Clark Capital MANAGEMENT GROUP

Navigator®
Global Equity ETF Hedged
K. Sean Clark, CFA, Chief Investment Officer

First Quarter 2016 — 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.

FIRST QUARTER 2016: A TALE OF TWO HALVES

The first quarter of 2016 was a tale of two halves, as the first half of the quarter saw a dramatic, waterfall decline that exhibited all of the signs of a major panic. In this case, the panic centered around the energy space. Through February 11th, the S&P 500 was down 10.27% year to date; the small-cap Russell 2000 declined 15.93% and oil & gas exploration declined by over 20%. Many indicators of extreme negative investor sentiment made multiyear highs on February 11th, particularly credit market indicators. While the stock market decline was part of a larger decline that began in mid-2015, the rally that followed indicated that the equity bottom was indeed real. The hardest hit sectors were outperformers from February 11th until the end of the quarter, as the Russell 200 gained 17.13%, emerging markets rose 17.65%, and oil & gas exploration rose 27.34%. In contrast, the S&P 500 gained a relatively lackluster 12.95%. Credit markets also showed substantial, broad improvement across many sectors. Our relative strength methodology continues to point the portfolio toward defensive equities. In general, our avoidance of the weakest, hardest hit sectors meant that the portfolio lost less when markets were declining, but then also gained less when the markets rallied back after the February 11th low.

First Quarter Attribution

The long-standing trend favoring growth over value may have peaked during the first quarter and, as a result, the portfolio held positions in defensive oriented sectors for the majority of the quarter. Growth stocks, particularly the Consumer Discretionary and Health Care sectors lagged, and the beaten down Energy and Basic Materials sectors rebounded. The portfolio's relative strength models no longer favored value or growth but rather stable large cap stocks that pay dividends and/or have high quality balance sheets.

Here are some additional key developments in the portfolio during the quarter:

- Dividend paying stocks are now a large portion of the portfolio, as the two largest positions are High Dividend (HDV) and Dividend Growth (DGRO). Dividend paying stocks are predominantly large cap and many are slower-growing companies. The market's favoring of dividend paying stocks over growth stocks reflects a defensive stance and a renewed focus on valuations.

- Mid and small cap stocks had broken down during the last half of 2014, but since the market bottom on February 11th, they began to outperform. Our relative strength matrix, however, only shows strength in mid caps (particularly mid cap value), and they are the segment with the most relative strength acceleration. Small cap stocks remain near the bottom of the ranks.

- The top contributors during the first quarter were the iShares MSCI Quality Factor (QUAL) and the iShares Core Dividend Growth (DGRO). The top detractors were the iShares S&P 500 Growth ETF (IVW) and the SPDR S&P 500 ETF (SPY).

- Telecommunication (VOX), Consumer Staples (XLP), and Utilities (XLU) were the highest ranked and fastest rising sectors during the quarter. These are considered to be the market's most conservative sectors. Their strength indicates the degree of weakness and fear that markets displayed in January and February. Industrials and Materials are the sectors currently displaying the most acceleration.
- U.S. markets have outperformed global markets for a number of years now, and there is no slowing of that trend to date. As a result, the portfolio remains overweight U.S.
- Latin America and emerging Asia are displaying the most relative strength momentum, and as a result, the portfolio added positions in Argentina (ARGT), Brazil (EWZ), Russia (RSX), South Korea (EWY), Thailand (THD), Malaysia (EWM), the Philippines (EPHE), and Indonesia (IDX) during the quarter.
- Europe remains a substantial underweight, and the portfolio owned only small positions in Ireland (EIRL) and Denmark (EDEN).
- Japan was a substantial weight in the portfolio for much of 2015, but its relative strength collapsed in 2016, and the portfolio completely exited Japan by the middle of the quarter.
- Indonesia (IDX), All Country World Minimum Volatility (ACWV), and EAFE Minimum Volatility (EFAV) were the top international contributors, while Hedged EAFE (HEFA), Japan (EWJ), and EAFE Small Cap (SCZ) were the top detractors.
- The largest negative contributor to the portfolio was its focus on hedging. The hedge helped the portfolio to mitigate some early losses but as equity markets quickly recovered the hedge acted as a drag on the portfolio. We continue to believe that for conservative investors, a hedged equity strategy will allow participation in market gains while reducing the risk of a major loss.

Outlook

We came into 2016 with a constructive outlook for the global equity markets, and the rebound off of the February 11th lows reinforces that view. Risk assets across the board have rebounded very strongly, and we expect the markets to hit fresh new highs as the longer-term trend remains bullish. We have seen participation broaden with emerging markets, energy, and basic materials leading the markets higher during the rebound. We see that as an encouraging sign for a continued advance. As there are very few attractive market sectors that can outperform the S&P 500, we have taken a large placeholder position in the S&P 500 (SPY) itself. We expect to find safety in the broad market until volatility in the market eases.

As far as the Fed goes, they are likely to err on the cautious side of hiking rates. Janet Yellen's latest comments indicate that while the Fed acknowledges improvements in the economy, they remain focused on weaker international growth. The Fed does not seem to be in a hurry to raise rates and aren't likely to hike again until the June FOMC meeting.

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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 Russell 2000 Index measures the performance of the 2000 smallest U.S. companies based on total market capitalization in the Russell 3000, which represents approximately 11% of Russell 3000 total market capitalization.

The S&P MidCap 400 provides investors with a benchmark for mid-sized companies. The index covers over 7% of the U.S. equity market, and seeks to remain an accurate measure of mid-sized companies, reflecting the risk and return characteristics of the broader mid-cap universe on an on-going basis.

The MSCI ACWI stands for All Country World Index. A market capitalization weighted index designed to provide a broad measure of equity-market performance throughout the world. The MSCI ACWI is maintained by Morgan Stanley Capital International, and is comprised of stocks from both developed and emerging markets.

The MSCI All Country World ex USA Total Return (MSCI ACWI), market capitalization weighted index designed to provide a broad measure of equity-market performance throughout the world. The MSCI ACWI is maintained by Morgan Stanley Capital International, and is comprised of stocks from both developed and emerging markets.

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 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 1 year. In addition, the securities have $250 million or more of outstanding face value, and must be fixed rate and non-convertible.

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 30-Year U.S. Treasury Bellwethers Index is a universe of Treasury bonds, and used as a benchmark against the market for long-term maturity fixed-income securities. The index assumes reinvestment of all distributions and interest payments.

The Barclays 10-Year U.S. Treasury Bellwethers Index is a universe of Treasury bonds, and used as a benchmark against the market for long-term maturity fixed-income securities. The index assumes reinvestment of all distributions and interest payments.

The Barclays 5-Year Municipal Bond Index is the 5 Year (4-6) component of the Municipal Bond index. It is a rules-based, market-value-weighted index engineered for the tax-exempt bond market. The index tracks general obligation bonds, revenue bonds, insured bonds, and pre-refunded bonds rated Baa3/BBB- or higher by at least two of the ratings agencies.

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 Year Treasury Index tracks the performance of the long-term U.S. government bond market.

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.

Morningstar is the largest independent research organization serving more than 5.2 million individual investors, 210,000 Financial Advisors, and 1,700 institutional clients around the world.

For each separate account with at least a three-year history, Morningstar calculates a Morningstar Rating™ based on a Morningstar Risk-Adjusted Return measure that accounts for variation in a separate account's monthly performance, placing more emphasis on downward variations and rewarding consistent performance. The top 10% of separate accounts in each category receive 5 stars, the next 22.5% receive 4 stars, the next 35% receive 3 stars, the next 22.5% receive 2 stars and the bottom 10% receive 1 star. The Overall Morningstar Rating for a separate account is derived from a weighted average of the performance figures associated with its three-, five- and ten-year Morningstar Rating metrics.

Past performance is not indicative of future results. This material is not financial advice or an offer to sell any product. Not every client's account will have these exact characteristics. The actual characteristics with respect to any particular client account will vary based on a number of factors including but not limited to: (i) the size of the account; (ii) investment restrictions applicable to the account, if any; and (iii) market exigencies at the time of investment.

Clark Capital Management Group, Inc. reserves the right to modify its current investment strategies and techniques based on changing market dynamics or client needs. The information provided in this report should not be considered a recommendation to purchase or sell any particular security, sector or industry. There is no assurance that any securities, sectors or industries discussed herein will be included in an account's portfolio. Asset allocation will vary and the samples shown may not represent an account's entire portfolio and in the aggregate may represent only a small percentage of an account's portfolio holdings. 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.

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.

The CBOE Volatility Index® (VIX®) is a key measure of market expectations of near-term volatility conveyed by S&P 500 stock index option prices and which shows the market's expectation of 30-day volatility. It is constructed using the implied volatilities of a wide range of S&P 500 index options. This volatility is meant to be forward looking and is calculated from both calls and puts. The VIX is a widely used measure of market risk. 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 Barclays U.S. Aggregate Bond Index is a market capitalization-weighted index, meaning the securities in the index are weighted according to the market size of each bond type. Most U.S. traded investment grade bonds are represented. Municipal bonds, and Treasury Inflation-Protected Securities are excluded, due to tax treatment issues. The index includes Treasury securities, Government agency bonds, Mortgage-backed bonds, Corporate bonds, and a small amount of foreign bonds traded in U.S. The Barclays Capital Aggregate Bond Index is an intermediate term index.

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.

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.

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