ClarkCapital MANAGEMENT GROUP

Portfolio Commentary

Navigator® Taxable 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:

Navigator® Taxable Fixed Income

The Navigator Taxable Fixed Income strategy finished the second quarter slightly outperforming its benchmark. Challenges in the first quarter became tailwinds in the second quarter as the Fed was able to stabilize the markets.

In April, it expanded the size and scope of the Primary Market Corporate Credit Facilities (PMCCF) and the Secondary Market Corporate Credit Facilities (SMCCF) and oversold market conditions from March created the best returns of the quarter. The Bloomberg Intermediate Corporate bond Index gained 4.00% for the month. May followed through with another stellar month with the index returning 1.82%. June tacked on another 1.63% to bring the second quarter to a close.

The quarter appears to be mission accomplished by the Fed. But just for good measure they modified their bond buying program of investment grade credits. Initially companies were supposed to apply to the Fed to have their bonds bought in the secondary market. Companies were fearful of this transparency and did not want to be first in line for what the market might view as sign of financial stress and weakness. The Fed eliminated this requirement and by mid-month were buying small amounts of investment grade corporate bonds.

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This resulted in investment grade and high yield issues rallying versus a backdrop of almost nonexistent Treasury yields. The 2-year Treasury yield closed the quarter at a paltry 15 basis points, the 5-year at 28 basis points, the 7-year at 49 basis points, and the 10-year at 65 basis points as the second quarter ended.

Taxable Outlook

The ultra-low interest rates and the Fed's willingness to support the markets has changed our stance on a barbell approach which we had begun in 2016. We are finding relative value in the 4-6-year part of the curve and 9-10-year part of the curve. The result is our duration is extending out further toward the 5-year range and with a more accommodative Fed, we feel comfortable with that extension.

Housing bonds that we own may experience some volatility if the consumer re-trenches. However, low rates and a possible movement out of the cities to suburbs should keep demand for housing steady. Other areas we like are Technology and some sectors that may benefit from an infrastructure bill that will have both parties' approval during the summer months.

The first six months of 2020 have proven to be filled with volatility. Since April 9th the Fed's support of the markets has enabled the VIX to move back to the lows of the quarter. Treasury volatility has also been rather benign over the last 2 months, adding confidence to buyers looking for exposure in fixed income despite the low absolute yields. A summer ahead of increasing Covid cases appears to be in front of us. We also may be in store for a presidential election that proves to be as contentious as anything we have seen before. The Fed has more ammunition as Jerome Powell has said, but the ride may get a little bumpy after a historic rally in the markets in Q2 2020.

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 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.

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 2 Year Treasury Rate is the yield received for investing in a US government issued treasury security that has a maturity of 2 year.

The 5 Year Treasury Rate is the yield received for investing in a US government issued treasury security that has a maturity of 5 year.

The 7 Year Treasury Rate is the yield received for investing in a US government issued treasury security that has a maturity of 7 year.

The 10 Year Treasury Rate is the yield received for investing in a US government issued treasury security that has a maturity of 10 year. The 10 year treasury yield is included on the longer end of the yield curve. Many analysts will use the 10 year yield as the "risk free" rate when valuing the markets or an individual security.

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 or an investment), credit, prepayment, 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).

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.