Portfolio Commentary

Navigator® Opportunity Update

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Stocks Say We Are in Paradise, but Bonds Say Something Else — Which Is Right?

Markets staged a fierce rally in the first quarter and followed through with further gains in the second quarter, despite a hiccup in May. Consider that at the end of December weak stock markets were concerned about a too hawkish Fed that, combined with a trade war, was spurring a global slowdown.

Now, six months later, markets are expecting four Fed rate cuts over the next year, yet markets have surged to a new high. The activity serves as a stark reminder that the stock markets' most important ally is a friendly Fed; for most of 2018 a hawkish Fed haunted stocks, but 2019 has been a completely different story since Powell pivoted on rates on January 4th.

Yet at the same time, we have completely opposite predictions from the stock and bond markets. Stocks are out at new highs, expecting a rebound in corporate earnings, a dovish Fed, and a positive resolution to the trade war. However, bond markets have an inverted yield curve and have priced in four future Fed rate cuts over the next year, predicting a major economic slowdown or a full on recession.

On one hand, we have an inverted yield curve since May 23rd that shows no signs of ending. Historically if the yield curve is inverted for over 60 days then the odds of an earnings recession or an outright recession are quite high. In addition, over half of the world's Global PMIs are below 50, indicating contraction. Then when we hear that in July this bull market will become the longest on record, we must be near the end, right?

Despite all of these concerns, which are well-recognized by the bond markets, there is a case for a bullish resolution. The Fed has now provided a friendly monetary environment for at least the next few quarters, and historically, market forward returns are positive when Global PMIs are this weak. An important bullish factor to us is the magnitude of this economic expansion–it has produced growth at about half the rate of prior 7 to 10-year expansions. Therefore, the economy is not as stretched to capacity, and there are not as many imbalances as one might infer. This is not to mention the strong possibility that at least a modest resolution to the trade war will arrive by early next year.

This mixed set of strong bullish and bearish indications is something new for the U.S. economy and investors, and it is a tough environment to operate in. At Clark Capital, we continue to believe that a focus on risk management will pay off in the long run, as a bear market and weak economy, when they come, will present opportunities to first preserve capital and then later be tactically opportunistic.

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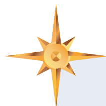

Sector Opportunity Portfolio

The Sector Opportunity portfolio uses a relative strength methodology to rank the top performing sectors over the intermediate-term, and by owning these sectors going forward (and avoiding lower-ranked sectors) attempts to outperform the S&P 500.

The first quarter's strong market environment continued into April, and after a brief, dramatic drawdown in May, was resurgent through June. Traditional cyclical leaders like Technology and Consumer Discretionary played their part and performed well, but were also joined by the interest rate-sensitive Utility and Real Estate sectors. Energy, Financials, and Industrials were laggards.

Within our sector and industry ranking system we saw few ETFs that were able to beat the S&P 500 Index, and very few that were out to new relative strength highs by the end of June. As a result, the portfolio is currently nearly half invested in the S&P 500 Index itself.

Some sectors like Aerospace (ITA) fared well in our ranks, but when we look at their charts they were flat to neutral. When conditions offer us mediocre holdings without genuine trends, our usual tact is to just index until the market clarifies. Right now with large-caps decisively leading markets, the S&P 500 on its own beats almost all comers, with the exception of Technology. Here are some further developments in the portfolio during the quarter:

- Software (IGV) and Homebuilders (XHB) had the strongest, clearest trends throughout the quarter. However, both trends have lost momentum and are flat recently. Financials and Energy were oversold but had a June bounce. Their relative trends remain weak and need a multi-month turnaround before they would become potential buys to us. Consumer Discretionary is very sensitive to Fed action, and is on the rise after the Fed's tone turned.
- Energy and Materials continue to suffer from the weak global economy and trade war fears. They continue to make new relative lows, and there is no sustained turnaround in sight.
- The S&P 500 (IVV) and Homebuilders (XHB) were the top contributors on the quarter, while Online Retail (IBUY) and Consumer Discretionary (VCR) were the top detractors.

Ticker	Quarter Ending June 30, 2019	Average Weight (%)	Contribution to Return (%)
Top Contributors			
IVV	iShares Core S&P 500 ETF	31.87	1.67
XHB	SPDR S&P Homebuilders ETF	15.34	1.30
IGV	iShares Expanded Tech-Software Sector ETF	15.18	0.53
FDN	First Trust Dow Jones Internet Index Fund	9.83	0.27
Top Detractors			
IBUY	Amplify Online Retail ETF	7.13	-0.16
VCR	Vanguard Consumer Discretionary ETF	5.20	-0.07
VGT	Vanguard Information Technology ETF	0.11	-0.07
VNQ	Vanguard Real Estate ETF	5.67	-0.01

International Opportunity Portfolio

The International Opportunity portfolio's stated mission is to allocate tactically between international style, factor, and regional ETFs that are displaying significant relative strength (and avoiding those that do not), and in doing so, to attempt to outperform the MSCI All Country World Ex-U.S. Index. The portfolio's universe of investments now includes: International Value, Growth, Quality, Small Cap, Currency Hedged, Minimum Volatility, Buyback, and Momentum ETFs, along with Emerging Markets, Emerging Markets Small Cap, and Emerging Markets Minimum Volatility ETFs.

As the quarter began the portfolio favored emerging markets and the Asia-Pacific region, but that quickly changed as trade war fears rocked China and Asian exporters. Our assets shifted to favor developed markets' high quality and growth stocks, which have stable growth rates and solid balance sheets. As the economic news turned for the worse in China and Europe, safety and quality were rewarded and they proved to have solid performance into quarter end.

We also established a currency hedged position in EAFE stocks, and we believe this is merited by negative interest rates in Europe and Japan. It is hard to see how any currency can hold its value when its interest rates are negative. As June ended, we did see a recovery in emerging markets as tempers eased in trade war negotiations and many emerging markets currencies surged against the dollar.

It is amazing to consider that emerging market nations, though filled with many political and structural flaws, still have a currency system with positive, though volatile, interest rates. Meanwhile, rates in developed nations in Europe and Japan have turned negative as their political and economic systems have stagnated under huge debt loads. That is why we expect Asia-Pacific equity to dominate this portfolio over time; their growth rates now and in the future are expected to be considerably higher. Furthermore, their valuations are in line or lower than Europe and Japan. Here are some further developments during the quarter:

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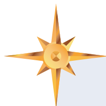

- U.S. markets have trounced international markets for many years now, and though the U.S. is more expensive, we do not see that trend letting up anytime soon. The International Opportunity portfolio has held a 25% position in the U.S. (the maximum allowed by policy) for most of 2019, and through all of the second quarter. Amazingly, U.S. small-caps fall dead last in our rankings. That is certainly reflective of the dominance that large-cap technology stocks, along with Facebook, Google, and Amazon have shown compared to the entirety of global markets.
- Given the new, smaller universe size that the portfolio follows, we expect that the portfolio will own between three to six ETFs, up to about one third of the universe of 18 different ETFs.
- Developed markets' value stocks, buybacks, and U.S. small-caps rank lowest in our matrix. Weakness in European financials continues to drive underperformance among value stocks. Stock buybacks can be viewed as a play to leverage international economic growth and profits; however, that factor has struggled as developed market economic growth has flatlined.

Style Opportunity Portfolio

The Style Opportunity portfolio focused on large-caps throughout the quarter, as small-caps lost the brief momentum that they had gained after the December bottom. Growth was favored over value, as it has been for many quarters and years; however, the pace of growth's gains versus value's has moderated. Now, more defensive growth ETFs have entered the portfolio.

In the table below, you can see that large-cap growth stocks have outperformed large-cap value by over 6.5% per year over the last three years–a huge gap. small-cap growth has also outperformed small-cap value by 3.5% per year. Even though value stocks are slower growing, value investors keep asking: at some point don't these cheaper stocks offer opportunity while rich growth stocks present too much risk?

Index Name	2019 YTD	3-Year Annualized Gain (%)	Index Forward P/E as of 1/26/18 Peak	Index Forward P/E as of 6/30/19
SPDR S&P 500 Value ETF (SPYV)	16.58%	10.60%	16.18	14.40
SPDR S&P 500 Growth ETF (SPYG)	20.02%	17.13%	21.59	22.18
iShares S&P 600 Small Cap Value ETF (IJS)	13.56%	9.99%	18.36	16.18
iShares S&P 600 Small Cap Growth ETF (IJT)	13.59%	13.48%	23.95	22.84

Source: Bloomberg. For illustrative purposes only.

We believe value is the longest lasting and most prominent investment "factor" in the markets, and for most of the past decade it has been punished relentlessly. When will that turn around? We cannot say, but we can say that the gap between value and growth is becoming extreme. large-cap value's Forward P/E (at 14.4) is at its largest difference with large-cap growth (at 22.2) since 2009. The same can be said of the difference between small-cap value and small-cap growth. Small-caps in general are also at their cheapest since 2009 in comparison to large-caps. In our opinion, value investing presents a multi-quarter and even multi-year mean reversion opportunity for investors.

The Style Opportunity portfolio has largely avoided value stocks, as their momentum has been poor. However, we recognize that the value factor will eventually provide an outsized chance for relative gains that we will be more than happy to jump into once a trend develops.

Global Tactical Portfolio

The methodology of the Global Tactical portfolio is to select ETFs that are part of a narrowed-down universe of 32 U.S. equity styles, sectors, country/regions, and commodities. The portfolio uses the Fixed Income Total Return credit market model as an overlay to manage risk.

When the credit market model is positive towards high yield bonds (and thus on credit risk and market risk in general), the portfolio will select from its ETF universe made up primarily of equities. However, when the credit model turns negative, the portfolio sells equities and owns cash or U.S. Treasury bonds that are in line with the Fixed Income Total Return portfolio's holdings.

When our credit market model turned positive towards stocks on January 10th, the Global Tactical portfolio flipped to 100% equity exposure, and the portfolio maintained that exposure through June 3rd, when our credit models turned negative and the portfolio moved into U.S. Treasuries. Our models have moved roughly halfway towards moving back into equities, but while equities have rallied, the economic data has been mediocre, and the chance that markets will still turn south remains very real.

- While the Global Tactical portfolio missed out on some of June's upside, it is important to remember that it avoided considerable volatility in late 2018. Between November 16th and our re-entry back into equities on January 10th, the iShares Core S&P 500 ETF (IVV) declined 4.8%, and the iShares Core S&P 600 Small Cap ETF (IJR) tumbled 6.2%.
- When the portfolio owns equity, it will own a suite of ultra-low cost, broad ETFs with a 70% U.S. to 30% in-

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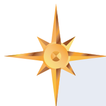

ternational equity weighting. The portfolio will include U.S. Large Caps (SPLC), U.S. Small Caps (IJR), broad Large Cap International Equity (IXUS), and Small Cap International Equity (VXUS).

- Now that markets have priced in a dovish Fed and more constructive U.S./China trade talks, third quarter earnings reports will face lofty expectations. If companies deliver, we would expect to re-enter equities before the third quarter ends.

Alternative Opportunity Portfolio

We recommend that investors view the Alternative Opportunity portfolio as a source of alternative beta and exposures that looks to capture available risk premia and tactical trading gains. The product is designed to serve as a diversifier and to provide lower downside correlation during times of volatility. The Alternative Opportunity portfolio contains a broad mix of themes which breaks down as follows: Alternative-Oriented Mutual Funds and ETFs 49.0%, Tactical Global Equity 26.0%, Fixed Income 16.0%, Commodities 5.0%, and Cash 4.0%. The following are some important events that occurred in the portfolio during the quarter:

- The primary purpose of the core liquid alternative portion of the portfolio is to provide non-correlated alternative exposure and includes seven mutual funds (and one ETF) in the alternative credit, long/short equity, long/short commodity, managed futures, options-based, high yield muni bond, and merger arbitrage areas. Neuberger Berman Long/Short (NLSIX—up 4.42%) and Nuveen High Yield Muni Bond (NHMRX—up 3.25%) were the best performing funds, while LoCorr Commodity Long/Short (LCSIX—up 0.20%) and James Alpha Domestic Equity Hedged (JDIEX—up 1.55%) were the worst performers.
- The Alternative investing sphere enjoyed gains, with the exception of commodities. The SG Trend Index, a trend-following managed futures index, gained 4.42%. The Bloomberg Commodity Index declined 1.19%, largely due to falling oil prices. Gold, on the other hand, surged, gaining 9.14% on the quarter. The HFRX Event Driven Equity Index was up 1.69%. Our Alternative portfolio benchmark, the HFRX Global Hedge Fund Index, gained 1.58%.
- Gold (GLDM) and Emerging Market Local Currency (EMLC) both surged after the Fed became outspokenly dovish in early June; both benefited from a reduction in real U.S. interest rates. Oil Services stocks (OIH) and farmland (FPI) were hurt by the slowing global European and Chinese economies, and particularly for farmland, by Chinese tactics in the trade war.
- The top contributors to return for the quarter were Gold (GLDM) and Emerging Markets Local Currencies (EMLC); the dollar may have taken a major turn after the Fed softened. Oil Services stocks (OIH) and Global Forestry (WOOD) were the top detractors and were collateral damage in the trade war.

Ticker	Quarter Ending June 30, 2019	Average Weight (%)	Contribution to Return (%)
Top Contributors			
GLDM	SPDR Gold MiniShares Trust	5.03	0.47
EMLC	VanEck Vectors J.P. Morgan EM Local Currency Bond ETF	4.69	0.37
NLSIX	Neuberger Berman Long Short Fund	6.09	0.24
NHMRX	Nuveen High Yield Municipal Bond Fund	6.09	0.20
BILPX	BlackRock Large Cap Srs Fds, BlackRock Event Driven Equity Fund	10.08	0.19
Top Deractros			
OIH	VanEck Vectors Oil Services ETF	4.92	-0.66
WOOD	iShares Global Timber & Forestry ETF	2.97	-0.08
MNA	IQ Merger Arbitrage ETF	2.92	-0.03
JNK	SPDR Bloomberg Barclays High Yield Bond ETF	0.00	0.00
BGCIX	BlackRock Global Long/Short Credit Fund	0.00	0.00

Source: Factset. For illustrative purposes only. Past performance does not guarantee future results. The holdings identified do not represent all of the securities purchased, sold or recommended for advisory clients. In the chart above, "weight" is the average percentage weight of the holding during the period, and "contribution" is the contribution to overall performance during the period. To obtain the calculation methodology and a list showing every holding's contribution to the overall composite during the period, contact: PortfolioAnalytics@ccmg.com.

Fixed Income Total Return

The Fixed Income Total Return (FITR) portfolio purchased high yield bonds on January 10th and held them until June 3rd, when the portfolio moved into U.S Treasuries. The move was precipitated more by the relative strength shown in U.S. Treasuries more so than the weakness of high yield bonds. Markets quickly turned around after the trade as credit rebounded upon numerous dovish Fed comments and high yield credit enjoyed solid June gains. What has been remarkable is that Treasuries have continued to provide gains at the same time as markets price in further rate cuts.

The yield on the Barclays U.S. Treasury Bond Index has fallen below 2%, and we continue to see a cognitive dissonance between credit and equity markets that expect a recovery and bond markets, which are betting on more downside. As we look forward to the Fed's first expected rate cut in July, we are mindful that historically credit spreads have widened heading into the first rate cut.

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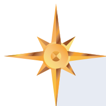

Ultimately, we believe de-risking the portfolio can provide a smoother risk-adjusted ride through the credit markets. The following were other developments in the portfolio during the quarter:

- Over 50% of the U.S. Investment Grade corporate market is now rated BBB, with the next downgrade moving them into the High Yield category. With low interest rates, this is not an immediate cause for concern. However, the next time that we see a recession or major credit downgrade cycle, the price pressure on lower quality investment grade and high yield credit will be huge, and it will provide opportunities to play defense and then become a tactical buyer as sentiment turns.
- On the quarter, the top performing holdings were the Navigator Tactical Fixed Income Fund (NTBIX) and the iShares 7-10 Year Treasury ETF (IEF). Detractors included the Bloomberg Barclays High Yield Bond SPDR (JNK) and the Deutsche X-Trackers High Yield Bond ETF (HYLB).

Ticker	Quarter Ending June 30, 2019	Average Weight (%)	Contribution to Return (%)
Top Contributors			
NTBIX	Navigator Tactical Fixed Income Fund Class I	49.92	0.19
IEF	iShares 7-10 Year Treasury Bond ETF	7.14	0.18
ITE	SPDR Bloomberg Barclays Intermediate Term Treasury ETF	4.76	0.09
LAHYX	Lord Abbett Investment Trust High Yield Fund Class I	2.10	0.03
AGDYX	AB High Income Fund, Inc. - Advisor Class	2.08	0.02
Top Detractors			
HYG	iShares iBoxx $ High Yield Corporate Bond ETF	6.28	-0.07
JNK	SPDR Bloomberg Barclays High Yield Bond ETF	5.63	-0.07
HYS	PIMCO 0-5 Year High Yield Corporate Bond Index ETF	1.38	-0.01
SJNK	SPDR Bloomberg Barclays Short Term High Yield Bond ETF	1.38	-0.01
HYLB	Xtrackers USD High Yield Corporate Bond ETF	1.39	-0.01

Source: Factset. For illustrative purposes only. Past performance does not guarantee future results. The holdings identified do not represent all of the securities purchased, sold or recommended for advisory clients. In the chart above, "weight" is the average percentage weight of the holding during the period, and "contribution" is the contribution to overall performance during the period. To obtain the calculation methodology and a list showing every holding's contribution to the overall composite during the period, contact: PortfolioAnalytics@ccmg.com.

Sentry Managed Volatility Portfolio

Hedging one's equity exposure during a strong market for equities, or even just a flat market for equities, is an exercise in patience and understanding the proper role of a hedge in a broader portfolio. As historical patterns had indicated, markets continued higher after the dramatic first quarter rally. The S&P 500 gained 4.3%, and those gains entirely came from the June Fed-driven rally. Amidst such a strong equity environment, our equity hedge strategy was left with nothing to do but tactically trade to minimize costs, as our primary hedges declined in accordance with their design.

Looking forward into the rest of 2019, a wide range of potential outcomes exists. That means volatility is likely to be elevated, and we will have opportunities to reduce the cost of our hedge. However, as we have discussed above, a bullish outcome in the end stands as the far from certain but most likely outcome. In this scenario, reducing our hedging cost will likely stand as the portfolio's primary action.

However, as we are at the later stages of the economic cycle, investors should keep in mind that an equity hedge can play a valuable volatility-reducing role when markets and the economy turn south. Its most valuable role of all might be to keep investors sticking to their long-term plan, and not deviating at an inopportune time.

We remain committed to keeping protection on at all times for our clients in the Sentry program, and when we see spikes in volatility, we are often looking to be opportunistic about reducing the cost of the hedge. That means taking profits on being long volatility. While these profits come quickly and dramatically, they disappear quickly as well.

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The MSCI ACWI ex USA Index captures large and mid cap representation across 22 of 23 Developed Markets (DM) countries (excluding the US) and 26 Emerging Markets (EM) countries*. With 2,206 constituents, the index covers approximately 85% of the global equity opportunity set outside the US.

A S&P 500 'BBB' rated obligation exhibits adequate protection parameters. However, adverse economic conditions or changing circumstances are more likely to weaken the obligor's capacity to meet its financial commitments on the obligation.

The SG Trend Index is a trend-following index that measures managed futures.

The Bloomberg Commodity Index is a highly liquid and diversified benchmark for commodity investments.

The HRFX Event Driven Index maintain positions in companies currently or prospectively involved in corporate transactions of a wide variety including but not limited to mergers, restructurings, financial distress, tender offers, shareholder buybacks, debt exchanges, security issuance or other capital structure adjustments. Security types can range from most senior in the capital structure to most junior or subordinated, and frequently involve additional derivative securities.

The HFRX Global Hedge Fund Index is designed to be representative of the overall composition of the hedge fund universe. It is comprised of all eligible hedge fund strategies; including but not limited to convertible arbitrage, distressed securities, equity hedge, equity market neutral, event driven, macro, merger arbitrage, and relative value arbitrage.

The Bloomberg Barclays US Treasury Index measures US dollar-denominated, fixed-rate, nominal debt issued by the U.S. Treasury

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 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. 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.

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