Clark Capital
MANAGEMENT GROUP

Portfolio Perspectives

A Focus on Strategy amid Volatility in Fixed Income

By **K. Sean Clark, CFA®,** *Chief Investment Officer*

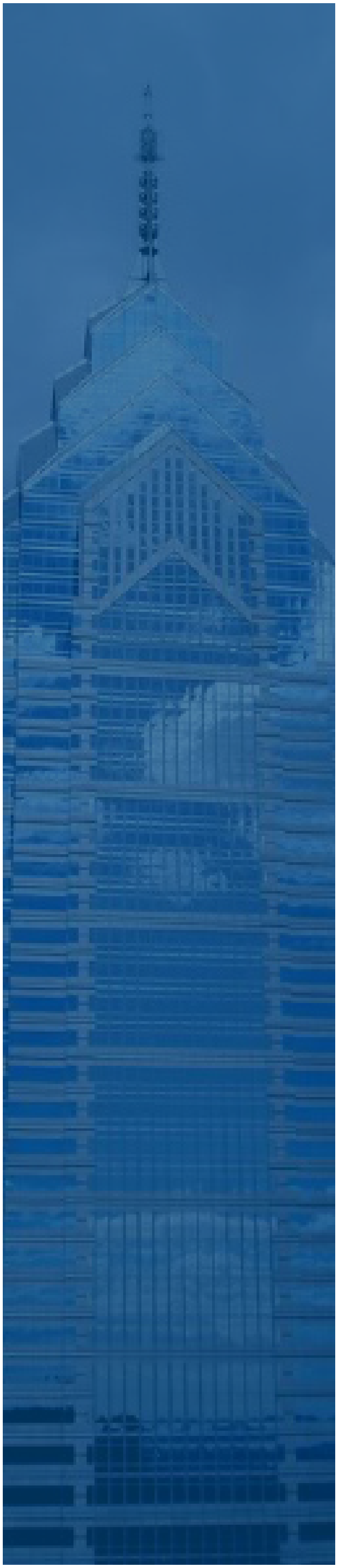
While the excitement of equities often earns the headline, it seems fixed income is finally getting the spotlight. This fervor comes amid a groundswell of concern among investors witnessing rising yields. Furthermore, all-time high durations in the U.S. bond market have done little to ease concerns. Let's take a look at some of the figures over the past few weeks.

The 10-year Treasury yield experienced the largest increase in 15 years over just the previous two weeks, rising nearly 100 bp (1.36% to 2.34%) from its July post-Brexit low. This represents a round trip from its 2015 closing yield of 2.27%. The journey began with a 100 bp decline early in the year, and now, following the Trump election, it has risen 100 bp. However, many expect these yield levels to abate despite these dramatic, short-term swings. In the meantime, investors have eschewed Treasuries for equities as the inauguration looms closer and investors seek to capitalize on relaxed regulations and thus strong U.S. growth.

Our expectation is that the pace of the back up in yields will slow. These bold movements have created a widespread sentiment of pessimism among bondholders. As a result, we may witness this area hold and see yields consolidate. Our intermediate-term stance is that the 3.0% level on the 10-year Treasury note, which represents the January 2014 high, is key to the long-term outlook.

We continue to see a heavy foreign sell-off in Treasuries characterized by liquidations from larger players like China and the Arab countries. Will U.S. and European demand offset this selling as was the case when China sold $300 billion worth of bonds earlier in the year? It's difficult to say. What's more evident is the retreat from bonds due to concerns of diminished fixed returns. In short: inflationary concerns persist. This concern comes as a result of recent comments pointing to a rate hike from Fed Chair Janet Yellen. Rising rates could be particularly problematic for high duration bonds.

Despite these problems elsewhere, our position is that corporate bonds, both investment and high yield, will perform well. They have proven resilient in the wake of post-election turmoil flowing through the fixed income markets. This performance is in keeping with the projections in our original 2016 Market Outlook. As the rate of change in our world accelerates, we believe an active approach to managing fixed income is required. Traditional laddered bond portfolios are likely too inflexible to meet the changing market dynamics. Additionally, we believe our active management style will help uncover opportunities in both municipal and corporate bonds.



However, the fact remains: a major component of investment management is risk management. Such risks include an economy at the dawn of new and unknown leadership and deteriorating credit conditions of high-yield issuers. For the moment, we view those risks as somewhat limited as we move towards a U.S. economy poised for moderate growth into 2017. Our expectation is for high-yield bonds to post mid-single digit returns in 2017 absent a recession. This projection is commensurate with the 674 bps yield on the Barclays High Yield Index as well as their previous performance following uptrend years in high-yield bonds.

Opportunities exist under any market condition. While we are witnessing volatility and uncertainty in the fixed income market, we firmly believe active management can help investors navigate choppy bond markets and remain on course to reach their long-term goals.

Author: 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 Investment Committee and the Executive 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.