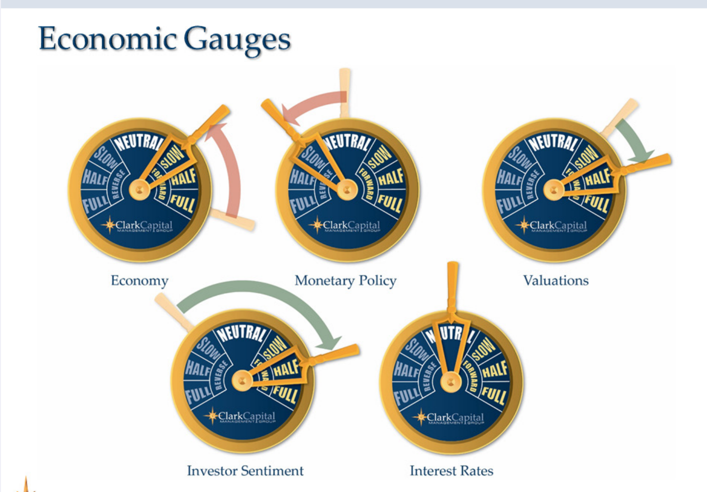
![Clark Capital Management Group]

Economic Review & Outlook

Video Transcript | Fourth Quarter 2018

Thanks for joining me for a recap of the latest economic and capital market developments as we close out 2018 and move into 2019. So let's begin.

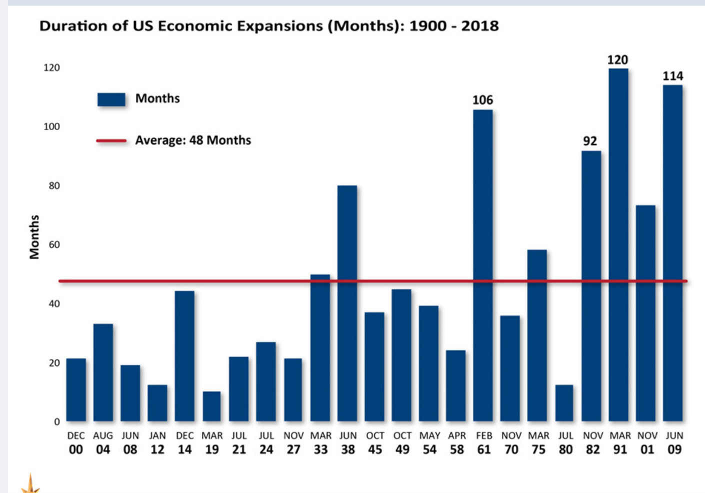
These gauges represent the 5 major areas that help shape our view for the overall economic environment, which in turn drives our expectations for the stock market.



The gauges reflect the degree of Clark Capital's positive (forward) or negative (reverse) outlook on the corresponding economic factors.

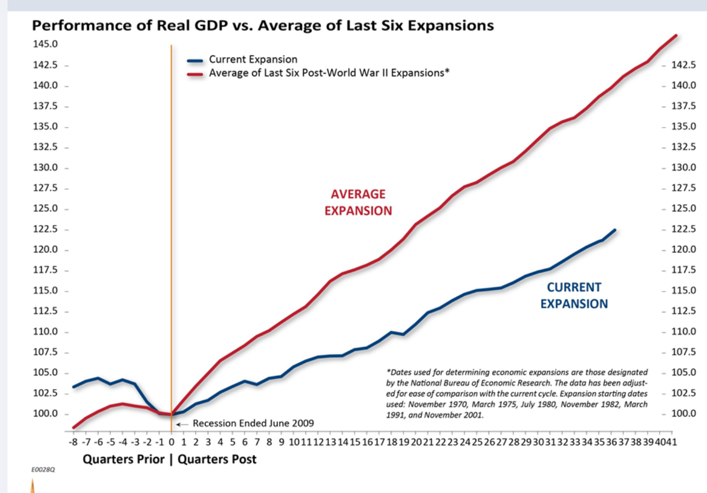
As a reminder, 12:00 is neutral. Anything to the right of 12:00 is positive for stocks, anything to the left of 12:00 is negative. We made adjustments to four of our five indicators this quarter, increasing two and reducing two. As a result, we currently have three gauges that are positive, one that is neutral and one that is negative.

First let's discuss the U.S. economy. The current U.S. economic expansion is the second longest expansion since 1900, surpassed only by the expansion from 1991 to 2000.



Source: Bespoke

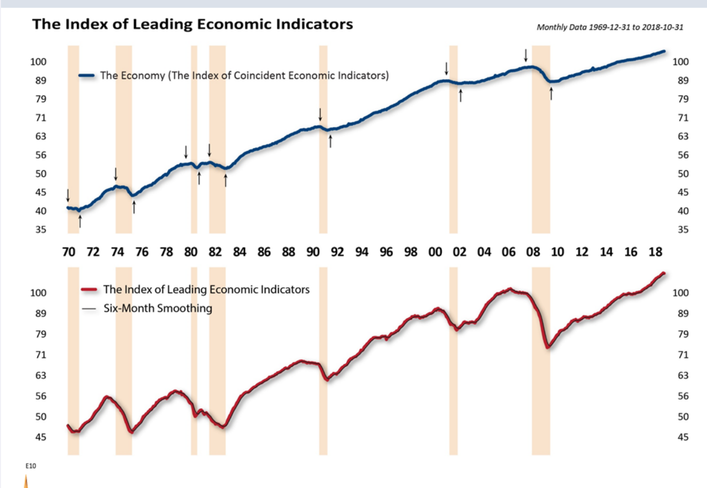
We have previously discussed that despite the length of this expansion, it has been one of the historically slowest in terms of growth as well, which helps explain its longer duration. Coming off one of the best years of this expansion in terms of economic growth in 2018, we expect growth to slow in 2019 and have reduced the economy gauge to reflect this expectation.



Source: Ned Davis Research

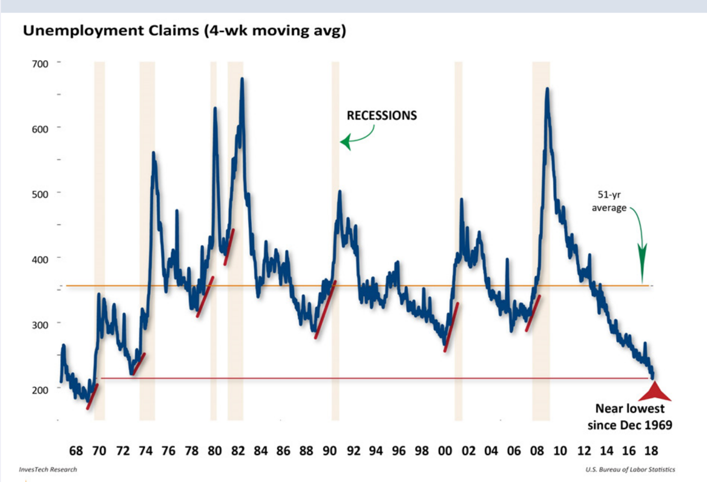
Ongoing trade concerns with China, a Fed that continues to raise rates, and less impact from the tax cuts lead us to temper our expectations. To be clear, we expect continued growth in the U.S. economy and still see the odds of a recession as low in 2019, but the pace of growth will likely slow this year and resemble the growth rates experienced during much of the recovery, closer to the 2-2.5% level. Economic indicators we follow that tend to be on the front edge of the economy continue to show growth, which keeps us positive about the economy overall in 2019, but with a more modest outlook.

The Conference Board's Leading Economic Indicators Index (the red line on the bottom of this chart) remained high late in the year and still shows no signs of rolling over, which it has historically done about 11 months prior to a recession.



Source: Ned Davis Research

Weekly initial jobless claims continue to hover near their lowest levels since the late 1960's reflecting strength in the job market, which is critical for our consumption led economy. Layoffs, which would be reflected in this reading, tend to turn up about six to 12 months before a recession and those indications are not present at this time.



Source: InvesTech Research

Additionally, the change to non-farm payrolls came in much stronger than expected for December as 312,000 jobs were added to the economy to end the year on a strong note for the labor market. This was the strongest month of job gains since February 2018.

The yield curve came under more and more scrutiny as the year has progressed following four rate hikes by the Fed in 2018. The slope of the yield curve flattened considerably last year but remained positively sloped. We continue to monitor the yield curve closely as it has become inverted prior to every recession since the late 1960s.

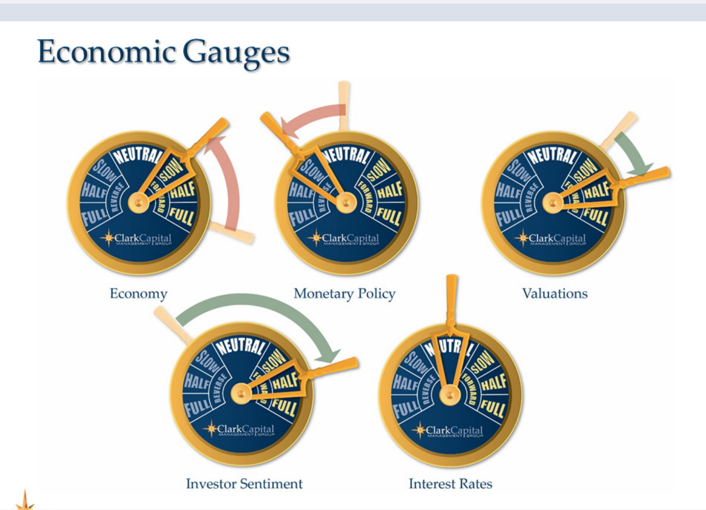
Yield Curve Leading Up to Recessions

	Yield Curve (bps)	
Start of Recession	At Start of Recession	52-Week Low
12/31/1969	-13	-45
11/30/1973	-61	-187
01/31/1980	-87	-208
07/31/1981	-20	-373
07/31/1990	61	-16
04/02/2001	72	-99
12/31/2007	79	-60
Current	31	31

Source: InvesTech Research

Despite all the recent market volatility and elevated concerns by investors, unemployment is low, consumer confidence is elevated, inflation is stable and likely dropping following the sharp drop in oil prices, interest rates have declined of late and corporate America is still benefitting from tax cuts.

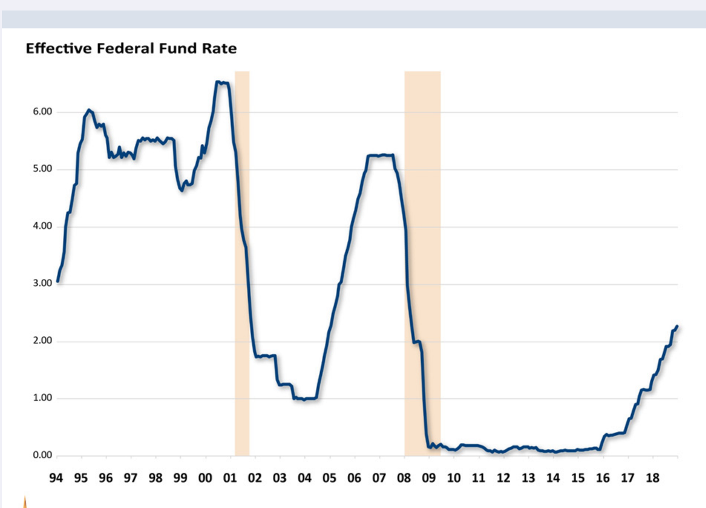
We believe the fundamental backdrop for the economy continues to look solid, but growth will likely slow from the strong pace experienced in 2018.



The gauges reflect the degree of Clark Capital's positive (forward) or negative (reverse) outlook on the corresponding economic factors.

The next gauge is Monetary Policy. After several quarters in the neutral position, we reduced monetary policy to a slight negative moving into 2019.

As we all know, the Fed is in a rate-tightening cycle, which has largely been in line with market expectations since the initial hike in December of 2015. However, now that we are nearing the end of this rate-hike cycle, each additional rate hike garners increased scrutiny with an elevated level of debate on whether the Fed is going too far or not far enough.

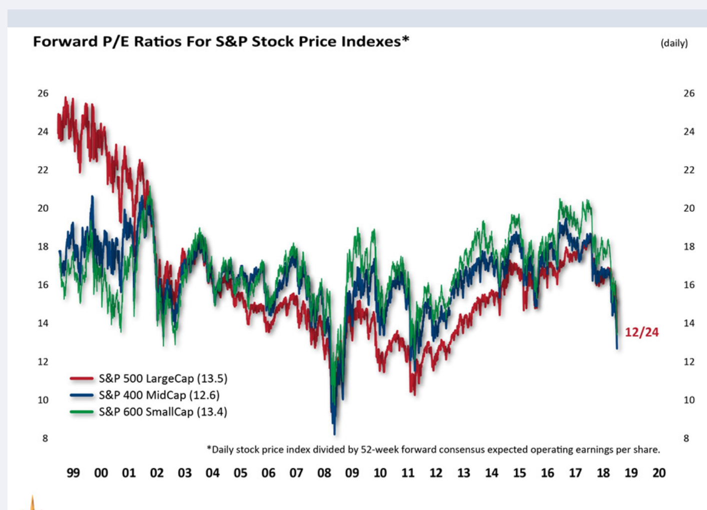


Source: FRED

With no clear consensus between the market and the Fed for the course of rate hikes this year, we believe the chances of a policy mistake are elevated in 2019. The market volatility experienced in the 4th quarter can at least partially be explained by the uncertain course of monetary policy late in this rate-hike cycle.

Additionally, while global central banks continue to be more accommodative than the U.S., they are beginning to reduce their accommodation as well. For example, the European Central Bank wound down its bond purchase program in the 4th quarter, so the next debate for the ECB will be when it might begin tightening rates.

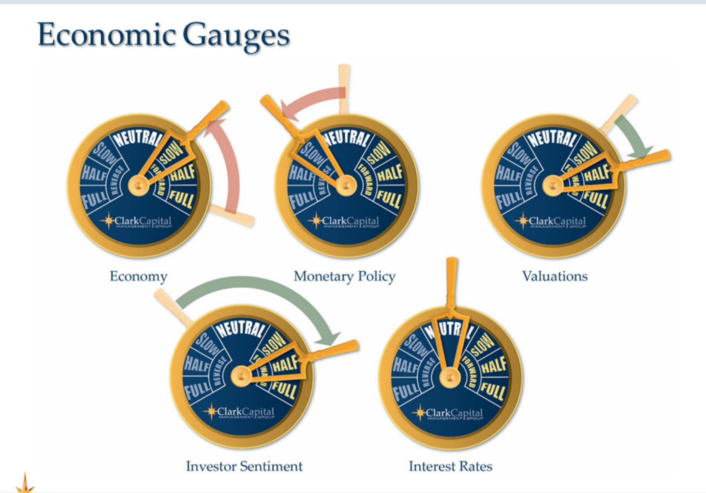
Next are valuations. While not pleasant, the sell-off in equities in the 4th quarter also resulted in a continued improvement in stock valuations. Strong earnings in 2018 coupled with down markets resulted in P/E ratios that became more and more attractive. Therefore, we improved the valuation gauge by one notch.



Source: Bespoke

When broad stock market declines occur like they did in the 4th quarter, we believe opportunities arise for active managers like Clark Capital to take advantage of better priced equities. We see earnings growth slowing in 2019 compared to 2018 as the tax cuts move to the rearview mirror, but earnings should still be growing at a healthy level.

As we have previously discussed, broader risks exist that could curb the pace of economic growth, such as continued trade tensions with China and more rate hikes from the Fed. However, we believe stock valuations have improved, creating potential opportunities for long-term investors.



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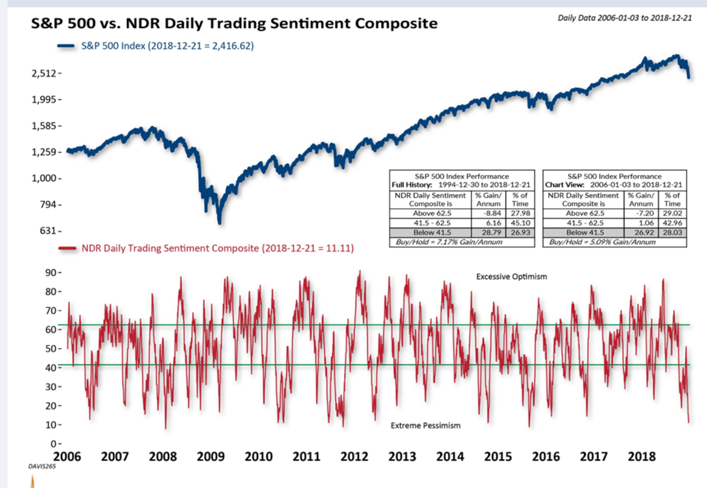
The next gauge is Investor Sentiment, which can be thought of as a measure of speculation. As markets have been on a volatile ride over the last few months, so too has the sentiment of investors whipsawed.

After appearing overly optimistic following steady gains in the 3rd quarter, (causing us to shift this indicator into a slight negative position last quarter), we enter 2019 with investors overly pessimistic. As a result, we've improved this indicator by three positions moving into the new year.

Sharp mutual fund outflows and pessimistic sentiment readings compelled us to improve this indicator as fear seems overdone, especially in light of a continued backdrop of solid economic fundamentals. To paraphrase Warren Buffett, "buy when people are fearful and sell when people are greedy".

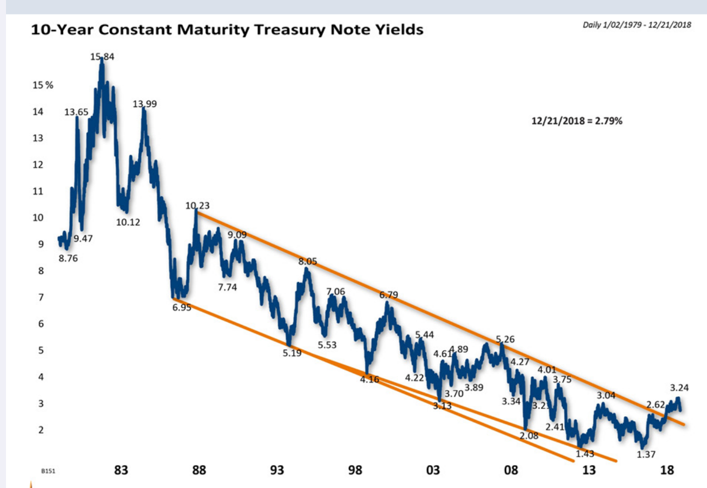
Furthermore, the VIX Index, a measure of stock market volatility, hit its highest level in late December since early February. These sentiment swings, which are largely driven by emotion, have moved from an underappreciation of volatility moving into the 4th quarter to an overly dire outlook moving out of the 4th quarter.

The contrarian nature of investor sentiment has moved, in our opinion, to a more positive position as some healthy skepticism has returned to the market once again.

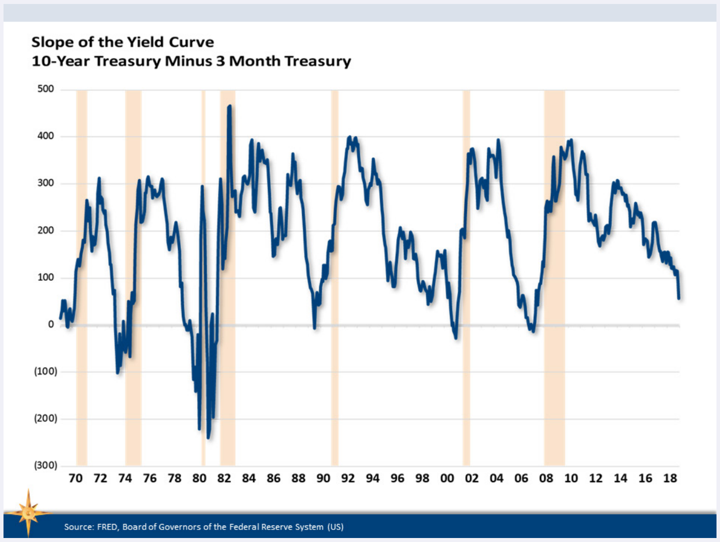


Source: Ned Davis Research

Our final gauge is interest rates, which we have left in a neutral position. The ride was clearly a volatile one for yields in 2018. The yield on the 10-year U.S. Treasury ended the 3rd quarter just above 3%, but it dropped dramatically to around 2.69% by the close of the year. As equities struggled in the 4th quarter,



Source: Ned Davis Research



a flight to quality ensued, and Treasuries rallied driving the 10-year UST yield to its lowest point since January.

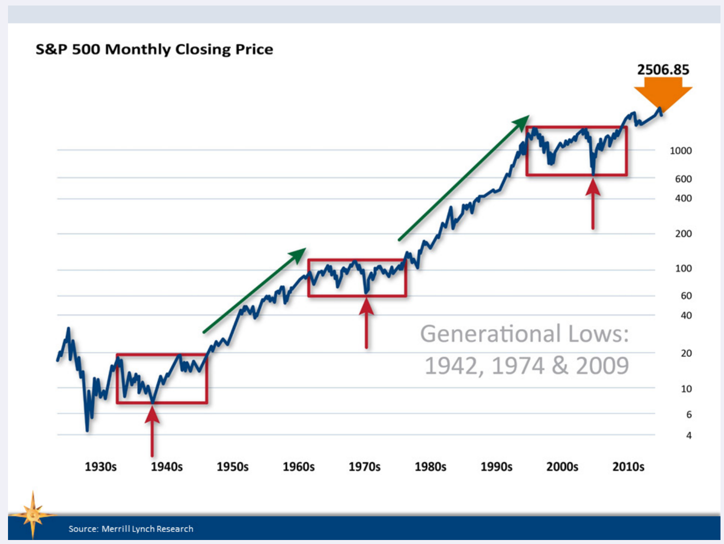
The yield curve continued to flatten as well moving through the 4th quarter. The Fed marched on with its 4th rate hike of 2018 in December, narrowing the spread between 10-Year yields and 3-month T-bills. As this spread gets narrower, the actions of the Fed will be more and more scrutinized in 2019.

From a longer-term perspective, rates remain low, and we believe the level of interest rates is still having a neutral effect on the U.S. economy at this point. Therefore, we keep this indicator in a neutral position. Fed policy and the shape of the yield curve will continue to be front and center discussion points in 2019 and will require close monitoring.

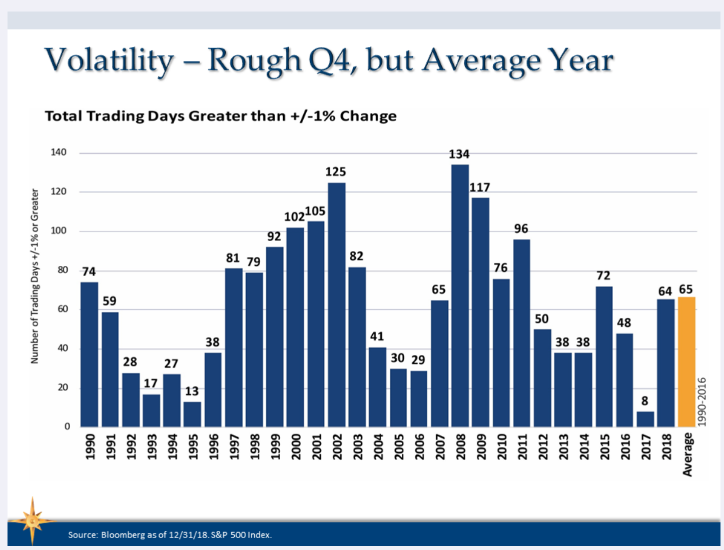
Moving to the capital markets, the second half of 2018 was the tale of two quarters. Equities enjoyed strong gains in the 3rd quarter as the historically slow summer months proved to be a great time for equity investors. Most major U.S. equity indices posted all-time highs during these months and volatility was subdued…so subdued that there were exactly zero trading days in the entire 3rd quarter that saw the S&P 500 move up or down by more than 1%.

The 4th quarter was just the opposite. The 4th quarter had 28 trading days in which the S&P 500 moved up or down by more than 1%. When the dust settled, the S&P 500 was down by -13.5%–the worst quarter since Q3 2011.

The S&P 500 came within a whisper of entering bear market territory, which is defined as down 20% from the prior high. The S&P 500 was off 19.8% at one point, but the tech-heavy NASDAQ Composite did enter into an official bear market in the 4th quarter as the once high-flying FAANG stocks took an equally sharp drop as equities broadly weakened.



While it might be hard to believe coming off the 4th quarter, volatility was about as normal as you get in 2018 when you look back historically at 1% trading days.

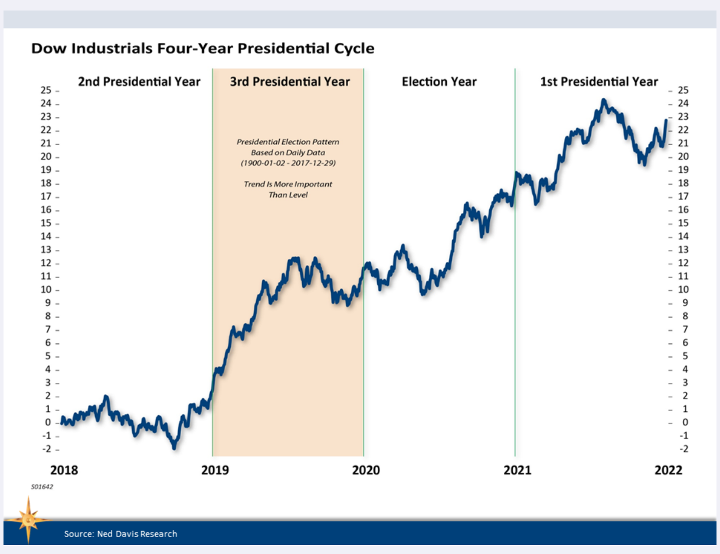


Looking at data dating back to 1990, we have averaged about 65 1% trading days in a calendar year, and we had 64 such days in 2018. Again, contrasting Q3 and Q4, we had exactly zero 1% trading days in Q3, but 28 1% days in Q4.

Obviously, the 4th quarter was very volatile, and sharp declines in December pushed equity results into negative territory for 2018.

At the beginning of 2018, we expected a return to more normal levels of market volatility following a historically low year of volatility in 2017, and we certainly got it as mid-term elections, a change in Fed leadership, and ongoing trade tensions with China set the market up for more turbulence.

While history does not need to repeat itself, we are entering a historically strong period for equity markets as the first two quarters of the 3rd year of the Presidential Cycle, which will be the first two quarters of 2019, have historically been the second and 3rd best quarters of the entire four-year Presidential Cycle for equities.



Turning to bonds, high yield bonds had been the clear outperformer through the first three quarters of 2018 as Treasuries struggled under a rising rate environment. However, the "risk-off/flight to quality" trade hit high yield in the 4th quarter and this pocket of fixed income dropped sharply as investors flocked to the perceived safety of U.S. Treasuries. As the Fed kept pushing up short-term rates, yields rose at the front end of the yield curve as well.

With this backdrop, the Clark Capital Fixed Income Total Return strategy exited its high-yield exposure in the middle of November after maintaining this allocation for 32 months, since February of 2016.

In general, fixed income was mixed in 2018. Most bond sectors outside of high yield struggled through the first three quarters of the year. However, yields dropped dramatically in the latter part of 2018, which in turn helped many bond sectors, with the exception of high yield, rally.

Nothing epitomizes this back and forth year in fixed income better than the widely followed bond benchmark, the Bloomberg Barclays Aggregate Bond Index, which enjoyed a December rally that turned what would have been only its 4th year of negative returns since 1976 into a slightly positive year. When it was all said and done, this index returned 1 basis point or 0.01% in 2018.

Putting this all together, 2018 turned out to be a challenging year for most asset classes as U.S. stocks, international stocks, and commodities declined during the year, while fixed income was more mixed. We believe the 4th quarter sell-off that culminated in panic selling during December has left stocks dramatically oversold and will likely prove to be a good buying opportunity as 2019 progresses.

Moving into the New Year, we continue to favor stocks over bonds, and we believe the long-term secular bull market is still intact, driven by a solid economic backdrop. Our forecast this year for the S&P 500 is 2900. Volatility will likely continue in 2019 as trade tensions with China remain unresolved, the Fed enters the latter stages of this rate hike cycle, earnings growth slows after extraordinary strength in 2018, the U.S. economy likely moderates from its exceptional growth pace last year and the political divide in Washington worsens.

Ultimately, however, we think that fundamentals are what matter in the long run, and the current fundamentals are positive. During these periods of elevated volatility, we believe it is imperative for investors to stay focused on their long-term goals and not let short-term swings in the market derail them from their long-term objectives.

Please contact your Investment Consultant to discuss how we can support your client reviews and how we can help you deliver successful outcomes to your clients.

Thanks for watching.