Mason Wev, CFA®, CMT®
Portfolio Manager

Mason joined Clark Capital Management Group, Inc. in 2005 as a Portfolio Manager. He is a member of the Clark Capital Investment Committee, contributing to asset allocation policy and security selection. Mason has more than a decade of experience in the investment industry. He is responsible for quantitative investment analysis, security selection, and communicating the firm's investment policy to wealth advisors and consultants. He participates in the research and product development efforts of the Portfolio Team. A graduate of Dickinson College, Mason earned an M.B.A. in International Management from the Garvin School of Management at Thunderbird (the American Graduate School of International Management) and holds the CMT and CFA designations.

2016 DEFINED BY TURN IN INTEREST RATES

Populism, the Brexit vote, and the election of Donald Trump dominated the news in 2016. While these events dominated the headlines, we found that investment returns were dominated by a change in attitude to risk that reversed course around mid-year, not surprisingly at the same time that interest rates established a major bottom. The first half of 2016 was defined by volatility, particularly surrounding Energy. As soon as the year began, a panic arose regarding the very solvency of many Energy sector companies. High yield bonds, particularly in the Energy sector, took the brunt of the hit, and the yield on high yield bonds reached their highest levels since 2009. Pessimism became extreme and markets bottomed on February 11th after a waterfall decline. Once we saw a bullish trend reversal in the high yield bond sphere, we moved into high yield bonds in the Multi-Strategy program on February 29th and remained in high yield for the rest of the year.

Often credit markets will lead equities, and this proved to be the case in 2016. After February, credit spreads narrowed throughout the rest of the year, indicating that risk was perceived to be waning. However, within equities, the attitude remained risk-off, and much of that was due to persistently falling interest rates. Then came the Brexit vote's shocking result, and panic bond buying ensued. By July 8th, the 10-year Treasury yield hit 1.36%, a multi-decade low since at least the 1950s. At the July 8th low, volatility stocks and high dividend stocks were at the top of our equity style box rankings. However, the low in interest rates proved to be a major turning point for investors, as interest rate sensitive areas lost favor, and the market's attitude became risk-on. As interest rates continued to rise, we saw small caps, high beta, and value stocks rise to the tops of our style box rankings. Prior leaders such as low volatility stocks and high dividend stocks fell all the way to the bottom. All of this was before the election. When surprisingly Donald Trump was elected, the market surprised many by rallying sharply. Small caps and value stocks surged, as optimism regarding Financials in particular took hold.

U.S. Equity – Style Rotation

The equity portion of the Multi-Strategy portfolios invests entirely in U.S. equities, emphasizing those style boxes and factors displaying the most relative strength. During the first half of 2016, we saw that the long-standing trend favoring growth over value had indeed reversed, and the Multi-Strategy portfolio shifted from growth stocks to value stocks and small caps. Coming into the fourth quarter, the portfolio favored small caps, particularly small cap value stocks, and high beta names. Despite the fact that the market's overall level had not moved higher, aggressive risk-on names had already become market leaders. When the U.S. election results came in and surprisingly

Donald Trump won, these particular risk-on oriented names surged higher, driven by optimism for greater economic growth and for a brighter regulatory environment for financials in particular. Among the major Morningstar Style Boxes, small cap value (IWN) continues to top our rankings. The S&P 500 High Beta ETF (SPHB) also remained near the top of the ranks. Large moves in both of these ETFs led us to take the proceeds from these sales and move a portion of the portfolio into the S&P 500 (SPY) as we anticipate a potential coming consolidation and mean reversion. High Dividend Paying Stocks (HDV) and Low Volatility (USMV) ETFs are near the bottom of our rankings, along with the Momentum Factor ETF (MTUM). Holdings of these ETFs were prior winners as of June 30th; a major shift in interest rates and the market's assessment of risk and future growth has since changed their fortunes.

Fixed Income – Favoring High Yield during the Second Half of 2016

The fixed income portion of the Multi-Strategy portfolios engages in asset class rotation within fixed income, owning high yield bonds, Treasuries, or cash, whichever our model indicates has recent trends in its favor. The strategy is effected via the Navigator Tactical Fixed Income Fund (NTBIX). We have often said that we believe high yield would outperform in rising interest rate environments, and the second half of 2016 proved to be such a case. 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.

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. 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, 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. 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 that level and we have a year-end target of 2.75%.

Within the equity portion of the Multi-Strategy portfolio, we continue to favor small caps, value stocks, and high beta stocks. In our opinion, a correction or stalling of their leadership is overdue, as they have become quite overbought. Nevertheless, we would view a correction as unlikely to change the broader trend. We are more sanguine regarding the second half of 2017, as historically the second half of a new president's first year has been volatile and not very profitable for investors. As always, we will follow our relative strength rankings, but we would expect the portfolio to take on a more defensive tone as the year develops.

Navigator®
Multi-Strategy Update

Mason Wev, CFA®, CMT®, Portfolio Manager

Fourth Quarter 2016 — Portfolio Commentary

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