Clark Capital Management Group

Benchmark Review
& Monthly Recap

Highlights

Yields bounced off multi-year and even historical lows to end September higher, putting pressure on fixed income results. However, yields still moved lower for the quarter and positive returns were seen across most bond sectors during that timeframe.

The S&P 500 Index moved higher in September after a volatile and weaker August. It cracked back above the 3,000 level at times in September and ended the quarter only modestly below all-time highs achieved in July.

A noteworthy change in leadership occurred in September as value stocks outperformed growth stocks and small/mid-cap equities outpaced large-caps.

International stocks outperformed U.S. equities in September as well, but still lag U.S. stocks for the quarter and year-to-date.

The current U.S. economic expansion continues to march on as the longest on record. Some signs of slower growth are appearing, but job market data and subsequently the U.S. consumer continued to look solid during the quarter.

The second rate cut by the Fed occurred in September, but confusion on the future course of Fed action, continued uncertainty regarding the trade situation with China, negative global bond yields, concern about U.S. economic growth and a formal impeachment inquiry linger. The result of these unknowns might be more volatility during the final quarter of 2019.

Yields and Stocks Rise as Third Quarter Ends

Equity Markets

The third quarter saw new all-time highs in the S&P 500 during July, followed by a volatile and weaker August. A final push higher by equities was made in September, which put the quarter back into positive territory. Fed activity was front and center during the quarter as rate cuts were introduced in July and September—the first rate cuts since 2008.

Despite moving rates lower at back-to-back FOMC meetings, uncertainty about the future course of Fed action persists in the market. Clearly, the Trump administration wants lower rates, and tweets continue to show the unhappiness of the President with the Fed's pace of rate cuts. Trade concerns also drove sentiment during the quarter, particularly in August, and led to some significant swings in the market. Volatility, as measured by the VIX Index, hit its highest level since January during the quarter, but settled down during September as stocks moved higher.

We have been discussing for some time the long-running theme of large-cap U.S. growth stocks outperforming most other pockets of the equity markets. A noteworthy shift in equity market leadership occurred in September, with small-cap and value-oriented companies rising to the top of the equity universe.

Although it is too early to call this change in leadership a new trend, September proved to be a good month for value and smaller-cap stocks, which had lagged in recent quarters. At Clark Capital, we employ value-oriented measures in our investment process and believe that over a full market cycle, buying good companies at a good price will be rewarded.

The numbers for September were as follows: The S&P 500 advanced 1.87%, the Dow Jones Industrial Average gained 2.05%, the NASDAQ Composite rose modestly by 0.54% and the Russell 2000 Index, a measure of small-cap companies, improved by 2.08%. For some perspective on the differences between company size and growth/value dynamics, the Russell 2000 Value Index gained 5.13% compared to the Russell 2000 Growth Index, which declined -0.82%. Large-cap value stocks, as measured by the Russell 1000 Value Index, advanced 3.57% compared to large-cap growth stocks, as measured by the Russell 1000 Growth Index, which gained all of 1 basis point (+0.01%) in September.

Despite ongoing U.S. dollar strength, international equities turned in solid gains in September and outpaced the S&P 500 Index. Emerging market equities, as measured by the MSCI Emerging Markets Index, gained 1.91% in September and the MSCI ACWI ex USA Index, a broad measure of international equities, advanced 2.57% for the month. Those two indices of international stocks were down for the third quarter and although they enjoy year-to-date gains, they still lag broad measures of U.S. stocks through the first nine months of 2019.

Fixed Income

Yields bounced higher in September after dropping to multi-year, and in some cases, historic lows in August. This put pressure on most fixed income sectors with the exception of high-yield bonds, which gained during a month when stocks also advanced.

After closing August at 1.5%, the 10-year U.S. Treasury yield moved higher and closed the month at 1.68% (after hitting 1.9% mid-month). The 30-year U.S. Treasury yield closed August at 1.96%, but ended September at 2.12%. We believe it will be hard for U.S. rates to bounce too high with the amount of global bonds with negative yields, but having them come off of lows in August was not unexpected.

As rates rose, bonds struggled during the month. In this environment, fixed income results were as follows: the Bloomberg Barclays U.S. Aggregate Bond Index fell -0.53% for the month, the Bloomberg Barclays U.S. Credit Index declined -0.65%, the Bloomberg Barclays U.S. Corporate High Yield Index inched higher by 0.36% and the Bloomberg Barclays U.S. Treasury Index slipped by -0.85%. TIPS and muni bonds also declined in September. The more interest rate sensitive pockets of fixed income showed the weakest results during a month when rates rose. Despite declines in September, most fixed income sectors were positive for the quarter and year-to-date.

Economic Data and Outlook

Concern still swirls around the future direction of the U.S. economy as the length of this expansion moves further into historic territory. The shape of the yield curve continues to be followed closely, but 10-year and 2-year Treasury yields moved backed to a positive slope after its inversion in August ushered in a period of elevated market volatility. However, the 10-year and 3-month Treasury yields continued to be inverted despite two cuts to the Fed Funds target rate in the third quarter.

We still acknowledge that an inverted yield has historically been a negative sign for the economy and has preceded each of our last seven recessions. At the same time, other economic data (as shown in the chart at the end of the commentary) is rather mixed and does not foreshadow a recession.

The widely followed Institute for Supply Management (ISM) manufacturing index for August declined below 50, the dividing line between expansion and contraction, for the first time since 2016. At 49.1, this reading was below the modest expected growth of 51.3. The subcategory of "New Orders" fell sharply to 47.2 for the month and helped drag the overall index down (furthermore, the ISM manufacturing index hit a 10-year low in September based on data released in early October).

Tariffs and ongoing trade uncertainty with China are likely impacting manufacturers and slowing the pace at which businesses are placing orders. Businesses that have some flexibility are likely taking a more "wait and see" attitude. Global PMIs slipped below the 50 mark earlier in the year and in August, the U.S. followed suit moving into contraction zone.

On a positive note, the ISM non-manufacturing index, which represents the much larger service industries in the U.S. economy, rose more than expected to 56.4, which was well ahead of the prior month's mark of 53.7. Housing market data was very strong in August with building permits, housing starts, existing and new home sales all coming in ahead of expectations and improved from the prior month's readings.

Non-farm payroll additions were 130,000 in August. While this was below the expected 160,000 gains, the unemployment rate stayed at 3.7% as the labor force participation rate continued to rise. Average hourly earnings grew by 3.2% on a year-over-year basis when expectations were calling for a 3.0% gain. Retails sales (ex. auto and gas station sales) advanced modestly by 0.1% (+4.2% compared to August 2018) when a 0.2% advance was anticipated. Consumer confidence, as measured by the final University of Michigan consumer sentiment index for September, popped back up to 93.2 compared to expectations of 92.1 and the preliminary reading of 92.0.

The leading economic indicators index from the Conference Board was flat in August, but expectations were for it to fall by -0.1%. The final reading of second quarter GDP stayed as expected at an annualized growth rate of 2.0%.

Debate and scrutiny continued to follow the Fed in September despite making a second cut to the Fed Funds target rate during the month. A new headline also popped up about liquidity issues in the repo market, which caused the Fed to intervene on multiple occasions in September to keep liquidity flowing. Several factors appeared to drive this issue, but at this point, it looks more mechanical and liquidity driven versus a sign of worsening credit conditions. We will monitor developments on this front closely.

The future pace of rate cuts continues to be uncertain and Fed officials appear to be dampening expectations of a sustained rate-cut cycle, but the market is pricing in about three more cuts over the next year. On top of which, the 25-basis point cut in September continued to draw the ire of the Trump administration, which wants rates significantly lower. Due to the uncertain course of the Fed and markets trying to discount these rate cuts, additional volatility could ensue if these two perspectives diverge from each other.

Political discord in Washington is certainly nothing new for the market. However, the formal inquiry into the impeachment of President Trump following a whistleblower's complaint, has amped up the political divide. Although we are more than a year away from the presidential election, it is likely little will be done by Congress for the next year as the impeachment proceedings move forward – the race for the White House has already begun.

We continue to expect economic growth through 2019 and well into 2020. However, risks exist with uncertainty in upcoming Fed policy decisions, unknowns on the trade front, some slowing of U.S. economic activity, and a newly formalized impeachment inquiry. We continue to believe that the range of outcomes for the stock market is wider than usual due to many of these factors. It seems capital market volatility will remain elevated until some clarity begins to develop around these issues.

Investment Implications

Clark Capital's Top-Down, Quantitative Strategies

Our relative strength driven equity portfolios had been appropriately allocated to the market leaders, which were large-cap growth, momentum, technology, and interest rate sensitive stocks. Those trends were upended with the massive rotation into value, small-caps and cyclically oriented stocks, potentially marking a sea change in the market's leadership.

This shift led to a dramatic rotation in our top-down equity portfolios into value and away from momentum. The shift wasn't only in equities as our top-down driven fixed income models began favoring credit in mid-September and we allocated back into high yield.

Clark Capital's Bottom-Up, Fundamental Strategies

Many of our fundamentally driven equity portfolios benefited from the change in market leadership as the value factors we incorporate in our stock selection process were rewarded. On a sector basis, economically sensitive sectors such as consumer discretionary added value. On the other hand, healthcare remained a relative underperformer, not from an earnings standpoint, but rather from Washington's ongoing drug pricing and the universal healthcare debate.

On the fixed income side, we remain focused on managing liquidity, duration and credit risk. Our fixed income portfolios are slightly longer in duration and have a bit more credit risk exposure than their benchmarks. Both of these factors have added value as rates decline and continued economic growth supports credit.

Past performance is not indicative of future results.
This is not a recommendation to buy or sell a particular security. Please see attached disclosures.

Economic Data

Event	Period	Estimate	Actual	Prior	Revised
ISM Manufacturing	Aug	51.3	49.1	51.2	—
ISM Non-Manf. Composite	Aug	54.0	56.4	53.7	—
Change in Nonfarm Payrolls	Aug	160k	130k	164k	159k
Unemployment Rate	Aug	3.7%	3.7%	3.7%	—
Average Hourly Earnings YoY	Aug	3.0%	3.2%	3.2%	3.3%
JOLTS Job Openings	July	7331k	7217k	7348k	7248k
PPI Final Demand MoM	Aug	0.0%	0.1%	0.2%	—
PPI Final Demand YoY	Aug	1.7%	1.8%	1.7%	—
PPI Ex Food and Energy MoM	Aug	0.2%	0.3%	-0.1%	—
PPI Ex Food and Energy YoY	July	2.3%	2.1%	2.3%	—
PPI Ex Food and Energy YoY	Aug	2.2%	2.3%	2.1%	—
CPI MoM	Aug	0.1%	0.1%	0.3%	—
CPI YoY	Aug	1.8%	1.7%	1.8%	—
CPI Ex Food and Energy MoM	Aug	0.2%	0.3%	0.3%	—
CPI Ex Food and Energy YoY	Aug	2.3%	2.4%	2.2%	—

Event	Period	Estimate	Actual	Prior	Revised
Retail Sales Ex Auto and Gas	Aug	0.2%	0.1%	0.9%	—
Industrial Production MoM	Aug	0.2%	0.6%	-0.2%	-0.1%
Building Permits	Aug	1300k	1419k	1336k	1317k
Housing Starts	Aug	1250k	1364k	1191k	1215k
New Home Sales	Aug	659k	713k	635k	666k
Existing Home Sales	July	0.30%	0.50%	-0.30%	-0.10%
Leading Index	Aug	-0.1%	0.0%	0.5%	0.4%
Durable Goods Orders	Aug P	-1.1%	0.2%	2.0%	—
GDP Annualized QoQ	2Q T	-0.1%	0.0%	0.5%	0.4%
U. of Mich. Sentiment	Sept F	92.1	93.2	92.0	—
Personal Income	Aug	0.4%	0.4%	0.1%	—
Personal Spending	Aug	0.3%	0.1%	0.6%	0.5%
S&P CoreLogic CS 20-City YoY NSA	July	2.10%	2.00%	2.13%	2.16%

Source: Bloomberg P=Preliminary T=Third 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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