugal, Spain, Italy, Ireland and Greece). In the chart below, one can see how Germany's trade surplus has dramatically grown since the launch of the euro. German export growth of this magnitude would have been difficult to achieve under the old deutschmark currency regime. The eurozone's problem is that there are no equilibrating mechanisms, such as common fiscal policy. So a Greek debt resolution doesn't address this fundamental problem. The status quo is preserved and global and intra-eurozone imbalances grow.



As an aside, the euro currency has been so successful for German industry, that Germany has recently surpassed China and has the largest trade surplus (as of 2013). In 2006, China was the "trade surplus bogeyman," being accused of keeping the yuan undervalued, and hence creating an unfair trade advantage for themselves. Since then, the Chinese government has allowed their currency to appreciate by 30%, while endeavoring to expand its domestic consumer markets. This has corrected some imbalances. Additionally, they have encouraged individuals to invest in their domestic equity markets, producing a dramatic blow off up trend. From June 2014 to the June 2015 high, the Shenzhen A Share Index had appreciated by 200% until breaking down in mid-June 2015. Thereupon, Chinese regulators went into large scale damage control: banning short sales, suspending stock trading, etc. Harken back to the SEC ban on short selling of financial stocks on September 18, 2008, following the Lehman Brothers bankruptcy. After this SEC order, most of the market price damage occurred in the following sixty days of trading. Again, government fiat attempting to override economic law. Likewise, the Chinese government has frantically been trying to keep investor confidence alive and preserve one of the greatest growth stories ever engineered.

The overarching message of this discussion is that monetary imbalances are caused by unaddressed fundamental problems; and if these imbalances are not acknowledged and resolved, then markets will eventually force equilibrium to be re-established, usually through crisis.

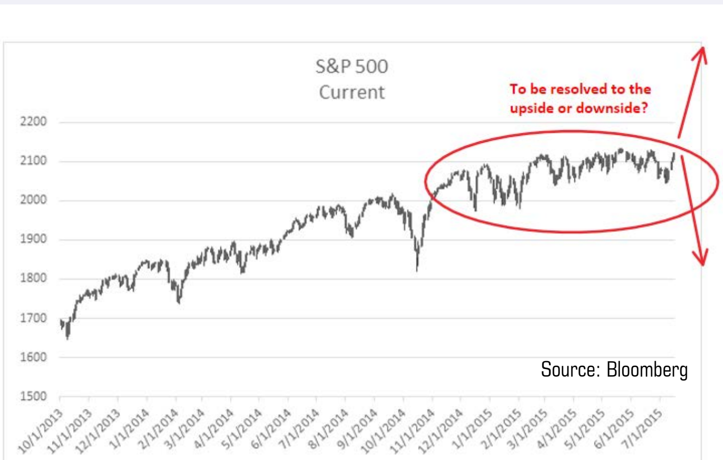
This is the view from 30,000 feet, and one should be aware of this high level perspective. However, we must manage money at ground level. As managers of the Global Opportunity portfolio, we live between these two mindsets: the high-level macro view and the current trading environment. For almost two years in these Commentaries, we have been writing that we expect to see the source of our next crisis come from currency related imbalances. We have begun to see the currency volatility, and indeed, that volatility is becoming a weekly fact of life for us. However, as of yet, we've not seen any price damage in the S&P 500 index exceeding 5%, in spite of the existence of ongoing negative internal divergences within equity markets.

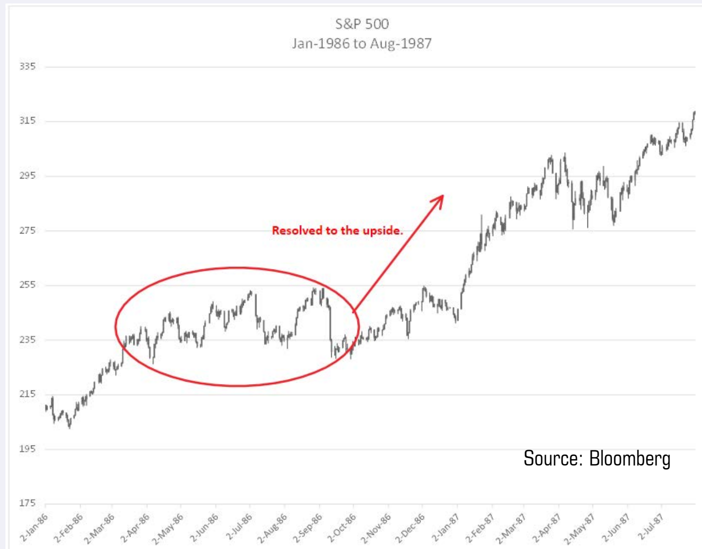
Let's review this quarter ended June 30, 2015 in the context of our process.

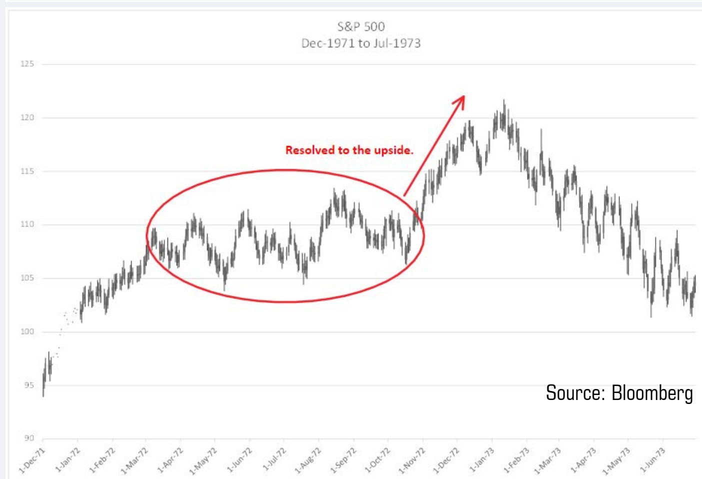
- **Step 1: Evaluate and establish the level of macro risk in the broad market and set the portfolio's overall allocation to risk based and defensive positions accordingly.**
- **Step 2: Select risk based assets based upon relative strength analysis, comparing all investable ETFs against one another.**

Step 1:

Here is how we've executed based on our macro view and trend analysis, referencing our "Defensive Positioning" histogram on the first page. In our first quarter 2015 Commentary, we noted that we have traded in a slightly upward grinding trend since the end of November 2014. At the start of December 2014, the S&P 500 began trading at 2067, and ended this quarter at 2063. A long sideways grind. During this thirty-week period, we've experienced four false upside breakouts and are now working on our second lower high. This type of struggling sideways trending action is a trend follower's nightmare. See the chart S&P 500 Current.







Normally after thirty weeks of this sort of struggling market action, this type of trend will resolve itself to the downside; typically, giving us a fast downward corrective trend. And hence, providing us with a low risk future entry to increase our equity exposure. At the end of March, the portfolio had 27.5% defensive positioning, as we thought there was a possibility for more struggling upside (which occurred). As we came into the May high (2134.28 intraday), we had incrementally increased our defensive positioning to 45% (4/30/15) and then to 55% (5/26/15). As the S&P 500 began to sell off after the May high, we expected to see a fast move down, but instead, the index found price support at a high level (2070) and rallied to a lower high on June 22nd (2129.87 intraday). On June 11th, we had decreased our defensive positioning to 29.5% due to the index finding support at a high level (2070) and the lack of fast downside trending action.

As portfolio managers, we position assets to capture the highest probability outcomes, based upon the existing evidence. Make no mistake about it, there are no certainties in our work, only probabilities. When our high probability scenario did not materialize, i.e., the breakdown of a struggling sideways trend at a multi-year high, then we had to consider the alternate hypothesis. That scenario is a sustained upside breakout, which culminates into an exhaustion high. We have two examples of this happening over the last fifty years: 1972 and 1986 (see charts of the S&P 500, December 1971 to July 1973 and January 1986 to August 1987).

You'll note in both time periods, the circled struggling up trends transpired over the same time durations (six to seven months), as well as on negatively diverging breadth. Transports, like now, were in downtrends during 1972 and 1986. Transports are currently down -14.4% from earlier highs, while in 1972 they were down by -24.3%. Likewise, in 1986, transports declined -17.3%. Utilities also had similar performance profiles to 2015, where we have lost -16.5% in the Dow Jones Utility Average. In 1972, the loss was -13.6%, and in 1986, only a brief -9% drop occurred. So the technical backdrop for these periods appears comparable to today and sufficiently valid.

We have always recognized this scenario of a final upside blow off as a valid possibility, especially due to the Fed's focus on engineering positive market outcomes. (Remember the importance the Fed assigns to the wealth effect.) However, this scenario has not yet been confirmed by price, but we must be aware of it. Therefore, we must be ready to exploit this type of a trend break out if a new high occurs and is sustained, keeping in mind that we have had four false breakouts over the last seven months.

Step 2:

For the remainder of the portfolio, not committed to defensive positions, we have allocated into broader markets ETFs. In higher risk markets, or better said, equity markets with poor trend characteristics, we prefer to keep our position list short and liquid. Broader market ETFs give us needed equity exposure, while allowing us the liquidity to efficiently move out of a position in the midst of adverse conditions. At the beginning of the quarter, our relative strength work had us allocated roughly to 50% domestic equity indices and 25% international equities. As the quarter progressed, we shifted increasingly towards broad international ETFs. By the end of May, we were entirely in international positions (40%). However, by the end of June, we were back to equal weighting between broad domestic and international markets. Fast relative strength shifts are often a condition in markets with poor trending characteristics.

This continues to be the most challenging type of trend environment for our process, but we believe in the end the process prevails, as long as it is applied consistently through time. Why? Because the "Step 1" of our process embodies risk management. In an equity market with virtually no deep or prolonged S&P 500 index drawdowns (10% or more) over the last three years, there reigns a "no risk" complacency mindset among market participants. Severe market corrections and multi-month bear cycles cannot be outlawed by government fiat.

Sources: International Monetary Fund, The Wall Street Journal.

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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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