Navigator® Multi-Strategy Update

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Third Quarter 2017 — Portfolio Commentary

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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.

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THE "SLOW GRIND" CONTINUES

The third quarter of 2017 continued a slow grind higher for U.S. equity markets, while international markets continued to provide leadership and even better returns. Within fixed income, credit continues to outperform duration, and while interest rates dipped lower in early September, by the end of the month they had returned to the range they have seen for most of 2017. Emerging markets led the way on the quarter with a 7.6% gain, while the NASDAQ gained 5.8% and the S&P 500 4.5%. The spike downward and then reversal in interest rates that we saw in early September could well be a shift in market leadership, as since then beneficiaries of risk-on and rising interest rates have soared.

Growth stocks have been strong outperformers year to date, beating value stocks across all market capitalizations. Economic sensitivity, commodity producers, liquidity, and positive earnings revisions are some of the factors that have been rewarded by investors this year. Commodities in particular saw a rebound in the third quarter, and even Energy joined the party in September with a furious rally. Interest rate sensitive stocks such as banks, Utilities, and Consumer Staples have been laggards. Banks at least have made a huge turnaround in September, and we are watching to see if banks and value stocks can establish a solid relative trend. To do so, if history is a guide, economic growth will need to pick up further from here.

U.S. Equity — Style Rotation

The equity portion of the Multi-Strategy portfolios ranks a number of U.S. equity styles and factors using Clark Capital's relative strength-based ranking methodology, and then purchases those ETFs with higher rankings (and avoids those with lower rankings), assembling them into a portfolio that attempts to outperform the S&P 500. Large cap growth and momentum dominate the portfolio's holdings, and there is no doubt that the solid performance among Technology stocks (up 8.3%, the best performing sector in the S&P 500) is the primary driver of this allocation, along with a lesser contribution from Health Care, where biotechnology stocks in particular led markets. Technology's outperformance over a one- and three-year period has been quite dramatic, and we are watching to see if this trend is poised to reverse. Within our style and factor rankings we are seeing some slippage among large cap growth stocks, whose relative strength, while not weakening, has flattened. Rising in the ranks are higher volatility stocks, including small cap and high beta. They are potential future additions if current trends hold.

- The portfolio added the iShares MSCI USA Quality Factor ETF (QUAL) during the quarter and exited positions in Mid Cap Growth (IWP) and Minimum Volatility (USMV). The changes and portfolio turnover were relatively modest.

- Of those candidates for the portfolio in our universe, momentum (MTUM) gained 7.9% and the S&P 500 Growth (IVW) gained 5.2%; both were leading performers in our style box and factor matrix during the quarter. Mid Cap Value (IVOV) and Minimum Volatility

(USMV) were up 2.8% and 3.3% respectively and were the weakest ETFs in our matrix. During the quarter we were not invested in IVOV and were only briefly invested in USMV although it did not become a major detractor.

- In aggregate, the Style Opportunity portfolio is overweight Technology and Consumer Discretionary, traditional growth sectors, and underweight Energy and Consumer Staples. The portfolio has lagged a bit since Energy and Financials, the dominant value-oriented sectors, took off in early September. We were surprised to see that a factor ETF like Momentum (MTUM) can maintain its strong relative performance despite the dramatic sector rotation that we saw in September.
- The top contributors to the portfolio during the quarter were the iShares Edge MSCI USA Momentum Factor ETF (MTUM) and the iShares S&P 500 Growth ETF (IVW). The top detractors were the iShares Edge MSCI USA Minimum Volatility (USMV) and the iShares Russell MidCap Growth ETF (IWP) was a major detractor — investment in USMV was not.

Fixed Income — High Yield Bonds Favored

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 determines has recent trends in its favor. The strategy is effected via the Navigator Tactical Fixed Income Fund (NTBIX). The portfolio has owned high yield bonds since the end of February, 2016, a period of over 18 months. It has been a great run for the asset class, as the Bloomberg Barclays High Yield Corporate Index is up 26.7% between February 29th, 2016, and September 30th, 2017. The Bloomberg Barclays High Yield Corporate Bond Index outperformed again in the third quarter, gaining 1.98%, while the Bloomberg Barclays Aggregate Bond Index gained 0.85% and the Bloomberg Barclays US Treasury Index gained 0.38%. The market's attention remained on the Fed, and for much of the quarter interest rates declined, particularly in early September, when the 10-year Treasury yield fell to 2.06% amid the North Korea showdown. However, that proved to be an intermediate-term bottom for Treasury yields, and rates rose sharply during the rest of September, ending the quarter at 2.33%, in the middle of their range for much of the year. Within the high yield space, spreads as indicated by the Bloomberg Barclays Corporate High Yield OAS (Option-Adjusted Spread) made new lows of 3.47% at the end of September, indicating strong confidence in the broad economy and corporate stability. Here are some additional developments during the quarter:

- Within the high yield bond universe there has been a substantial decline in issuance. In April 2015, the BofA Merrill Lynch High Yield Index contained 2326 issues, but as of September 30th it only contained 1873 issues, a 19.5% decline. The falling supply has been a bullish factor for high yield, as the huge group of investors hungry for yield are pursuing a smaller and smaller pool of issues.
- While high yield bond issuance has declined over the past few years, that does not mean that overall corporate leverage has not increased. Instead, the lending has been in the leveraged loan area, where 2017 has seen the highest leveraged loan issuance since 2011. In addition, many providers of leveraged loans (often large private equity firms) have been willing to provide covenant-lite or even covenant-free loans (thus the borrower can become even more leveraged without the lender's permission). We view these developments as just another reminder of the importance of managing the risk of this asset class. When the next major earnings or economic downturn does come our way, the high yield and leveraged loan spaces will see substantial losses as they have in the past, and we will rely on our model to guide us regarding the bigger economically based trends.
- The popularity of leveraged loans is easy to understand. Borrowers pay 0.75% to 1.00% less in interest compared to a high yield bond issuance. Now with covenants becoming much lighter or non-existent (and thus less constraining for the borrower), leveraged loans have become a prime vehicle for financing. From our perspective on behalf of clients, these leveraged loans do not have great appeal as an investment. We receive a yield that is 15 to 20% lower. In addition, these loans are very, very illiquid. In a potential crisis, they are much harder to unload in large amounts at a reasonable price.

Outlook

The bears waiting for downside have had the markets tell them: resistance is futile. Many investors have been anticipating and fearing a sizeable correction this year, and if you positioned yourself defensively in anticipation of a waterfall decline, you have taken on pain. The S&P 500 is up 14.2% year to date through September 30th, with the NASDAQ up 20.7% and emerging markets up 23.5%. Despite the many headline-making events: potential for rising interest rates, a credit bubble in China, lofty stock market valuations, and North Korean bom-

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bast, the real risk markets have presented in 2017 is the risk of not participating in the upside. The last 5% correction in the S&P 500 occurred in November 2016, and a 3% correction occurred only once in March. As always, the single biggest factor investors monitor is Federal Reserve activity. In this regard, the market has been surprisingly resilient. Another interest rate hike in December is now largely priced into expectations. The Fed announced in September that it will now finally begin to reduce the size of its balance sheet, though only by a small amount. Even the suggestion of a reduction has stoked fears and a "taper tantrum" in the past, but now that balance sheet reduction is a reality, there has been no adverse reaction. While it has been nearly a year since a 5% retracement and valuations indicate that a correction is overdue and possible at any time, economic indicators are absolutely solid, and international economies are now virtually all growing. We'd particularly like to note that Europe has finally joined the party. So while we are well aware of the risks that a correction could come, we need to see much more evidence of cracks in the foundation before we would take action to play defense and preserve the gains that 2016 and 2017 have provided.

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The benchmark is the Bloomberg Barclays U.S. Corporate High-Yield Index. The Bloomberg Barclays U.S. Aggregate Bond Index is a supplemental benchmark. The Bloomberg 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 Bloomberg 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 benchmarks for this composite are used because the Bloomberg Barclays U.S. Corporate High-Yield Index is generally representative of U.S. high yield fixed income and the Bloomberg Barclays U.S. Aggregate Bond Index is generally representative of broad based U.S. fixed income. The volatility (beta) of the Composite may be greater or less than its respective benchmarks. It is not possible to invest in these indices.

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