# YIELDS OF DREAMS . . .
## IF YOU RAISE THEM THEY WILL RISE

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Senior Portfolio Manager

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.

### The Third Time Is the Charm

On December 16, 2015, the Fed finally raised interest rates. After setting up the market for a rate increase in June and September, the Fed finally pulled the trigger and raised rates 25 bps in December. So we have effectively left zero-bound interest rates for the first time since the financial crisis. Future raises will be the hyper-focus of market watchers going forward.

### Rate Increase = Lower Bond Prices

I think many people are under the impression that the rate hikes can be negative for bonds. The U.S. economy is growing slowly, inflation is contained and this economic cycle may be very different than previous cycles. We think the Fed is raising rates just because it doesn't like them at zero and wants to have tools available to stimulate an economy if a global recession moves to our shores.

### Is This CD Heaven?

The million dollar question is: can mom and pop finally look forward to finding some risk-free return and cash flow in short term CDs? Ideally a steep yield curve is what banks and the Fed want. The Fed does not operate in a vacuum. We believe raising rates will slow the economy. The European Central Bank, Bank of Japan, and China appear ready to continue the easy monetary policy into 2016. Thus a real possibility is that the yield curve flattens, stymying investors from extending out and increasing income. In other words, low rates continue.

### Credibility vs Global Growth and Concerns

If you have read my previous market updates, you may recall that I have been in the "lower for longer" camp for years. In our opinion, the Fed waited too long and should have raised rates earlier, perhaps as early as 2014. After not raising rates in June and September, the Fed in December was at risk of losing credibility.

The zero interest rate policy allowed many to refinance at lower interest rates but has also created an explosive debt expansion. Debt is deflationary and this will be figured out in years ahead by economists when they write about QE. Every commodities company was able to borrow at low rates, dig a hole in the ground and try to sell oil, natural gas, gold, copper, etc. This created a global commodities glut and collapsing prices which affect emerging market economies that sell to China.

ClarkCapital MANAGEMENT GROUP

# Navigator® Fixed Income

Jamie Mullen, Senior Portfolio Manager

Fourth Quarter 2015 — Portfolio Commentary

## 2015 in U.S. Treasury Interest Rates

| | 3/31/15 | 6/30/15 | 9/30/15 | 12/31/15 |
|---|---|---|---|---|
| 2 year | 0.55% | 0.64% | 0.63% | 1.00% |
| 5 year | 1.37% | 1.65% | 1.35% | 1.74% |
| 7 year | 1.70% | 2.08% | 1.73% | 2.10% |
| 10 year | 1.92% | 2.35% | 2.03% | 2.29% |
| 30 year | 2.53% | 3.12% | 2.85% | 3.00% |

Source: Bloomberg

The yield curve flattened further in the fourth quarter with 2s to 30s narrowing 22 bps. Global growth concerns are one reason investors seek the safe haven of U.S. Treasuries. It is the general consensus that issuance of notes and bonds will be much lower in 2016 than 2015. I have read some estimates that new issuance may drop below $500 billion, signifying narrowing budgetary needs.

This reduced supply may keep rates capped and the "lower for longer" mantra to stay intact. Also, as you will see, global rates are not attractive compared to the U.S. debt markets. Add in liquidity, new regulations creating demand for T-bills, and the safe haven nature of treasuries, and one can see rates staying contained and not derailing the slow growth economy.

## Income Not Found Overseas in Sovereign Debt

| | 5 year | | 10 year | |
|---|---|---|---|---|
| | 9/30/2015 | 12/31/2015 | 9/30/2015 | 12/31/2015 |
| France | 0.21% | 0.08% | 0.98% | 0.98% |
| Germany | 0.00% | -0.04% | 0.58% | 0.62% |
| Italy | 0.74% | 0.50% | 1.72% | 1.59% |
| Spain | 0.88% | 0.66% | 1.88% | 1.76% |
| Portugal | 1.13% | 1.05% | 2.38% | 2.50% |

Source: Bloomberg

European interest rates again moved lower in the fourth quarter. The German two-year bond turned to negative yields in August 2014 and has traded there ever since. That trend in negative rates has now extended to the German five-year bond. For 60 of the 63 trading days in the third quarter, the German five-year traded at negative interest rates. And the European Central Bank is looking to do more stimulus.

Clearly, one look at these yields and you will see why interest rates in the U.S. are more attractive than those of their sovereign counterparts. Portugal is a junk bond credit with a Moody's rating of Ba1. Banks need U.S. Treasuries for liquidity and AAA paper for their balance sheets and to meet regulatory standards. Insurance companies need yield and investment grade bonds for policy liabilities. There are many market participants that are attracted to Treasuries and we believe the relative attractiveness of U.S. Treasury rates still has great appeal.

## Macro Issues Abound

Consider these issues: Less Treasury supply and increased demand. China and emerging market growth issues. Commodities sinking. Russian tensions with Turkey. The Mideast and ISIS. Refugees and the de-stabilizing issues it poses for the EU countries.

Bond traders can find bad news in anything to bolster a bullish argument for bonds. The simple fact is the market digests all of these issues and the result is what it is doing to bond prices. Based on what I am seeing in the trend of European yields, I believe lower U.S. rates will continue.

## 1+1 Does Not Equal 2

Let's summarize: The Fed raised rates and the U.S. dollar has been rising, causing profits to shrink in the S&P 500. Global economies are slowing. Higher rates would raise mortgage rates and could slow housing, one of the leading sectors post financial crisis. Commodity prices have collapsed. U.S. growth is slow and inflation below the Fed's target. Is that the scenario for the Fed to continue to raise interest rates? We shall see, and the bond market will arbitrate yields, which may surprise some as the 10-year Treasury stays around 2% and possibly lower.

Of course, if something changes, we will change, but not yet, and that leads us to the portfolios.

## The Portfolios at Yearend

The fourth quarter is traditionally the best for municipal bonds. This year was no exception. The municipal market has become more and more correlated with fewer dealer participants and more new regulations since the financial crisis. One constant is the January and July effect that occurs in the market. January and July are the largest coupon payment and maturity schedules during the year. Spreads to Treasuries tend to narrow around these times and December exasperates this effect because the new issue supply of municipals dries up.

The calendar for two high-tax states, California and New York, should continue to be light when 2016 starts. These two states are closing 2015 with strong demand, tightening yields as a percentage of Treasuries toward their lows for the year.

## The Taxable Portfolios Trade Much Differently

Going into yearend, oil continued to trade lower. Chesapeake Energy, which is a highly visible traded bond in the high yield indexes, came under enormous tax loss selling. "Risk-off" was the trade as dealers scrambled to reduce high yield names carried on their books for yearend. Dealers have an incentive to remove risk from their books heading into yearend for regulatory purposes. Even investment grade corporate spreads widened as it appeared the only paper dealers wanted to carry over the end of the year was Treasuries. All of this led to a December that was completely opposite of the municipal market as spreads widened.

Finally, a wish to all for a happy and healthy 2016. And don't get too negative on news events. They are always out there amid the one constant — markets will always change and survive.

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