ClarkCapital MANAGEMENT GROUP

Portfolio Commentary

Navigator® Fixed Income Total Return

Portfolio Manager

K. Sean Clark, CFA®
EVP, Chief Investment Officer

Risk Assets Reach New All-Time Highs

Market Review

The fourth quarter began with investors still on edge with a lot of uncertainty from the looming presidential election, rising case counts again here in the U.S., and a second spike in cases across Europe. The markets endured a politically charged environment post-election, record case counts, additional targeted economic shutdowns, and cheered the approvals of the first COVID-19 vaccines. The markets finished 2020 with a huge post-election rally that took risk assets to new all-time highs.

The market has broadened out since the COVID-19 vaccine announcements. The combination of clear Fed and fiscal policy along with the likelihood of improved mobility due to the vaccination rollout in the first half of 2021 has been met with corporate revenues and earnings exceeding expectations at record rates.

Cyclicals continue to perform well with the expectation of increased economic activity in 2021. This positive momentum was reinforced by Congress approving a $900 billion COVID-19 relief package and the FOMC offering guidance about its purchases of Treasuries and mortgage-backed securities by linking the purchase program to economic conditions.

Risk assets surged during the quarter, with the S&P 500 gaining 12.14%, the Russell 2000 surging 31.36%, the MSCI ACWI ex-US Index up 17.01%, and the Bloomberg Barclays U.S. Corporate High Yield Index up 6.45%. It was a remarkable quarter to close out a very strong year for the markets, with each of those indices closing at all-time highs.

Fourth Quarter Performance Highlights

For the quarter, Fixed Income Total return slightly underperformed the Bloomberg Barclays U.S. Corporate High Yield Index (gross and net of fees) and outperformed the Bloomberg Barclays U.S. Aggregate Bond Index (gross and net of fees). For the calendar year 2020, the strategy outperformed both the Bloomberg Barclays U.S. Corporate High Yield Index (gross and net of fees) and the Bloomberg Barclays U.S. Aggregate Bond Index (gross and net of fees).

- The strategy remained fully invested in high yield bonds throughout the fourth quarter and enters the New Year with a risk-on bias. Strong post-election gains and optimism of vaccine approvals have high yield bonds trading at all-time highs. The risk-on bias for the quarter is evident by the performance spread between high yield bonds and Treasuries. For the quarter, the Bloomberg Barclays U.S. Corporate High Yield Index gained 6.45% while the Bloomberg Barclays 7-10 Year Treasury Index declined 1.31%.
- High yield spreads ended the year at 360 basis points, a post-pandemic low, and a strong improvement from the 1100 basis point spread at the depth of the declines in March. The steady grind lower in corporate credit spreads has continued virtually unabated since the March lows. We expect that credit spreads

will continue to inch toward their pre-pandemic levels.

- Low macro volatility following recent positive vaccine developments and the accommodative stance of monetary policy should support credit risk appetite. Valuations limit long-term upside relative to the stellar performance since late March, but credit will likely deliver decent excess returns and solid Sharpe ratios in 2021.

Positioning and Outlook

There's a lot of positive influences on the economy right now including strong economic momentum, an unprecedented amount of monetary and fiscal stimulus, a booming housing market, pent up demand for spending, inventory rebuilding, and the COVID vaccines roll out. We expect 5% economic growth in 2021, and given the potential for additional fiscal spending with Democrats controlling D.C., we could see an upside surprise.

We will continue to see monetary and fiscal policy support to prop up asset prices, which is a global phenomenon. The yield curve has steepened with short rates anchored and longer-term rates drifting higher. The 10-year Treasury yield recently broke above 1.0% after falling to an all-time low of 0.50% on March 9th. We can easily see a scenario where market yields continue to gradually rise given continued economic growth and pent-up demand for spending once the pandemic is behind us. Now with the 10-year yield breaking through 1.0%, we could see a run towards 1.5%, which is the next level of technical resistance.

In our opinion, the main risks to the outlook include excessive short-term investor sentiment, lofty equity market valuations, an unexpected rise in inflation, a slower-than-expected vaccine rollout, and potential policy changes from a unified Democratic control in D.C., including tax hikes. Our sense is that concerns about higher tax rates and increased regulation will likely start to weigh on the market at some point, but the economy and market will get a cyclical boost from additional fiscal spending.