Clark Capital Management Group

Portfolio Commentary

Navigator® Taxable Fixed Income

Portfolio Manager

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Q4 Report Card: Mission Accomplished

Market Review

October was a challenging month for bonds as the election, stimulus deals and SCOTUS appointment weighed heavily on the market. However, November and December saw a strong rebound as demand for fixed income accelerated.

A positive November and December enabled the fourth quarter of 2020 to end on a positive note as the Bloomberg Barclays U.S. Aggregate Bond Index returned 67 basis points. The Bloomberg Barclays Intermediate Corporate Total Return Index was up 176 basis points. Negative rates persisted globally, and we noticed a steady foreign demand. The persistent demand for bonds kept volatility low during the quarter as any supply was easily absorbed.

Spreads compressed during the quarter as the average Bloomberg Barclays Corporate Index option-adjusted spread (OAS) contracted from 136 basis points to 96 basis points at year end. This marked a full recovery from starting 2020 at 93 basis points after peaking in March at 373.

The front-end of the yield curve remained unchanged for the quarter. 2-year yields closed at 12 basis points (down 1 basis point). The biggest change was where 10-year rates rose 24 basis points to close the quarter at 91 basis points. The result was a steepening yield curve of 2-10 years to 79 basis points.

The markets ended the last two weeks of December with relative calm. The steepening yield curve helps banks, and we believe it is a sign of confidence in future economic growth. The report card for Q4 and year end is A+ and mission accomplished by Fed Chairman Powell.

Fourth Quarter Performance Highlights

- Liquidity is not always a measurable number, but rather more of a confidence indicator of a functioning market. In that vein, we saw BB credits refinance several of our holdings.
- We have had positive views on housing bonds for several years. Two of our housing holdings were upgraded by Moody's to investment grade, which set off a rally in the housing sector. A mortgage insurances and services company, a long-term holding of ours, benefited from a strong housing market as well.
- Economic sectors that would benefit from a vaccine roll-out rebounded as well. Two of our hotel chain holdings along with a luxury fashion brand and a luxury department store had credit spreads tighten.
- A few of our Energy holdings lagged during the quarter. One of our Healthcare holdings was also a laggard as the stock refused to rally, and leveraged buyout rumors circulated.

Past performance is not indicative of future results.
This is not a recommendation to buy or sell a particular security. Please see attached disclosures.

Positioning and Outlook

The portfolio had a recurring theme of increasing its position in Technology and Housing during the quarter. We also continue to look for excess yield in the BB credit space. We believe that identifying BB credits in the front-end of a company's debt stack that can be re-financed given today's low short-term rates and liquidity can add to returns.

We are looking for a return in 2021 of the consumer to be the dominant theme later in the year. We are overweight in Consumer Discretionary and Materials, with a slight overweight to Information Technology and Energy. The portfolio is underweight Consumer Staples, Utilities and Healthcare. We are also underweight Financials, which has been more of an issue of finding regional banks. We look to increase exposure in regional banks in the New Year. Portfolio duration continues to be in the 4-year range.

We believe that credit spreads and security selection will be the key drivers of return as we turn to Q1 2021. A new administration could look to introduce both an infrastructure bill and a new pandemic stimulus package.

OAS starting the year at 96 could make it difficult for investment grade credit to tighten much further without sellers appearing. If a move lower in spreads occurs and the new issue calendar increases dramatically, any tightening of spreads may be short lived. We believe callable BB paper that can benefit from a stimulus package will be key for producing excess return.

Given an eventual vaccine rollout, we would suspect that the yield curve will rise. Looking at stocks as a guide, many charts look poised to return to pre-pandemic prices. In our opinion, that would mean the 10-year Treasury's first move would be to a 1.20 yield, and then into the 1.40-1.50 area. Positioning in the front-end of the yield curve may be the best solution while waiting to see if yields rise to pre-pandemic levels.

We remain diligent in our belief that active fixed income solutions are beneficial in a constantly changing rate and credit environment.