Clark Capital Management Group

Benchmark Review
& Monthly Recap

Highlights

February started with a powerful recovery in equity markets following some initial fears of the coronavirus in late January. New all-time highs were achieved in the middle of the month. However, markets were focused once again on concerns of a global pandemic the last week of February as equities dropped dramatically and volatility soared.

The Dow Jones Industrial Average declined over 1000 points on Monday, February 24th. At the time, it was the sharpest one-day decline in more than two years. Declines continued to mount and worsen throughout the week. By week's end, the major U.S. equity indices were all down over 10% from their highs, sending the Dow Jones Industrial Average, the S&P 500 and the NASDAQ Composite into official stock market correction territory.

Volatility, which had been largely dormant in recent months, spiked and the VIX Index rose above 40 for the first time since the "Flash Crash" in August 2015. We had expected volatility to pick up in 2020 and that materialized dramatically as the virus concerns spread more widely, but volatility and fear reached extremes as the month ended.

A flight to quality drove U.S. Treasury yields to historic lows. The 10-year U.S. Treasury yield dropped to 1.13% to close out February, and the yield on the 30-year U.S. Treasury fell to 1.65% by month's end.

The impeachment episode ended as expected with an acquittal in the Senate in early February. At the same time, the Democratic primary season kicked-off and heated up quickly with initial results putting Bernie Sanders in the lead.

Despite ongoing concerns of the likely spread of the coronavirus, economic fundamentals continue to look solid and we would not change long-term strategic asset allocations at this time due to the virus.

Coronavirus Scare Continues to Impact Global Markets

Equity Markets

The final week of February turned out to be the worst week for equities since November 2008, which was at the height of the credit crisis. The week included a drop of -4.42% for the S&P 500 Index on Thursday, February 27th, which was the worst daily decline since August 2011 and the 106th worst day on record for this index going back to 1926. The selling pressure reached extremes and the market moved into oversold territory as the month ended.

Highlighting these oversold conditions, as well as expected potential action by the Fed, the S&P 500 rebounded by 4.6% on the first trading day of March. Although a lot of uncertainties still exist with the coronavirus, we believe the economy is in a much stronger fundamental position in 2020 compared to 2008.

We had anticipated a more volatile ride moving into 2020 due in part to valuations getting stretched after the year-end run in 2019, optimism reaching extreme levels (which can be a bearish indicator of complacency in the market), and normal election year volatility that markets historically experience in the first half of a presidential election year. We had even believed that a 5%-10% correction could materialize in the first part of 2020.

Clearly, we did not anticipate a global virus scare, but that turned out to be the trigger that moved stocks lower. Reflecting this heightened market volatility, the VIX Index, a measure of equity market volatility, spiked above 40 after spending most of 2019 and early 2020 below 15, with only a few moves above 20 during that time. The last time the VIX Index was at 40 was during the "Flash Crash" episode in August 2015 and following that point, the S&P 500 Index was up 9.6% over the next two months. Now, extreme optimism has turned into extreme pessimism and valuations have declined.

We acknowledge that there could be some material impact due to the virus on the global economy and the impact on corporate earnings could also turn out to be meaningful, especially in those sectors directly impacted by global trade and travel. At this point, trying to determine growth or earnings estimates is difficult. Volatility will likely remain elevated as the virus news continues to be a central focus of the market – the impact of which leads to uncertainty regarding near-term economic growth and corporate earnings. Based on historical impacts of prior epidemics/pandemics, we still consider this a shorter-term event and we believe the key to achieving long-term investor success is to not react to these types of short-term situations.

With this background, equities were lower across the board in February, but there was still a meaningful difference between value and growth stocks. U.S.

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large-cap growth stocks still performed better on a relative basis compared to most other parts of the U.S. equity market and emerging markets performed modestly better than developed international markets in relative terms.

The numbers for February were as follows: The S&P 500 was down -8.23%, the Dow Jones Industrial Average was off -9.75%, the Russell 3000 declined -8.19%, the NASDAQ Composite slid by -6.27% and the Russell 2000 Index, a measure of small-cap companies, fell -8.42%. As mentioned, growth stocks outpaced value stocks on a relative basis rather dramatically for the month.

The large-cap and value focused Russell 1000 Value Index declined -9.68% compared to the Russell 1000 Growth Index, which fell by -6.81%. The value/growth difference held in the small-cap universe as well. Small-cap value stocks, as measured by the Russell 2000 Value Index, were off -9.72%, while the Russell 2000 Growth Index declined -7.22%.

International equities struggled as well in February. After strengthening rather steadily through January and the first half of February, the U.S. dollar slid lower over the final week and a half of the month. The dollar closed February only modestly changed from where it ended January. Emerging market equities, as measured by the MSCI Emerging Markets Index, fell -5.27% in February. The MSCI ACWI ex USA Index, a broad measure of international equities, declined -7.90% for the month.

Fixed Income

Outside of high-yield bonds, most sectors of fixed income enjoyed gains for the month with the backdrop of sharply declining interest rates. The flight-to-quality trade was the unquestioned winner late in February and U.S. Treasury yields hit historic lows as bond prices rallied. The yield on the 10-year U.S. Treasury closed February 28th at 1.13% compared to the January close of 1.51% and a close on February 27th of 1.30%.

The yield on the 30-year U.S. Treasury fell to 1.65% at the end of February after it had closed January at 1.99%. The more interest-rate sensitive parts of the market were the leaders in fixed income in February. During the last week of February, Clark Capital's Fixed Income Total Return strategy reallocated from 100% high-yield bonds to 50% high-yield bonds and 50% U.S. Treasures with the goal of protecting capital.

Driven by a declining interest rate environment, the returns in fixed income were as follows: the Bloomberg Barclays U.S. Aggregate Bond Index gained 1.80%, the Bloomberg Barclays U.S. Credit Index advanced 1.36%, the Bloomberg Barclays U.S. Corporate High Yield Index declined by -1.41% and longer-dated U.S. Treasuries were among the best gainers. For example, the Bloomberg Barclays U.S. 30 Year Treasury index advanced 8.03% in February and the general Bloomberg Barclays U.S. Treasury index gained 2.65% for the month. TIPS and muni bonds both advanced during February as well.

Economic Data and Outlook

Clearly the market was not focused on economic data over the final week of February as the coronavirus sell-off hit with full force. However, economic data covering January, which was released in February, was for the most part positive and continued to point to an economy that we believe will grow in 2020.

In a surprise, the widely followed Institute for Supply Management (ISM) manufacturing index broke back above 50 in January with a reading of 50.9. That was well ahead of expectations of 48.5 helped in part by the new orders subcomponent, which rose to 52 compared its revised prior mark of 47.6. The ISM non-manufacturing index, which covers the much larger service industries in the U.S. economy, also came in ahead of expectations at 55.5 when a reading of 55.1 was expected. Recall that ISM readings above 50 indicate expansion and both the manufacturing and service industries in the U.S. economy showed growth in January.

Job market numbers reported in February for January also easily surpassed expectations. Non-farm payroll additions were 225,000, which was well ahead of the anticipated 165,000 payroll gain. The unemployment rate ticked unexpectedly higher to 3.6% from the prior mark and expectations of 3.5%, but this was under the context of the labor force participation rate increasing as well.

This means more people moved into the labor force looking for jobs. The labor force participation rate rose to 63.4% from the prior level and expected reading of 63.2%. Average hourly earnings topped estimates as well increasing to 3.1% on a year-over-year basis in January when a 3.0% increase was expected. Furthermore, the prior month's reading was revised higher to show a 3.0% gain compared to the prior estimate of a 2.9% increase.

The strong job market in the United States continues and, as a consumption driven economy, financially healthy and employed consumers are an important factor to economic growth. This continues to be one of the strong data points supporting our expectations of ongoing economic growth.

Retails sales growth (ex. auto and gas station sales) increased 0.4% in January, which was better than the expected 0.3% advance. Housing starts and building permits also easily exceeded expectations in January. Housing starts were at a 1.567 million annualized pace, while permits were at a 1.551 million annualized rate. Expectations were calling for readings of 1.428 million and 1.450 million, respectively. Existing home sales and new home sales were also better than expected.

The Leading Economic Indicators index from the Conference Board advanced at twice the anticipated rate in January with a 0.8% monthly gain compared to expectations of a 0.4% improvement. The second reading of fourth quarter 2019 GDP showed a 2.1% annualized growth rate, matching expectations and the preliminary reading.

After reviewing several of these economic data points, it is not too surprising that equity markets enjoyed positive momentum through the first part of February with the major equity indices putting in new all-time highs during the month. However, the coronavirus situation became the focus of the market and derailed equity market progress.

The Federal Reserve found itself once again as a central topic of the market (and President Trump's tweets) late in February and investors were wondering if the Fed would take any action in light of the market sell-off. Expectations were building that the Fed might potentially take action before the next scheduled FOMC meeting on March 17th-18th and a 50-basis point rate cut was being priced into the market by that meeting. Indeed, on March 3rd, the Fed announced an emergency 50-basis point rate cut due to the potential economic risks posed by the coronavirus. This followed the conclusion of a meeting of G7 officials earlier in the morning where officials reaffirmed their commitment to be ready to act, but without announcing any concrete measures.

At this time, we maintain our expectation that the U.S. economy will grow in 2020. Clearly, how the virus outbreak spreads and impacts economic growth is yet to be seen and we are certainly not epidemiologists and don't pretend to know how this virus situation will play out.

We will continue to assess economic growth and corporate earnings, but late month action in the markets showed that we were hitting some oversold levels. We still believe fundamentals will drive long-term results and at this point, the economy looks poised to continue to grow. However, volatility has picked up as uncertainly has moved into the market with the coronavirus, not to mention a presidential election that will only heat up in the months ahead.

Investment Implications

Clark Capital's Top-Down, Quantitative Strategies

Coronavirus fears have roiled the markets, resulting in a sharp decline in global risk assets and a flight to safety into defensive asset classes. During the month, the S&P 500 declined 8.23% and the CBOE Volatility Index spiked to close the month above 40, a level that it has only closed at in only 2% of market trading days since 2004.

As a result, we have made some tactical changes in our top-down strategies. In the Alternative portfolio, we trimmed holdings in emerging market debt and in our equity positions and as the month came to a close, we used the sharp spike in the CBOE Volatility Index to add exposure to inverse volatility. In our Fixed Income Total Return portfolio, we shifted the allocation from 100% high yield to 50% high yield and 50% U.S. Treasuries in an attempt to preserve capital. As the large-cap growth leadership trend continues, the Style Opportunity portfolio holds large-cap growth, momentum, and the S&P 500.

Clark Capital's Bottom-Up, Fundamental Strategies

The "corona concern" created a perfect storm when combined with an overvalued U.S. market and the U.S. presidential primary results. The S&P 500 dividend yield of 2.04% looks like a good value compared to the 1.13% 10-Year Treasury yield. 60% of S&P 500 members offer dividend yields that exceed that on 10-Year Treasury yield, which is the highest proportion in at least two decades.

Historically, after a significant decline in rates, cyclical growth sectors such as Technology and Consumer Discretionary provide the strongest relative returns. Technology remains one of our largest sector weights in our bottom-up equity portfolios. The threat to global growth and lower interest rates have also caused us to trim leveraged money center banks.

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Economic Data

Event	Period	Estimate	Actual	Prior	Revised
ISM Manufacturing	Jan	48.5	50.9	47.2	47.8
ISM Non-Manf. Composite	Jan	55.1	55.5	55.0	54.9
Change in Nonfarm Payrolls	Jan	165k	225k	145k	147k
Unemployment Rate	Jan	3.5%	3.6%	3.5%	—
Average Hourly Earnings YoY	Jan	3.0%	3.1%	2.9%	3.0%
JOLTS Job Openings	Dec	6925k	6423k	6800k	6787k
PPI Final Demand MoM	Jan	0.1%	0.5%	0.1%	0.2%
PPI Final Demand YoY	Jan	1.6%	2.1%	1.3%	—
PPI Ex Food and Energy MoM	Jan	0.2%	0.5%	0.1%	—
PPI Ex Food and Energy YoY	Jan	1.3%	1.7%	1.1%	—
CPI MoM	Jan	0.2%	0.1%	0.2%	—
CPI YoY	Jan	2.4%	2.5%	2.3%	—
CPI Ex Food and Energy MoM	Jan	0.2%	0.2%	0.1%	—
CPI Ex Food and Energy YoY	Jan	2.2%	2.3%	2.3%	—
Retail Sales Ex Auto and Gas	Jan	0.3%	0.4%	0.5%	—
Industrial Production MoM	Jan	-0.2%	-0.3%	-0.3%	-0.4%

Event	Period	Estimate	Actual	Prior	Revised
Building Permits	Jan	1450k	1551k	1416k	1420k
Housing Starts	Jan	1428k	1567k	1608k	1626k
New Home Sales	Jan	718k	764k	694k	708k
Existing Home Sales	Jan	5.44m	5.46m	5.54m	5.53m
Leading Index	Jan	0.4%	0.8%	-0.3%	—
Durable Goods Orders	Jan P	-1.4%	-0.2%	2.4%	2.9%
GDP Annualized QoQ	4Q S	2.1%	2.1%	2.1%	—
U. of Mich. Sentiment	Feb P	99.5	100.9	99.8	—
Personal Income	Jan	0.4%	0.6%	0.2%	0.1%
Personal Spending	Jan	0.3%	0.2%	0.3%	0.4%
S&P CoreLogic CS 20-City YoY NSA	Dec	2.85%	2.85%	2.55%	2.54%

Source: Bloomberg as of February 29, 2020

P=Preliminary, S=Secondary

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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 Growth Index measures the performance of the large-cap growth segment of the U.S. equity universe. It includes those Russell 1000 Index companies with higher price-to-book ratios and higher forecasted growth values.

The Russell 1000 Value Index measures the performance of the large-cap value segment of the U.S. equity universe. It includes those Russell 1000 Index companies with lower price-to-book ratios and lower forecasted growth values.

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

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The Russell 2000 Value Index measures the performance of the large-cap value segment of the U.S. equity universe. It includes those Russell 2000 companies with lower price-to-book ratios and lower expected growth values.

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.

The Bloomberg Barclays 10-Year U.S. Treasury Index is a universe of Treasury-bonds, and used as a benchmark against the market for long-term maturity-fixed-income securities. The index assumes reinvestment of all distribution-sand interest payments..

The Bloomberg Barclays 30-Year U.S. Treasury Index is a universe of Treasury-bonds, and used as a benchmark against the market for long-term maturity-fixed-income securities. The index assumes reinvestment of all distribution-sand interest payments..

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 Consumer Price Index (CPI) is a measure that examines the weighted average of prices of a basket of consumer goods and services, such as transportation, food, and medical care.

Personal consumption expenditures price index is the component statistic for consumption in gross domestic product collected by the United States Bureau of Economic Analysis.

The CBOE Volatility Index, known by its ticker symbol VIX, is a popular measure of the stock market's expectation of volatility implied by S&P 500 index options.

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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