Clark Capital Management Group

Portfolio Commentary

Navigator® Tax-Free Fixed Income

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"Whatever It Takes" Squared.

On July 26th 2012, Mario Draghi issued his famous "whatever it takes" speech that became a defining moment in turning around the Euro Crisis enveloping the old world. On April 9th 2020, the Fed announced unprecedented steps to keep credit flowing. The Fed unveiled programs to provide an additional $2 trillion in loans to companies and to help cash-strapped municipalities and states.

One of the highlights of the Fed's April 9th announcement was an expansion in the Fed's $500 billion Municipal Lending Facility (MFL) providing a backstop to the municipal bond market. To buoy the taxable markets, the Fed expanded the size and scope of the Primary Market Corporate Credit Facilities (PMCCF) and the Secondary Market Corporate Credit Facilities (SMCCF). The result of the Fed's announcement produced the best quarter in equities since 1998 and dragged bonds along with it for the reflation ride.

Fixed Income markets responded sharply and ended higher for the quarter. Using the Bloomberg Barclays Municipal Bond Total Return Index as a reference, the muni market gained 2.72% on a total return basis during the second quarter. The Bloomberg Intermediate Corporate Bond Index gained 7.63% for the quarter. This moved both fixed income classes back to positive territory for 2020. Other key drivers contributing to the positive returns for the quarter included an accommodative Fed leading to a lower rate backdrop, positive fund flows for the quarter, and optimistic investor sentiment surrounding the potential economic reopening.

Here is how the quarter unfolded:

Municipal Fixed Income Strategy Overview

Municipal bonds finished sharply higher in the second quarter. Using the Bloomberg Barclays Municipal Bond Total Return Index as a reference, the muni market gained 2.72% on a total return basis during the second quarter. According to the Investment Company Institute (ICI), the municipal bond asset class experienced positive fund flows totaling over $12.7 billion during the second quarter (as of 06/24/2020), reversing record outflows for the muni asset class in March. Some of the key drivers contributing to the positive return for the quarter included an accommodative Fed leading to a lower rate backdrop, an expansion in the Fed's $500 billion Municipal Lending Facility (MFL), positive fund flows for the quarter, and optimistic investor sentiment surrounding the potential economic reopening. At the beginning of the quarter, the 5-year Municipal Market Data (MMD scale) scale read 1.19% on April 1st and finished the quarter on June 30th reading 0.41%, representing a 78-basis point drop during the quarter.

April

In April, improving coronavirus trends, optimism surrounding a potential economic reopening, and aggressive monetary and fiscal policy measures improved investor sentiment as we saw positive fund flows return to the municipal market. A positive

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technical backdrop combined with renewed optimistic investor sentiment helped push muni yields lower by 10 bps, finishing the month with a 1.09% yield on April 29th, using the 5-year MMD scale. The muni market finished April with a 0.63% positive performance as referenced by the Bloomberg Barclays 5-year Muni index. At the end of April, Senator Mitch McConnell (R-KY) said he would be in favor of allowing struggling states with high public pension burdens to declare bankruptcy rather than offer them a federal bailout. McConnell's comments proved to be one of the more noteworthy headlines during the quarter as muni markets responded negatively to the remarks, causing prices to fall and yields to rise as we exited April and started May. The muni volatility was short-lived as many politicians publicly questioned the constitutionality of state bankruptcies. Investor confidence returned to the muni market when the Fed announced an expansion to the MLF, lowering the entity population threshold level from 500,000 to 250,000 and increasing the maturity tenure of eligible issues from 24 months to 36 months, allowing more entities to participate in the borrowing facility.

May

Municipal bonds continued to rally in May amid this positive news from the FED, the slowing growth in reported coronavirus infections, and increased optimism over a potential economic reopening. The 5-year MMD scale finished May with a yield of 0.38% and the Bloomberg Barclays 5-year Muni index improved by 2.65% during the month. Municipal bond mutual fund flows were positive in May as investors added over $5.1 billion into the asset class during the month according to ICI.

June

The municipal bond market logged a modest rise in June as the Bloomberg Barclays 5-year Muni index improved slightly by 0.53%. Strong performance at the beginning of the month was abated by renewed coronavirus fears as new hotspots, particularly in the southern and western states, started to emerge during the second half of the month. The Fed issued forward guidance after its June 10th meeting, indicating it planned to hold the Fed Funds rates inside the 0.00%-0.25% range through year-end 2022. The municipal market interpreted the Fed's dovish decision as favorable. Positive fund flows continued in June as investors added over $10.8 billion (as of 06/24/2020) according ICI to municipal bond mutual funds during the month. The 5-year MMD scale finished June up three bps yielding 0.41% on June 30th. The .41% represented a 78 basis point drop in yields after beginning the quarter at 1.19%.

Navigator® Tax-Free Fixed Income Strategy

Clark Capital's Tax-Free Fixed Income strategy focuses on reducing risk, increasing liquidity, and maintaining long-term income as we continue to navigate a challenging environment resulting from the uncertainty caused by Coronavirus pandemic. To do so, we continue to allocate to high quality bonds focused on essential services and to local bonds backed by stable property tax bases. We feel the coupons attached to these types of high-quality bonds are less susceptible to a downturn in economic activity and therefore the credits tied to these holdings will likely experience minimal impact during a credit downgrade cycle. The essential service sector is comprised mainly of water and sewer bonds, which we feel offer excellent liquidity, provide stable operations, and offer sound debt service coverage. We generally look for high quality issuers that maintain large reserved funds that will help fund debt service coverage over the short to intermediate term.

In addition to essential service bonds, we continue to purchase local school district bonds. We view local school district bonds in a favorable lens since these bonds tend to be backed by stable property taxes rather than variable income tax or sale taxes, which tend to be cyclically oriented. We generally allocate to geographic areas that we believe are home to stable businesses with steady economic activity and growing property tax bases. We believe these local bonds with strong fundamentals should experience modest credit deterioration during a credit down grade cycle.

Municipal Outlook

Moving forward, we believe fund flows are likely to remain positive as net supply continues to increase over the summer months, keeping yields stable. Relative valuations of municipal bonds versus Treasuries have come down from recent extreme highs in March, but with the 5-year Bloomberg AAA ratio finishing the quarter at 139%, municipal bonds still provide attractive relative value compared to U.S. Treasuries, which should help keep demand elevated as we move through the summer.

State and local governments will continue to experience revenue shortfalls as social distancing guidelines are enforced during this challenging time period. As result, we anticipate credit downgrades as we move through the next phase of the coronavirus cycle, particularly for municipalities with high debt burdens, lower debt service ratios, and lower credit ratings. In this environment, we are focusing on investments that represent high-quality, liquid names. Credit selection and active portfolio management, in our opinion, should continue to drive returns as we move through the summer and into the autumn season.

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Fixed income securities are subject to certain risks including, but not limited to: interest rate (changes in interest rates may cause a decline in market value of an investment), credit, payment, call (some bonds allow the issuer to call a bond for redemption before it matures), and extension (principal repayments may not occur as quickly as anticipated, causing the expected maturity of a security to increase)

The Bloomberg Barclays 5 Year Municipal Bond Index is a capitalization weighted bond index created by Bloomberg Barclays intended to be representative of major municipal bonds of all quality ratings with an average maturity of approximately five years.

The Bloomberg Barclays Municipal AAA Index is the AAA component of the Bloomberg Barclays U.S. Municipal Bond Index

The Bloomberg Barclays U.S. Municipal Index covers the USD-denominated long-term tax exempt bond market. The index has four main sectors: state and local general obligation bonds, revenue bonds, insured bonds and prerefunded bonds.

The Bloomberg Barclays US Intermediate Corporate Bond Index measures the investment grade, fixed-rate, taxable corporate bond market. It includes USD-denominated securities publicly issued by US and non-US industrial, utility and financial issuers that have between 1 and up to, but not including, 10 years to maturity.

Municipal securities can be affected by adverse tax, legislative or political changes and the financial conditions of the issuers of the municipal securities.

Municipal bonds can be significantly affected by political and economic changes, including inflation, as well as uncertainties in the municipal market related to taxation, legislative changes, or the rights or municipal security holders. Municipal bonds have varying levels of sensitivity to changes in interest rates. Interest rate risk is generally lower for shorter-term municipal bonds and higher for long term municipal bonds.

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