Clark Capital MANAGEMENT GROUP

Navigator® Fixed Income

Jamie Mullen, Senior Portfolio Manager

Second Quarter 2015 — Portfolio Commentary

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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.

"GREECE" IS THE WORD

Tsipras: "I got debt that's multiplying, and I'm losing control, 'cause the deal that you're supplying, it's terrifying."

Merkel: "You better shape up, 'cause I need a deal, and my heart is set on you."

Eurogroup members: "You're the one that I want, you are the one that I want, Oo, Oo, Oo, the one that I need."

The Year in U.S. Treasury Interest Rates

	9/30/14	12/31/14	3/31/15	6/30/15
2 year	0.57%	0.66%	0.55%	0.64%
5 year	1.75%	1.65%	1.37%	1.65%
7 year	2.20%	1.97%	1.70%	2.08%
10 year	2.49%	2.17%	1.92%	2.35%
30 year	3.16%	2.75%	2.53%	3.12%

Source: Bloomberg

On and on the bailout negotiations continue as the second quarter ends with the financial world focused on bond markets in Greece and Puerto Rico.

The European authorities and Greek officials have failed to negotiate an agreement of further bailout money prior to the expiration of the current bailout program on June 30. When I was a kid it was called a game of "chicken." Two people rode bikes at each other until one swerved away. The one who swerved was "chicken." Now it is called game theory or "the study of mathematical models of conflict and cooperation between intelligent rational decision makers."[1] I guess with derivatives, pensions, jobs, and perhaps a banking system at stake, "chicken" is too simplistic.

The European Central Bank (ECB) is trying to cure the Greece problem with more debt and demands on how the debt will be repaid. "Chicken" is simplistic, but so is the problem, and it is all about bond math or "compounding." Compounding is an irrefutable law of nature, just as gravity is. Compounding is a problem globally as all the central banks have created a massive debt load to try to pump up financial assets such as stocks.

The compounding of the debt load Greece now owes resulted in an amount virtually impossible to pay back. By most estimates, Greece represents 1.8% of the eurozone's GDP. Some people say, let them leave the euro, but that is not the solution and, in my opinion, is the biggest problem. Imagine, if Greece leaves the euro, prints its own money, goes through a crushing depression but emerges in a couple of years with a stronger, vibrant economy, free of the euro debt burden, then what? Some game theorist in Italy, or Spain or Portugal might say, it's our turn to play "chicken."

Everybody now, you know the tune, "You're the one that I want. . . ."

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Global Government Bonds as of 6/30/2015

	5 year		10 year	
	3/31	6/30	3/31	6/30
France	0.05%	0.32%	0.47%	1.19%
Germany	-0.10%	0.07%	0.17%	0.76%
Italy	0.53%	1.24%	1.23%	2.33%
Spain	0.52%	1.12%	1.20%	2.30%
Portugal	0.89%	1.65%	1.66%	2.98%

Source: Bloomberg

European interest rates moved higher in yield after the speculative lows that were reached in the first few weeks of April. The move in European yields was probably a factor in the move higher in U.S. yields. What is not on the chart is that two year interest rates in France, Germany, Sweden, the Netherlands and Switzerland are all still trading at negative yields.

The Portfolios at a Glance:

The Tax Free Portfolios

Municipals had credit headwinds in the quarter. Chicago was downgraded to junk status on May 12 by Moody's to Ba1. Moody's downgrade was based on future pension liabilities. Standard & Poors was not quite as dour on Chicago's prospects, responding with a downgrade from A+ to A- on May 14th. Subsequently, Chicago came to market with a new deal that was viewed as a bargain and traded up quickly in the secondary market. Chicago is an economically vibrant and diversified city. Hopefully, this does not spread to other national names and can be contained as an Illinois event.

The second issue was that after a multi-year struggle with an excessive debt burden, the Governor of Puerto Rico has publicly stated that the Commonwealth cannot pay back its debt and is likely to run out of cash in July. Up until this past Sunday, the market appeared to perceive that Puerto Rico would honor its debts, particularly the general obligation (GO) bonds. Municipal market investors were therefore surprised at the rapid decline from a distressed situation to a potential default. The jolt to the market was due to the sudden write-down in the GO market. The risk to the market is that this may become a tail risk event. Agencies like the Puerto Rico Electric Power Authority debt had been trading in the $50s for some time. The hope is that, since much of the debt is written down, selling pressure will not erupt.

The Taxable Portfolios

The taxable portfolio's investment grade bonds were moving with the Treasury swings during the month of June. High yield, which had held together through the first part of the month, went down in price in the last week of the quarter when Greece and Puerto Rico turned the market to "risk off."

We will turn the page to July 1 with the June unemployment report due out on Thursday July 2nd. Hopefully, it will provide more clarity on the timing of a possible Fed hike. And as darkness falls across the Pond what is that I hear?

Tsipras: "They think our debt is just a growing pain. Why don't they understand ? It's just a crying shame."

Because Greece is the word.

[1]Myerson, Roger B. (1991). Game Theory: Analysis of Conflict. Harvard University Press, p. 1. Chapter-preview links, pp. vii–xi.

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