Clark Capital Management Group

Benchmark Review
& Monthly Recap

Highlights

Bonds rallied in August as multi-year and even historic lows were seen in U.S. Treasury yields. The 10-year U.S. Treasury yield fell sharply and broke below the 1.5% level. Even more dramatic, the 30-year U.S. Treasury yield dropped below the 2% mark in August — a record low for these long-dated bonds.

After achieving 3,000 for the first time in history in late July, stocks drifted lower and volatility returned in August.

International stocks struggled as the U.S. dollar strengthened to its highest level since 2017, creating a headwind for non-U.S. dollar investments.

The market reacted negatively to the inversion between the 10-year and 2-year U.S. Treasury yields — a historically negative sign for the U.S. economy — which occurred in August for the first time since June 2007.

The current U.S. economic expansion is the longest on record but grumblings about a pending recession have now taken center stage in the market. While U.S. economic data is more mixed, we expect ongoing growth into 2020.

Confusion on the course of Fed action, continued uncertainty regarding the trade situation with China, negative global bond yields and concern about U.S. economic growth led to a volatile month for markets as stocks declined.

Yields Plunge as Stock Market Volatility Returns

Equity Markets

The volatility that equity markets experienced in August really kicked-off in late July when stock market highs, trade concerns and Fed uncertainty collided. The S&P 500 Index achieved a new all-time high in July and broke above the 3,000 level for the first time in its history, but suffered a rather large sell-off following the July FOMC meeting.

Investors were not pleased to hear Fed Chairman Powell's characterization of the rate cut as more of a mid-cycle adjustment versus a new loosening cycle, and President Trump announced new tariffs on China soon afterwards. Fed policy uncertainty and trade concerns were front and center during most of August and led to some significant swings in the market. Volatility, as measured by the VIX Index, hit its highest levels in August since early January as equities had a hard time finding their footing during the month. As August concluded, trade issues remained unresolved and the meeting of central bankers in Jackson Hole, Wyoming led to another volley of tweets by the President pressuring the Fed to cut rates.

To say the markets will watch closely the lead up to and conclusion of the FOMC meeting on September 17-18 is an understatement. Additionally, progress and/or setbacks on the trade front with China will preoccupy the market until some clarity is achieved on this matter.

The ongoing theme of large-cap growth stocks outperforming other equities continued in August despite stock market declines across the board. Small and mid-cap stocks underperformed their large-cap counterparts, growth outperformed value and U.S. equities outpaced international stocks. The value/growth relationship continues to be stretched to historic extremes and should the current situation revert to more historical norms, value-oriented stocks should benefit.

The numbers for August were as follows: The S&P 500 declined – 1.58%, the Dow Jones Industrial Average fell – 1.32%, the NASDAQ Composite dropped – 2.46%, and the Russell 2000 Index, a measure of small-cap companies, lost – 4.94%. Large-cap value stocks, as measured by the Russell 1000 Value Index, lagged their growth counterparts once again in August declining – 2.94% compared to large-cap growth stocks, as measured by the Russell 1000 Growth Index, which fell only – 0.77%.

International equities continued to feel the brunt of U.S. dollar strength and declined during August. In fact, the U.S. dollar index continued to rise and put in its highest mark since 2017. Sluggish international economies also contributed to global stock market weakness. With this backdrop, emerging market equities, as measured by the MSCI Emerging Markets Index, fell by – 4.88% in August and

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the MSCI ACWI ex USA Index, a broad measure of international equities, declined – 3.09% for the month. International stocks are positive year-to-date, but in general, their gains have been well below the returns of U.S. stocks.

Fixed Income

The headline story in August (in a month of many headline stories) was the dramatic drop in U.S. Treasury yields. By the end of August, all points along the Treasury yield curve were below the Fed Funds target rate. The 10-year U.S. Treasury yield approached lows last seen in July 2012 and July 2016 below 1.5%. The 30-year U.S. Treasury yield dropped below 2.0% during the month, its lowest point on record.

The amount of global bonds with negative yields continued to increase in August with the count well above $15 trillion. The yield on the 10-year U.S. Treasury ended July at 2.02%, but plunged to close August at 1.50%. Even more dramatic, the yield on the 30-year U.S. Treasury closed August at 1.96% after closing July at 2.53%. During a month of sharply declining yields, bond prices rallied.

The yield curve inversion now exists throughout the curve when comparing yields to the Fed Funds target rate. We acknowledge that an inverted yield curve has been a historically negative signal for the direction of the U.S. economy. At the same time, other economic readings that tend to be on the front end of the economy, like the leading economic indicators index and job market data, are not showing the same cautionary signals. We continue to monitor developments in this area closely but expect ongoing economic growth through 2019 and into 2020.

The Fed is trying to engineer a challenging balancing act by supporting economic growth, but at the same time, not cutting rates too much too soon. Market forces are already lowering rates on their own when one looks across most points on the yield curve. Negative global yields, declining rates in the U.S. and continued pressure from the Trump administration to cut rates only complicates the job of the Federal Reserve as we move toward the September FOMC meeting.

In this environment, fixed income results were as follows: The Bloomberg Barclays U.S. Aggregate Bond Index was up 2.59% for the month, the Bloomberg Barclays U.S. Credit Index gained 3.13%, the Bloomberg Barclays U.S. Corporate High Yield Index inched higher by 0.40% and the Bloomberg Barclays U.S. Treasury Index gained 3.40%. TIPS showed gains for the month and muni bonds also advanced in August. One of the most interest rate sensitive fixed income categories is long maturity U.S. Treasury bonds and, reflecting this sensitivity, the index measuring 30-year U.S. Treasury performance gained 12.53% for the month alone.

Economic Data and Outlook

Economic readings continued to paint a mixed picture for the U.S. economy in August. Concern over future U.S. economic growth spiked following the inversion of the 10-year and 2-year U.S. Treasury yields in August – a historically negative sign. However, we have been noting the inversion of the 10-year and 3-month Treasury yields since May, so this development was not too unexpected from our perspective. Economic data released in August (see table on the next page), which largely covered the month of July, was rather mixed.

The widely followed Institute for Supply Management (ISM) manufacturing index for July declined further from an almost two-year low in July of 51.7. Instead of improving modestly as expected to 52, this index slid to 51.2 moving closer to the all-important 50 level, the dividing line between expansion and contraction. (On September 3, the ISM manufacturing index for August was released and it dropped to 49.1, the lowest level and first reading below 50 since 2016.) Uncertainty over the global trade situation is likely leading manufacturers to delay activity until more clarity emerges.

The ISM non-manufacturing index, which represents the much larger service industries in the U.S. economy, dropped as well in July to 53.7 when a modest improvement was expected from June's mark. Housing market data was the epitome of mixed with building permits and existing home sales stronger than expected in July and improved from the prior month, but housing starts and new home sales below expectations and weaker than the prior month's levels.

Non-farm payroll additions were 164,000 in July, which was virtually in-line with expectations of 165,000. The unemployment rate stayed at 3.7%, when it was expected to drop to 3.6%, but that coincided with an increase in the labor force participation rate for the month. Average hourly earnings ticked higher to 3.2% on a year-over-year basis when expectations were calling for no increase from the 3.1% gain in June. Showing the resilience of the U.S. consumer, retails sales (ex. auto and gas station sales) were much stronger than expected in July, increasing by 0.9% for the month when a 0.5% gain was anticipated. However, consumer confidence, as measured by the University of Michigan consumer sentiment index, fell unexpectedly in its final August reading, so monitoring the spending of consumers moving forward will be important.

The leading economic indicators index from the Conference Board was stronger than expected, increasing by 0.5% in July when a 0.3% gain was anticipated and the prior month's decline of – 0.3% was revised to a more modest drop of – 0.1%. Finally, the second reading of second quarter GDP showed annualized growth of 2.0% as expected, which was

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modestly lower than the preliminary estimate of 2.1%.

Debate and scrutiny continued to follow the Fed in August. Although no FOMC meetings occurred during the month, the widely followed annual symposium in Jackson Hole, Wyoming took place. The general sense from central bankers seemed to take on a more wait-and-see approach to additional monetary policy action. This continued to draw the ire of the Trump administration, which keeps pressing the Fed for further and more aggressive rate cuts.

Additional concern exists that upcoming Fed action and market expectations for ongoing rate cuts might be out of step with one another. From our perspective, market expectations about the ultimate amount of rate cuts by the Fed seems to be too aggressive with stocks still near all-time highs, unemployment near multi-decade lows and ongoing (albeit somewhat sluggish) economic growth.

We continue to expect economic growth through 2019 and into 2020. However, due to uncertainty in upcoming Fed policy decisions, unknowns on the trade front, and some slowing of U.S. economic activity, we also believe that the range of outcomes for the stock market is wider than usual. While these issues continue to be uncertain, it seems as though capital market volatility will remain elevated until some clarity begins to develop.

Investment Implications

Clark Capital's Top-Down, Quantitative Strategies

Our top down strategies maintain a defensive posture with exposure to minimum volatility, large-cap growth equities and U.S. Treasuries where applicable.

Clark Capital's Bottom-Up, Fundamental Strategies

In general, our equity portfolios remain overweight large-cap vs. small-cap and are focused on owning high quality companies. In fixed income, we continue to focus on increasing credit quality and slightly extending duration. Our barbell approach allows the portfolio to seek opportunities at different ends of the duration spectrum. In our opinion, an active approach to managing fixed income is more important now than ever as yields challenge the lower bound.

Economic Data

Event	Period	Estimate	Actual	Prior	Revised
ISM Manufacturing	July	52.0	51.2	51.7	—
ISM Non-Manf. Composite	July	55.5	53.7	55.1	—
Change in Nonfarm Payrolls	July	165k	164k	224k	193k
Unemployment Rate	July	3.6%	3.7%	3.7%	—
Average Hourly Earnings YoY	July	3.1%	3.2%	3.1%	—
JOLTS Job Openings	June	7326k	7348k	7323k	7384k
PPI Final Demand MoM	July	0.2%	0.2%	0.1%	—
PPI Final Demand YoY	July	1.7%	1.7%	1.7%	—
PPI Ex Food and Energy MoM	July	0.1%	-0.1%	0.3%	—
PPI Ex Food and Energy YoY	July	2.3%	2.1%	2.3%	—
CPI MoM	July	0.3%	0.3%	0.1%	—
CPI YoY	July	1.7%	1.8%	1.6%	—
CPI Ex Food and Energy MoM	July	0.2%	0.3%	0.3%	—
CPI Ex Food and Energy YoY	July	2.1%	2.2%	2.1%	—

Event	Period	Estimate	Actual	Prior	Revised
Retail Sales Ex Auto and Gas	July	0.50%	0.90%	0.70%	0.60%
Industrial Production MoM	July	0.10%	-0.20%	0.00%	0.20%
Building Permits	July	1270k	1336k	1220k	1232k
Housing Starts	July	1256k	1191k	1253k	1241k
New Home Sales	July	647k	635k	646k	728k
Existing Home Sales	July	5.40m	5.42m	5.27m	5.29m
Leading Index	July	0.30%	0.50%	-0.30%	-0.10%
Durable Goods Orders	July P	1.20%	2.10%	1.90%	1.80%
GDP Annualized QoQ	2Q S	2.00%	2.00%	2.10%	—
U. of Mich. Sentiment	Aug F	92.4	89.8	92.1	—
Personal Income	July	0.30%	0.10%	0.40%	0.50%
Personal Spending	July	0.50%	0.60%	0.30%	—
S&P CoreLogic CS 20-City YoY NSA	June	2.30%	2.13%	2.39%	2.37%

Source: Bloomberg P=Preliminary S=Second F=Final

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The Dow Jones Industrial Average indicates the value of 30 large, publicly owned companies based in the United States.

The NASDAQ Composite is a stock market index of the common stocks and similar securities listed on the NASDAQ stock market.

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 Russell 1000 Index measures the performance of the highest ranking 1,000 stocks in the Russell 3,000 Index, which represent about 90% of the total market capitalization of that index.

The Russell 2000 Index is a small-cap stock market index that represents the bottom 2,000 stocks in the Russell 3000.

The Russell 3000 Index measures the performance of the 3,000 largest U.S. companies based on total market capitalization, which represents approximately 98% of the investable U.S. equity market.

The MSCI Emerging Markets Index is used to measure large and mid-cap equity market performance in the global emerging markets.

The MSCI ACWI ex USA Index captures large and mid-cap representation across 22 of 23 developed market countries and 24 emerging market countries, covering approximately 85% of the global equity opportunity set outside of the U.S.

Bloomberg Barclays U.S. Aggregate Bond Index: The index is unmanaged and measures the performance of the investment grade, U.S. dollar denominated, fixed-rate taxable bond market, including Treasuries and government-related and corporate securities that have a remaining maturity of at least one year.

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. Credit Index measures the investment grade, U.S. dollar denominated, fixed-rate taxable corporate and government related bond markets.

ISM Manufacturing Index – A widely-watched indicator of recent U.S. economic activity. The index is often referred to as the Purchasing Manager's Index (PMI). Based on a survey of purchasing managers at more than 300 manufacturing firms by the Institute for Supply Management (ISM), the index monitors changes in production levels from month to month. The index is the core of the ISM Manufacturing Report.

The ISM Non-Manufacturing Index is an index based on surveys of more than 400 non-manufacturing firms' purchasing and supply executives, within 60 sectors across the nation, by the Institute of Supply Management (ISM). The ISM Non-Manufacturing Index tracks economic data, like the ISM Non-Manufacturing Business Activity Index. A composite diffusion index is created based on the data from these surveys, that monitors economic conditions of the nation.

The Composite Index of Leading Indicators, otherwise known as the Leading Economic Index (LEI), is an index published monthly by The Conference Board. It is used to predict the direction of global economic movements in future months. The index is composed of 10 economic components whose changes tend to precede changes in the overall economy. The Conference Board is an independent research association that provides its member organizations with economic and financial information.

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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