October 2018

Clark Capital Management Group

Benchmark Review & Monthly Recap

Let's Call It What It Was...

HIGHLIGHTS:

- Equity markets dropped sharply in October, however, a late-month rebound helped curb those losses and the three major U.S. equity indices remained in positive territory year-to-date.
- Yields continued to rise in October, which put further pressure on bond returns. While high-yield bonds struggled for the month, they remained one of the few pockets within fixed income to have positive year-to-date results.
- U.S. economic data in October continued to show ongoing growth in the U.S. economy, although data was a bit more mixed.
- Despite the capital market volatility in October, we believe that fundamentals continue to reflect a solid economic backdrop.

EQUITY MARKETS

Let's call it what it was – one of the worst months for U.S. equity markets in years. Pre-election jitters and ongoing concerns about a trade war with China were among the factors that spurred capital market volatility and weakness during the month. For the second time this year, the S&P 500 Index entered into "correction" territory defined as drop of 10% or more from its prior high. (The S&P 500 hit the 10% correction mark on an intraday basis in October.) The Russell 2000 Index and the NASDAQ Composite experienced even sharper declines during the month.

The numbers played out as follows for October: The S&P 500 dropped -6.84%, the Dow Jones Industrial Average fell -4.98%, the NASDAQ Composite slumped -9.16%, and the Russell 2000 Index declined -10.86%. Growth stocks suffered more than value, as the Russell 1000 Growth Index fell -8.94% compared to the decline of the Russell 1000 Value Index of -5.18%. However, growth stocks still enjoyed a clear advantage over value on a year-to-date basis.

Mid cap and small cap stocks struggled more than their large-cap counterparts in October and U.S. equity indices were down across the board for the month. Despite these sharp declines in October, through ten months of 2018, the S&P 500, the Dow Jones Industrial Average and the NASDAQ Composite still enjoyed positive returns year to date. Declines in October pushed small-cap stocks, as measured by the Russell 2000 Index, into slightly negative year-to-date territory.

International equities struggled equally in October. Losses for the month exacerbated already weak results through the first three quarters of 2018. Despite the announcement in late September of the trade agreement between the U.S., Mexico, and Canada (in essence a NAFTA replacement), trade issues with China continue to exist, which weighed on international markets.

Emerging markets continued to experience the brunt of the declines amid dollar strength and rising rates in the U.S. during October. Overall, developed international equities declined in October as the MSCI ACWI ex USA Index, a broad measure of international equities, fell -8.13% and the MSCI Emerging Markets Index declined -8.78%. On a year-to-date basis, those indices are off -10.97% and -17.48%, respectively, in what has been a very difficult year for international equities after strong gains in 2017.

FIXED INCOME

The yield on the 10-year U.S. Treasury rose 10 basis points during the month from 3.05% to 3.15%. As would be expected during a month when rates rose, most fixed income sectors declined in October. High-yield bonds had been one pocket of strength during 2018 in fixed income, but these bonds had some of the sharpest declines during the month. While the front end of the U.S. Treasury market showed some modest gains for the month, the long end of the U.S. Treasury market showed some of the sharpest declines as rates increased.

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Overall, the Bloomberg Barclays U.S. Aggregate Bond Index fell -0.79% and the Bloomberg Barclays U.S. Credit Index fell -1.40%, which pushed those indices further into negative territory on a year-to-date basis. TIPS and muni bonds fell as well during October.

The Bloomberg Barclays U.S. Aggregate Corporate High Yield Index declined -1.60% in October. Despite those declines, high yield bonds have been the best performing fixed income asset class in 2018 with a gain of 0.93% through the first ten months of the year. On a year-to-date basis, investors continue to be rewarded for taking on credit exposure during this ongoing economic expansion in-line with our position, which favors credit over pure interest rate exposure in this current market environment.

ECONOMIC DATA AND OUTLOOK

Economic data released in October was somewhat mixed, but it continued to show solid U.S. economic growth. The latest reading of the Institute for Supply Management (ISM) manufacturing index in September remained elevated at 59.8, but it was modestly below expectations and fell short of the prior month's mark. However, the ISM non-manufacturing index, which represents the much larger service industries in the U.S. economy, came in at 61.6 exceeding expectations and surging past its level from August. Recall that ISM readings above 50 indicate expansion.

Non-farm payroll additions were disappointing at 134,000 in September, when 185,000 job gains were expected. However, that was buffeted by a strong revision to the August's job additions and an unexpected drop in the unemployment rate to 3.7% in September. (Employment data released in early November showed a strong increase in payroll gains in October at 250,000 with revised additional gains in August offset by fewer jobs than previously reported for September.)

The Conference Board's leading economic indicators index (the Leading Index) continued to advance as it rose as expected by 0.5% in September. Retail sales (excluding autos and gas) were flat in September when an increase of 0.3% was anticipated. On a final positive note, the first (advanced) reading of Q3 2018 GDP growth was stronger than expected at a 3.5% annualized pace compared to expectations of 3.3%. This follows Q2 2018 GDP growth of 4.2%, the strongest GDP reading since 2014.

The Federal Open Market Committee did not meet in October, but it will have two more meetings in the final months of 2018. Markets will not only watch the actions of the Fed closely in these final two meetings of the year, but will also watch for any hints of the potential pace of additional rate hikes in 2019. The Fed has come under scrutiny by the President and some market commentators of late, so as an independent body, it will be interesting to see how the central bank acts in the months ahead. We continue to expect an ongoing and measured rate-hike cycle.

Event	Period	Estimate	Actual	Prior	Revised
ISM Manufacturing	Sept	60.0	59.8	61.3	—
ISM Non-Manf. Composite	Sept	58.0	61.6	58.5	—
Change in Nonfarm Payrolls	Sept	185k	134k	201k	270k
Unemployment Rate	Sept	3.8%	3.7%	3.9%	—
Average Hourly Earnings YoY	Sept	2.8%	2.8%	2.9%	3.0%
JOLTS Job Openings	Aug	6900k	7136k	6939k	7077k
PPI Final Demand MoM	Sept	0.2%	0.2%	-0.1%	—
PPI Final Demand YoY	Sept	2.7%	2.6%	2.8%	—
PPI Ex Food and Energy MoM	Sept	0.2%	0.2%	-0.1%	—
PPI Ex Food and Energy YoY	Sept	2.5%	2.5%	2.3%	—
CPI MoM	Sept	0.2%	0.1%	0.2%	—
CPI Ex Food and Energy MoM	Sept	0.2%	0.1%	0.1%	—
CPI YoY	Sept	2.4%	2.3%	2.7%	—
CPI Ex Food and Energy YoY	Sept	2.3%	2.2%	2.2%	—
Retail Sales Ex Auto and Gas	Sept	0.3%	0.0%	0.2%	0.1%
Industrial Production MoM	Sept	0.2%	0.3%	0.4%	—
Building Permits	Sept	1275k	1241k	1229k	1249k
Housing Starts	Sept	1210k	1201k	1282k	1268k
New Home Sales	Sept	625k	553k	629k	585k
Existing Home Sales	Sept	5.29m	5.15m	5.34m	5.33m
Leading Index	Sept	0.5%	0.5%	0.4%	__
Durable Goods Orders	Sept P	-1.5%	0.8%	4.4%	4.6%
GDP Annualized QoQ	3Q A	3.3%	3.5%	4.2%	—
U. of Mich. Sentiment	Oct F	99.0	98.6	99.0	—
Personal Income	Sept	0.4%	0.2%	0.3%	0.4%
Personal Spending	Sept	0.4%	0.4%	0.3%	0.5%
S&P CoreLogic CS 20-City YoY NSA	Aug	5.8%	5.49%	5.92%	5.90%