Clark Capital Management Group

Portfolio Commentary

Navigator® Opportunity Update

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Navigate Your Future. Enjoy the Journey.

2020 Should Be Highlighted by Stable Fed Policy & Election-Driven Opportunities

While 2018 featured rising interest rates and losses among virtually all major asset classes, 2019 was the polar opposite. Both stocks and bonds soared as the Fed shifted course to become in unison with most other global central banks. The rush of liquidity drove a 30% gain in the S&P 500, a surge in corporate credit, and even gains for government debt across the globe. The famous warning: "don't fight the Fed" never proved to be more true. Looking out into 2020, central bank policy risk is projected to be very low.

We can expect a stable Federal Reserve stance, with a small possibility of further easing, while the bar for an interest rate increase has been set quite high. Furthermore, trade tensions have been greatly reduced, and signing of a Phase One trade deal between the U.S. and China is set for this month. Of course, markets have now priced in much of this good news into their 2020 estimates. Valuations, particularly among the Technology sector, have become quite lofty, and investor sentiment is in the top decile or even the top one to five percent of many historical measures. Thus, we believe the odds are quite high that we face a correction in the first quarter or half of 2020.

While a healthy correction may hit markets in the first half of the year, we believe that the economy is on course for growth between 1.5% to 3%, with a possible bias to the upside. After seeing considerable weakness in 2019, global economic conditions have picked up, and most encouraging has been the improvement in the breadth of Global PMIs, indicating that the rest of the world is participating and enjoying improving conditions.

Inventories are pretty lean across most nations, making an upturn in their economies more sustainable. We have mentioned that sentiment and valuation represent risks, particularly shorter-term risks, to further upside. Other risks include the economy failing to broaden globally, leaving the U.S. as one of the few growth areas. Inflation exceeding expectations perhaps would be the most surprising risk, given the inability of the Fed to exceed its inflation target for many years now. While we view this as possible, and own gold in our Alternative portfolio partially as an inflation hedge, we do not see any forces out there supporting a sustained uptick in inflation. Therefore, we believe an inflation driven correction we would be a potential buying opportunity.

Credit and debt are focuses of ours, in terms of being tactical in managing risk and in understanding the bigger macroeconomic picture. The sheer amount of debt issuance by corporations and governments continues to grow. Frankly, the charts of overall debt growth are alarming. However, one chart does not provide all the relevant information. While debt issuance is large, the burden of that debt is not as high because we have such low interest rates.

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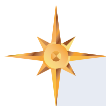

S&P 500 debt/equity is nowhere near its 2000 to 2008 levels, times during which the market struggled mightily, as we all remember. Today's debt levels deserve to be watched closely and should enhance the market's downside when a real economic downturn comes. However, the debt levels in and of themselves are unlikely to be the cause of the market's undoing

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. It was pretty much a straight up ride for U.S. markets during the quarter, and the sector portfolio reflected that shift towards great beta.

Out of the portfolio went interest rate sensitive Consumer Staples, Real Estate, and Homebuilders, while Health Care (broad Health Care, Biotechnology, and Pharmaceuticals), Financials, and Steel took their place. Leadership from Technology was a constant for much of 2019, however, and the Technology and Semiconductor ETFs have been portfolio mainstays.

The market's strength has been a large-cap and Technology-driven rally, as witnessed by the fact that S&P 500 Index ranks highly in our rankings; few sectors – really only Technology itself – are consistently beating the index. Smaller Cap Energy, Retail, and Bank stocks have enjoyed gains, but are nowhere near leading the market. Looking out into 2020, we expect that interest rate sensitive stocks will remain underweight in the portfolio, and sectors like Health Care and Energy could move in accordance with the market's expectations regarding the election. Here are some further developments in the portfolio during the quarter:

- Three strong sectors from the fourth quarter of 2019 tell a story about Technology's dominance of the year. Broad Technology (VGT) was up 13.9% for the quarter, and 48.6% for the year, while Semiconductors (SOXX) were up 19.2% for the quarter, and 62.4% on the year. Meanwhile, Pharmaceuticals (XPH) surged 28.5% for the quarter, but were only up 25.6% on the year. They had been pummeled when Elizabeth Warren surged in the polls, spurring fear across the sector.
- Semiconductors (SOXX) are probably the highest beta, most volatile sector in our universe, and that has been particularly true this year, as they have proven to be the sector most leveraged to U.S. / China trade headlines (a bullish factor for the second half of 2019). We continue to see that semiconductors have become an essential commodity in today's internet of things world, and their earnings have delivered. Given that its rally is so extended, we are watching it closely for a breakdown.
- Technology was a market leader, and the portfolio was well represented with broad Technology (VGT) and Semiconductors (SOXX) as the top contributors on the quarter, while Aerospace (ITA) and Real Estate (VNQ) were the top detractors.

Ticker	Quarter Ending December 31, 2019	Average Weight (%)	Contribution to Return (%)
Top Contributors			
VGT	Vanguard Information Technology ETF	20.98	2.95
SOXX	iShares PHLX Semiconductor ETF	14.06	2.62
XPH	SPDR S&P Pharmaceuticals ETF	3.28	1.21
Top Detractors			
ITA	iShares U.S. Aerospace & Defense ETF	3.31	-0.72
VNQ	Vanguard Real Estate ETF	3.21	0.11
XLP	Consumer Staples Select Sector SPDR Fund	1.65	0.08

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.

International Opportunity Portfolio

The International Opportunity portfolio's stated mission is to allocate tactically between international style, factor, and region 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 factor, style box, and regional ETFs such as: international value, growth, quality, small-cap, currency hedged, minimum volatility, buybacks, and momentum ETFs, along with emerging markets, emerging markets small-cap, and emerging markets minimum volatility ETFs.

Our move to broader, multi-country ETFs has been beneficial, as the portfolio and ETF matrix now follows longer-term and less volatile trends. It appears that 2020 could provide a better backdrop for international equity investors. After weakening to the lowest level of positive year-over-year changes since 2012, Global PMIs (Purchasing Manager Indexes) have begun to rise from below 20%.

International economies and corporate earnings have a relatively lower bar to exceed in 2020; we believe that

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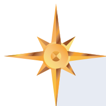

if momentum begins to develop in the global economy, international stocks have a chance to at last deliver outperformance, given their cheaper valuations. The portfolio's holdings have begun to reflect a higher beta, as we added international buybacks (IPKW), EAFE small-cap (SCZ), and emerging markets in the fourth quarter. Here are some further developments during the quarter:

- 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 mandate) for most of 2019, and since the first quarter. As of December 31st, the S&P 500 was up 31.2% for 2019 versus 23.1% for EAFE (IEFA) and 20.8% for Emerging Markets (VWO); over a three-year period, the S&P 500 gained 15.1% per year versus 10.0% for EAFE and 10.6% for Emerging Markets.
- One trend that has worked among international equities has been quality. Those companies with steady growth and sound balance sheets have been winners, while near zero growth in Europe and many parts of the world has left indebted companies starving for air. Only a sustained upturn in global growth will reverse that condition. We have seen some green shoots coming from international economies; however, that is quite different than even moderate sustained growth, which has been elusive.
- The dollar stalled as the fourth quarter came to a close, but for much of the quarter currency hedged EAFE (DBEF) topped our ETF rankings. With zero to negative rates continuing in Europe and Japan, betting against the dollar seems foolhardy. If global economic weakness does appear in 2020, we would expect currency hedged EAFE to become a holding upon persistent weakness.

Ticker	Quarter Ending December 31, 2019	Average Weight (%)	Contribution to Return (%)
Top Contributors			
IVV	iShares Core S&P 500 ETF	25.05	2.23
SCZ	iShares MSCI EAFE Small-Cap ETF	15.41	1.45
IQLT	iShares Edge MSCI Intl Quality Factor ETF	15.31	1.37
Top Detractors			
IPKW	Invesco International BuyBack Achievers ETF	8.11	0.49
EFV	iShares MSCI EAFE Value ETF	4.07	0.13
VWO	Vanguard FTSE Emerging Markets ETF	0.30	0.05

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Style Opportunity Portfolio

The Style Opportunity portfolio emphasized large-caps during the quarter, and favored value stocks, albeit modestly. The S&P 500 itself, quality stocks, and buybacks top our ETF rankings matrix, and though we currently favor value over growth, we see no discernible trend favoring either. Large-caps are clearly favored over small, as they have been for much of the past year. Value may have had a temporary advantage in 2019, as damage from the trade war turned Apple temporarily into a value stock – it was the largest holding in the S&P 500 Value ETF (SPYV).

After a spectacular last half of 2019 and new price highs, Apple is now the largest stock in the S&P 500 Growth ETF (SPYG), which you would think is the proper long-term fit for it. Stronger performance by Financials, along with formerly beaten down Biotech and Pharmaceuticals, also helped value ETFs on the quarter. After a long run favoring relative strength and momentum, the relative strength of buying recent winners has stalled and it recently was at the same level as in late 2017. Our methodology thus has recently faced some headwinds, but we remain confident in it since relative strength or momentum has been the strongest factor over the longer term. The following were other developments in the portfolio during the quarter:

- For the quarter, large-cap value (SPYV) gained 9.9%, while large-cap growth (SPYG) rose by 8.2%. small-cap value (IJS) was up 7.7%, while small-cap growth (IJT) gained 8.7%. Momentum (MTUM) was a laggard and gained only 5.7%, while quality (QUAL) increased by 9.8%. Minimum volatility (USMV) lagged during risk-on and was up only 2.9%. High beta (SPHB) was the clear winner, up 13.3%, while the S&P 500 (IVV) was up 9.0%. Among major factors, both high beta and quality were the top performers in 2019, while Small Cap Value and Small Cap Growth were weakest.
- For all of 2019, growth again trounced value; the Russell 3000 Growth gained 35.9% while the Russell 3000 Value gained 26.3%. The growth versus value gap becomes even more massive over three- and five-year periods. Growth beats value by 19.9% to 9.3% over three years, and 14.0% to 8.0% over five years. Growth companies have strong and stable cash flows and less debt – as a result, they can plow that cash into buying back their stock. Thus, despite being pricier, growth stocks could continue to outpace value as

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they have done.

- The top contributors to the portfolio during the quarter were the iShares S&P 500 ETF (IVV) and the SPDR S&P 500 Value ETF (SPYV). The top detractors were the iShares Edge MSCI USA Momentum ETF (MTUM) and the iShares Edge MSCI USA Minimum Volatility ETF (USMV).

Ticker	Quarter Ending December 31, 2019	Average Weight (%)	Contribution to Return (%)
Top Contributors			
IVV	iShares Core S&P 500 ETF	35.66	4.19
SPYV	SPDR Portfolio S&P 500 Value ETF	36.59	3.49
QUAL	iShares Edge MSCI USA Quality Factor ETF	5.91	0.51
Top Detractors			
MTUM	iShares Edge MSCI USA Momentum Factor ETF	2.25	-0.69
MDYV	SPDR S&P 400 Mid Cap Value ETF	6.39	0.20
USMV	iShares Edge MSCI Min Vol USA ETF	7.33	-0.15

Source: Bloomberg. 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.

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 Treasury bonds that are in line with the Fixed Income Total Return portfolio's holdings. Equities declined and stocks surged over the summer, with bond yields bottoming in late August. As September began, interest rates rose quickly, as bond markets had priced too much pessimism into rates. Our credit-based models moved to favor risk-on, and in mid-September we sold Treasuries and moved back to a 100% equity position.

Markets and the economy surged for the rest of 2019, and the Global Tactical portfolio was fully invested during the quarter and enjoyed the gains of the market's rally. Our credit-based models show that the economy and corporate balance sheets are healthy, and given a stable and accommodating Federal Reserve, we expect to maintain an equities position for the foreseeable future. One of the most encouraging signs has been improved performance by international markets, where it appears that bottoming Global PMIs could be a harbinger of good times to come.

- When the portfolio owns equity, it will own a suite of ultra-low cost, broad ETFs with a 70% U.S. to 30% international equity weighting. The four ETFs that we own produced solid gains in the fourth quarter: the SPDR U.S. large-caps (SPLC – up 9.1%) led U.S. stocks, while U.S. small-caps (IJR – up 8.3%) and broad large-cap international equity (IXUS – up 8.9%) nearly kept up. The leader was small-cap international equity (VXUS – up 11.12%).
- While the Global Tactical portfolio missed out on upside between June and September, 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%. So the Global Tactical portfolio's defensive positioning has proven effective in the very recent past.
- Large-cap U.S. stocks (SPLG) and broad international stocks (IXUS) were the top contributors for the quarter, while small-cap U.S. and international equity were the largest detractors (IJR And VSS).

Ticker	Quarter Ending December 31, 2019	Average Weight (%)	Contribution to Return (%)
Top Contributor			
SPLG	SPDR Portfolio Large Cap ETF	48.38	4.38
Top Detractor			
VSS	Vanguard FTSE All-World ex-US Small-Cap ETF	9.07	1.00

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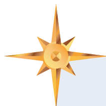

Alternative Opportunity Portfolio

We recommend that investors view the Alternative portfolio as a source of alternative beta and exposures that still when possible 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 portfolio contains a broad mix of themes which breaks down as follows: alternative-oriented mutual funds and ETFs 49.0%, tactical global equity 21.0%, fixed income 17.0%, commodities 9.0%, 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. For all of 2019 Neuberger Berman Long-Short (NLSIX – up 17.1%) and James Alpha Managed Risk Domestic Equity I (JDIEX – up 12.1%) were the best performers and managed futures funds LoCorr Long/Short Commodity (LCSIX – down 6.0%) and Altegris Managed Futures Evolution Fund (EVOIX – up 4.2%) were the worst performers.
- The alternative investing sphere generally enjoyed gains during the fourth quarter, with the exception of managed futures. The Bloomberg Commodity Index increased by 4.24%. Gold (GLDM) was up 3.0% and 18.1% for all of 2019. The HFRX Event Driven Equity Index was up 5.5%. The SG Trend Index, a trend-following managed futures index, declined by 3.89%. Our Alternative portfolio benchmark, the HFRX Global Hedge Fund Index, gained 2.6%.
- During the quarter we purchased or added to positions in gold miners (GDX), clean energy (ICLN), European financials (EUFN), and emerging markets (IEMG). As the quarter ended and investor sentiment reach both short-term and intermediate-term extremes in optimism, we sold Clean Energy and reduced other equity positions. We maintain our positions in emerging markets equity and currencies.
- The top contributors to return for the quarter were emerging markets (IEMG) and oil services stocks (OIH); Altegris Managed Futures (EVOIX) and LoCorr Commodity Long/Short (LCSIX) were the top detractors. Managed futures funds and quant-oriented funds in general have struggled in recent years.

Ticker	Quarter Ending December 31, 2019	Average Weight (%)	Contribution to Return (%)
Top Contributors			
IEMG	iShares Core MSCI Emerging Markets ETF	6.55	0.77
OIH	VanEck Vectors Oil Services ETF	4.31	0.72
WOOD	iShares Global Timber & Forestry ETF	3.31	0.45
Top Detractors			
EVOIX	Altegris Futures Evolution Strategy Fd Cl I	6.01	-0.30
LCSIX	LoCorr Long/Short Commodities Strategy Fd Cl I	5.60	-0.12
EMLP	First Trust North American Energy Infrastructure Fund	4.56	-0.08

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Fixed Income Total Return

The Fixed Income Total Return portfolio purchased high yield bonds on September 13th and held high yield throughout the quarter. We continue to own and favor lower quality credits into 2020. A stable and accommodative Fed, a steady and growing U.S. economy, and an improving global economy should bode well for credit investors this year. As a result, we don't foresee any changes in our high yield position on the horizon. As always, our model is prepared to play defense if credit markets take a turn for the worse.

- While we favor high yield and own the asset class, we have to acknowledge that it is richly priced, particularly higher quality high yield Bonds. Yield on BB-rated high yield bonds, the highest credit quality within the space, is 3.63%, an all-time low. B-rated bonds yield 5.1%, which is in the second percentile of yield historically. It is important to note that low yields on corporate credit can persist for multiple quarters or even years, so rich valuations in and of themselves are not an indication to sell. Our models follow and pursue this strong performance, but we are ready to play defense once a trend towards weakness is established. We do not know when a major adjustment in the high yield markets will come, but at these valuation levels we know that active risk management will be a necessary tool for success in the future.
- Counterintuitively, the huge runup in BB and B high yield bonds has been offset by considerable damage in the lowest quality CCC bonds that are closest to bankruptcy. Confidence is these highly levered companies plummeted, and at end of 2019 there were

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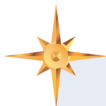

more CCC bonds at deep discounts (below 70 cents per dollar) than there were in 2018. Bears could take this as a sign of overleverage and stress in companies despite a strong economy. On the other hand, bulls could say that CCC bonds are attractively priced, and could be a source of outperformance in an otherwise richly priced space.

- Our models comparing high yield to Treasuries are both near and at all-time highs favoring high yield. With Treasury yields having fallen by over 50% between October 2018 and August 2019, Treasuries present a less compelling yield opportunity – though their safety in risk-off periods remains an essential feature. At these lower Treasury yield levels, high yield still offers yields that are over two and a half times Treasuries. As long as the economy remains stable, that should keep them in good stead.

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. Hedging an equity portfolio is always a costly endeavor but was particularly so in 2019 with the S&P 500 soaring over 30%. Amidst such a strong rally, our equity hedge strategy can only act to tactically trade and minimize costs, as our primary hedges declined in accordance with their design.

Looking forward into 2020, we believe that greater market volatility is in the works, and that should provide some means to reduce the cost of our equity hedge. We continue to be constructive on the economy and the markets by the end of 2020, however. We would like to remind our investors that an equity hedge can play a valuable volatility-reducing role when markets and the economy turn south – and we are in the later stages of this economic advance that is nearing ten years of age. While a major bearish turn is not imminent, we believe that it is likely over the next few years, and we are on watch accordingly. An equity hedge's 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 – these profits come quickly and dramatically but disappear quickly as well.

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A S&P obligation rated 'B' is more vulnerable to nonpayment than obligations rated 'BB', but the obligor currently has the capacity to meet its financial commitments on the obligation. Adverse business, financial, or economic conditions will likely impair the obligor's capacity or willingness to meet its financial commitments on the obligation.

A S&P obligation rated 'BB' is less vulnerable to nonpayment than other speculative issues. However, it faces major ongoing uncertainties or exposure to adverse business, financial, or economic conditions that could lead to the obligor's inadequate capacity to meet its financial commitments on the obligation.

A S&P obligation rated 'CCC' is currently vulnerable to nonpayment and is dependent upon favorable business, financial, and economic conditions for the obligor to meet its financial commitments on the obligation. In the event of adverse business, financial, or economic conditions, the obligor is not likely to have the 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.

Russell 3000 Growth Index measures the performance of those Russell 3000 Index companies with higher price-to-book ratios and higher forecasted growth values. The stocks in this index are also members of either the Russell 1000 Growth or the Russell 2000 Growth indexes.

Russell 3000 Value Index is a market-capitalization weighted equity index maintained by the Russell Investment Group and based on the Russell 3000 Index, which measures how U.S. stocks in the equity value segment perform. Included in the Russell 3000 Value Index are stocks from the Russell 3000 Index with lower price-to-book ratios and lower expected growth rates.

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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