ClarkCapital MANAGEMENT GROUP

Navigator®
Fixed Income Total Return
K. Sean Clark, CFA, Chief Investment Officer

Fourth 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.

A GREAT YEAR FOR HIGH YIELD . . . AS PREDICTED

In our *Outlook* last year, we stated that "High yield bonds had one of the best risk-adjusted return profiles." High yield bonds certainly did turn in a great performance in 2016 with the Barclays High Yield Index up 17.13%. In a highly anticipated and telegraphed move, the Federal Reserve hiked interest rates for only the second time in over a decade during the fourth quarter and, leading up to the event, there was some fear and trepidation about the impact that any rate hike would have on the fixed income markets. So far this time, as with the rate hike in 2015, there has been no real negative impact on the markets. We have often said that we believe high yield would outperform in rising interest rate environments.

Over the past 23 years, there have been seven instances where the 10-year Treasury yield has risen by over 100 bps. In each one of those cases, high yield bonds posted positive total returns while Treasuries were lower across the curve. The current case, now the eighth time rates have risen by at least 100 bps, is no exception. The 10-year Treasury yield bottomed on July 8th at 1.36% and so far has risen to a high of 2.60% on December 16th, rising nearly 125 bps. From that point to the end of the year, the Barclays 7-10 Year Treasury Index was down 6.96% while the Barclays High Yield Index was up 5.93%, outperforming Treasuries by 1289 bps.

Our long-term view on interest rates is that the low is in and a new secular bear market has begun. However, that does not mean that fixed income investors are doomed to experience losses. History suggests quite the opposite. For example, the 10-year Treasury yield has risen in 19 of the 41 years since the inception of the Barclays Aggregate Bond Index. In 16 of those years, or 84% of the time, the Aggregate Bond Index gained as rates rose. In addition, yields rose in 13 of the 33 years since the inception of the Barclays High Yield Index. High yields rose in 10 of the 13 years, or 77% of the time, and the average gain in those years was 11%. In addition, yields rose in 16 of the 37 years since the inception of the Barclays Municipal Bond Index. Muni bonds rose in 11 of the 16 years, or 69% of the time that rates were rising. Finally, using the Barclays Aggregate Bond Index since its inception, only 1% of the total return has been from price appreciation, 16% of the index total return has been from coupons, and a staggering 83% of the index return has been from reinvesting coupons. This is why higher rates are not entirely bad, higher rates often mean higher coupons and more reinvestment income.

Fourth Quarter Attribution

The Fixed Income Total Return (FITR) portfolio remained fully invested in high yield for the duration of the quarter, as it has been since taking a risk-on posture on Febru-

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

ary 29th. For the quarter, the Fixed Income Total Return portfolio rose 1.34% gross of fees (0.58% net of 3.00% max fee). For calendar year 2016, the portfolio gained 17.98% gross of fees (14.53% net of 3.00% max fee), outperforming both of its benchmarks. For comparison, the Barclays High Yield Bond Index gained 1.75% and the Aggregate Bond Index lost 2.98% during the fourth quarter and they gained 17.13% and 2.65% respectively for the year. The strategy's strong returns were primarily driven by the asset class decisions.

The story in the fourth quarter was the surprise election win by Donald Trump and the much anticipated Fed rate hike. The rate hike had no real impact on the markets but the Trump victory caused a risk-on rally as investors looked toward anticipated pro-growth policies to boost economic growth expectations. As a result, those areas of the credit markets levered to the economy performed well and those with longer durations and more interest rate sensitivity, such as Treasuries and municipal bonds, got hit hard. Credit spreads have now declined from a high of 840 bps on February 11th to 363 bps at yearend. Credit spreads are now at their lowest levels since the energy decline in mid-2014. In that vein, it appears that high yield is approaching fully valued levels, but as history has shown in the past, credit spreads can remain low for years in a moderately expanding economic environment.

Outlook

The 10-year Treasury yield surged from a post-Brexit low of 1.36% to a post-Trump high of 2.60%, rising nearly 125 bps. The 10-year yield ended the year at 2.45%. Essentially the 10-year Treasury yield made a round trip with the journey beginning with a 100 bps decline early in the year, followed by a Trump election victory surge. Our expectation is that the pace of the backup in yields will slow as widespread pessimism among bond investors is now evident. As a result, we may witness this current area holding for the moment as yields consolidate. Our intermediate-term stance is that we will see the 3.0% level on the 10-year Treasury Note, which represents the January 2014 high, and in our opinion that level is key to the long-term outlook. While 3.0% is our intermediate-term upside target for yields, we think yields could back off of that level and we have a year-end target of 2.75%.

We continue to favor credit and as such are fully exposed to high yield in the Fixed Income Total Return portfolio. While it is unlikely that we will see the same surge in credit this year as we saw in 2016, with little chance of recession over the next 12 months and higher interest rates coming, we continue to overweight credit. History shows that spreads can remain tight for a long period of time without an economic downturn. Additionally, higher inflation means a reduced probability of default, and historically, higher inflation expectations have correlated with falling credit spreads.

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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 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 CBOE Volatility Index (VIX) is a forward looking index of market risk which shows expectation of volatility over the coming 30 days.

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.

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

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 U.S. Treasury Bond Index is an issuances-weighted index measuring the performance of the U.S. Treasury bond market, one of the largest and most liquid government bond markets in the world.

Barclays U.S. Aggregate Bond Index: The index is unmanaged and measures the performance of the investment grade, U.S. dollar denominated, fixed-rate taxable bond market, including Treasuries and government-related and corporate securities that have a remaining maturity of at least one year.

MSCI All Country World Index is 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 and is comprised of stocks from both developed and emerging markets.

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.

Gross performance shown is 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. Net performance includes the deduction of a 3.0% annual wrap fee, which is the highest anticipated wrap fee charged by any sponsor. Management and performance of individual accounts will vary due to differences such as the availability of securities, trading implementation or client objectives, and market conditions. For a fee schedule, please contact your advisor or refer to AssetMark's Form ADV Part 2A. If you enter into an agreement directly with Clark Capital, refer to Clark Capital's Form ADV Part 2A. The Firm's policies for valuing portfolios, calculating performance, and preparing compliant presentations are available upon request.

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