Cliff Notes on the Economy

Economic Review & Outlook

Authors

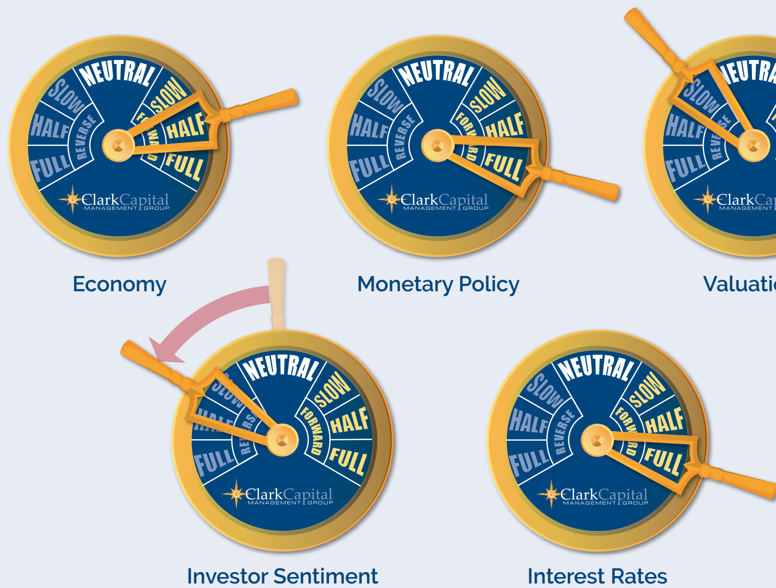
Glenn Dorsey, CFA®, CAIA®
SVP, Head of Client Portfolio Management

Peter Eisenrich, CFA®
VP, Senior Client Portfolio Manager

Navigate Your Future. Enjoy the Journey.

Fourth Quarter 2020

Each quarter, we review our gauges that help shape our view for the overall economic environment. These 5 gauges in turn drive our expectations for the stock market. Recall 12:00 is neutral, anything to the right of 12:00 is positive for stocks, anything to the left of 12:00 is negative.



U.S. Economy

The first gauge covers the U.S. economy. We keep this gauge at a half forward position heading into the new year. For the third straight quarter, this gauge is in the half forward position, reflecting our expectation of above trend economic growth. We believe we are still in the "V-shaped" portion of this economic recovery. Q3 GDP jumped by just over 33% and the Atlanta Fed GDPNow forecast calls for over 10% growth in Q4.

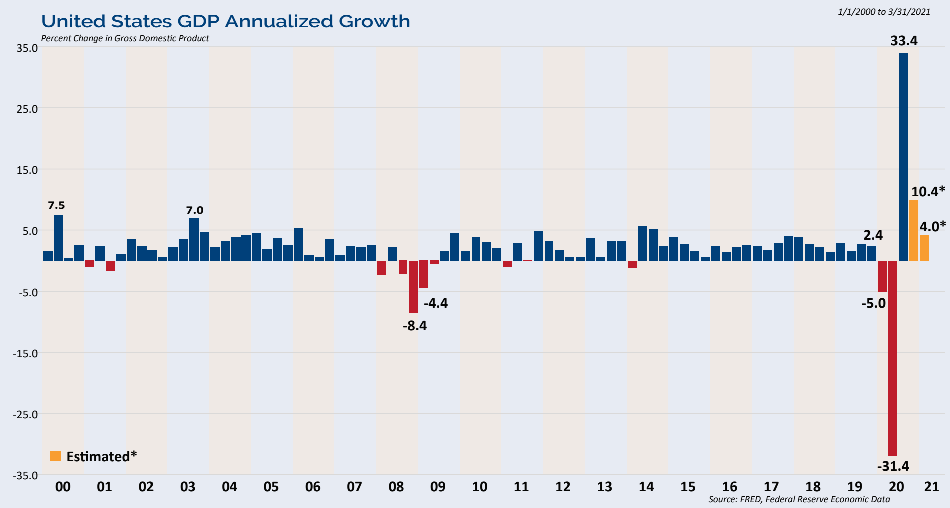
As the vaccine rolls out more broadly in 2021 and the economy moves ahead with the reopening process, we expect economic strength to continue well into 2021. Ultimately, we believe that economic growth will return to long-term trend levels just above 2%, but the rebound effect from the economic shutdown should continue in the first part of the new year.

Cliff Notes on the Economy

Economic Review & Outlook

Economy

Navigate Your Future. Enjoy the Journey.



All of this is said with the understanding that the near term is still very uncertain from an economic perspective. Over the next few months as the pandemic surges, more shutdowns and economic hardships will persist. It will take time for the vaccine to become more broadly available.

While late in arriving, the next round of fiscal stimulus was signed into law just days before the new year. Hopefully, this aid will help bridge the gap during this challenging period until we get further into 2021 and make more progress against the pandemic. At $900 billion, the package represents over 4% of the U.S. economy.

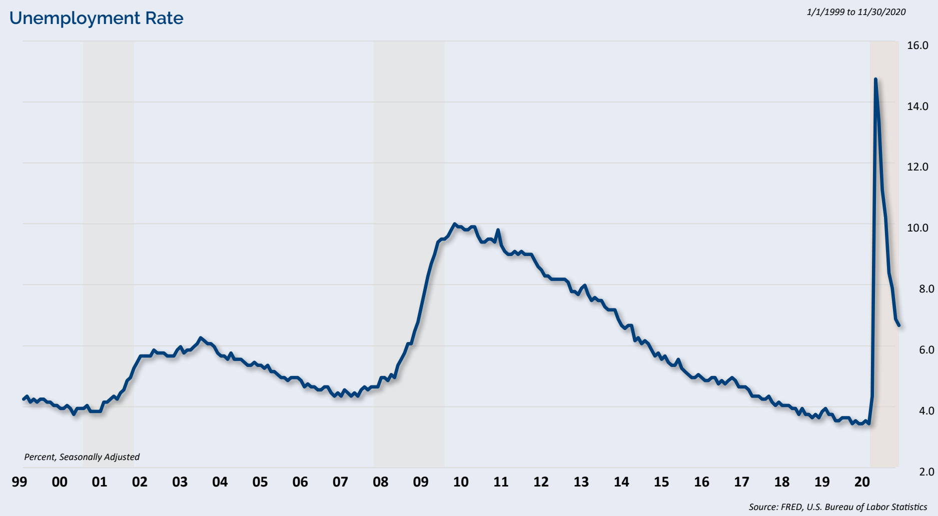
As we have expected all along, the reopening process will inevitably encounter bumps along the way until we make significant progress against COVID-19. This keeps us from moving the gauge to the full forward position.

The job market has bounced back strongly from layoffs early in this pandemic crisis and progress continues to be made on this front. However, job improvement has slowed and with a tough couple of months in front of us, the job market could come under some near-term pressure.

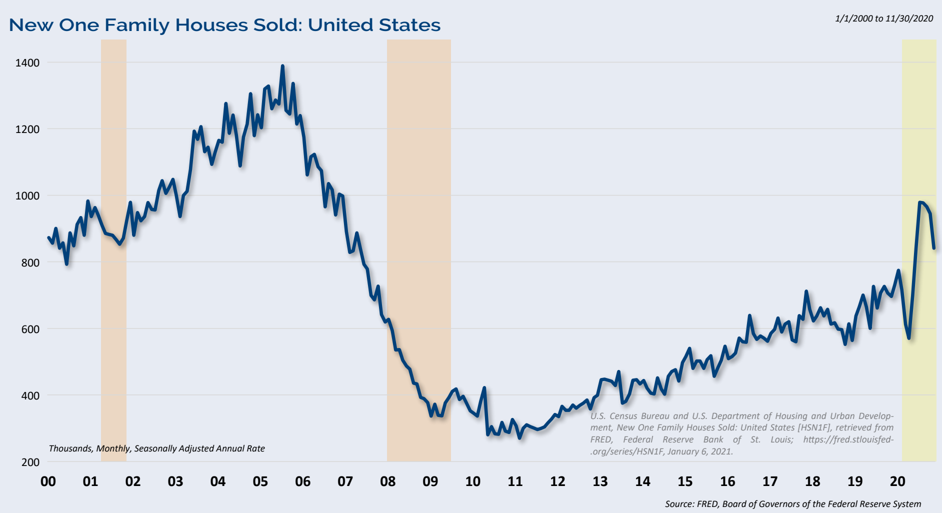
ClarkCapital MANAGEMENT GROUP

Cliff Notes on the Economy

Economic Review & Outlook



One part of the economy that has provided a strong tailwind has been the housing market. With interest rates low and some movement out of cities occurring, in the middle of 2020, new home sales approached the 1-million-unit annualized sales pace for the first time since 2006. Although sales levels cooled later in the year, the November reading of an 841,000 annualized pace was still at a level not seen since before the housing crisis.



Existing home sales, housing starts and building permits also hit levels not seen since before the '08-'09 Financial Crisis.

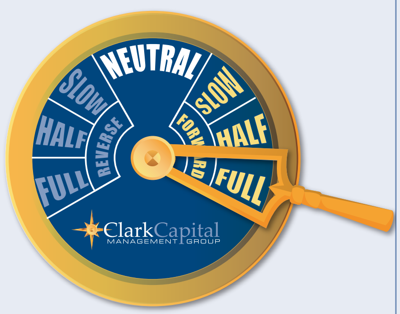
We believe that the economic recovery will continue in 2021, but there will be some bumps along the way. Overall, we believe the U.S. economy is headed in the right direction and improvements will continue.

Navigate Your Future. Enjoy the Journey.

ClarkCapital MANAGEMENT GROUP

Cliff Notes on the Economy

Economic Review & Outlook



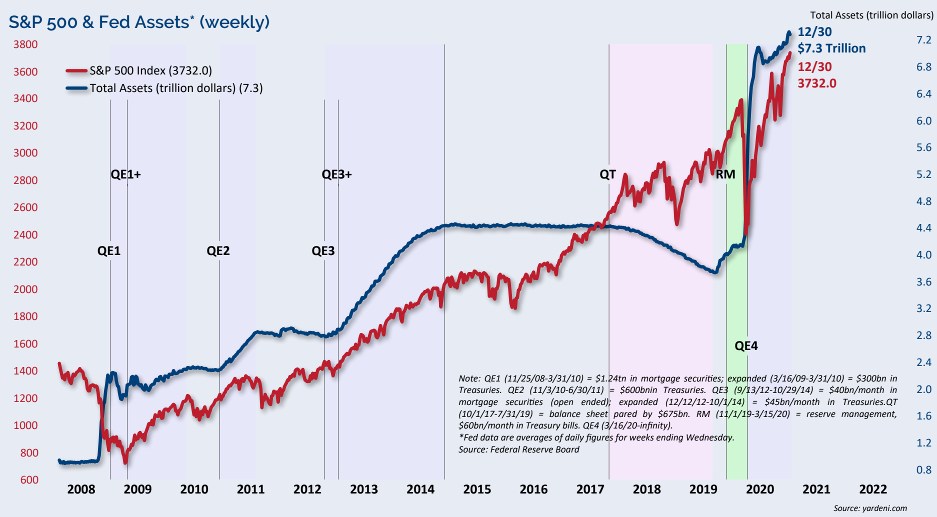
Monetary Policy

Monetary Policy

One of the items supporting the economic recovery is Monetary Policy. We keep this gauge in a full forward position.

There is not a lot of new news to report about the Fed as we go into 2021. The massive support from the Fed that began in March with unlimited quantitative easing and a whole host of other programs continues with no end in sight.

The Fed has reiterated repeatedly that it will continue to support the proper functioning of the financial markets and their actions have backed this up. The Fed's balance sheet, which had been slowly declining prior to this crisis, increased by more than $3 trillion dollars in just a matter of months, pushing the total balance sheet to over $7 trillion dollars near the end of 2020.



Ultimately, this massive stimulus by the Fed helped support capital markets from the early days of the pandemic crisis period. Over the past decade, we have seen that when the Fed is increasing its balance sheet, stocks have reacted favorably and subsequently, both stocks and bonds enjoyed a powerful rebound from the crisis lows through year-end.

Inflation has become a bigger topic of late driven in part by the massive increase in public debt responding to the pandemic crisis. Furthermore, the anticipated post-vaccine recovery accompanied by a massive surge in money supply, could put upward pressure on inflation.

Also, the Fed indicated it would look at inflation a bit differently with the broad interpretation they would be willing to let inflation run above 2% for a period of time, meaning a bit hotter moving forward. This will be a topic we continue to monitor, but currently inflation expectations are still only suggesting 2% inflation five to ten years out.

We know this will be a choppy reopening process, but the Fed is providing unwavering support and we therefore keep this gauge in the full forward position.

Navigate Your Future. Enjoy the Journey.

Clark Capital Management Group

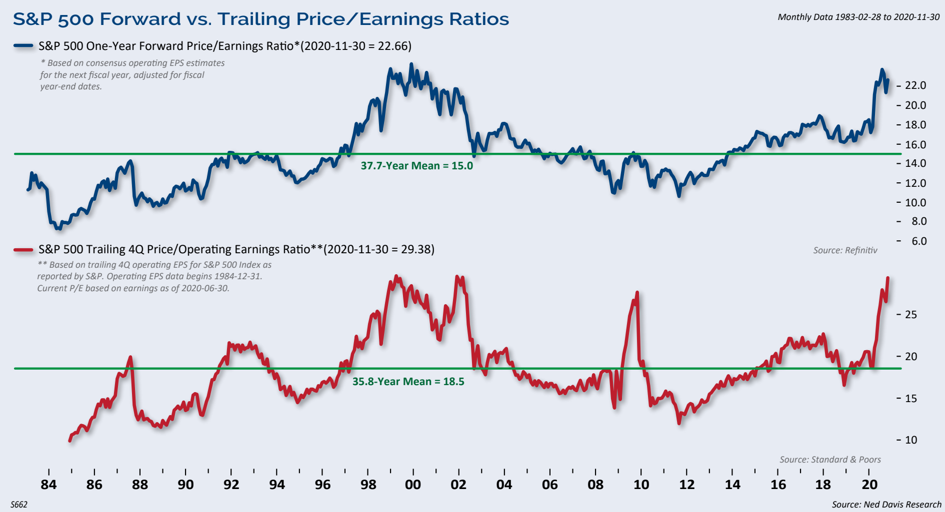
Cliff Notes on the Economy

Economic Review & Outlook

Valuations

Valuations

Next are valuations, which we keep in a slow reverse position. Needless to say, the rally in the stock market from the lows in March has been strong, pushing the forward price to earnings or P/E ratio of the S&P 500 to its highest level in about 20 years.



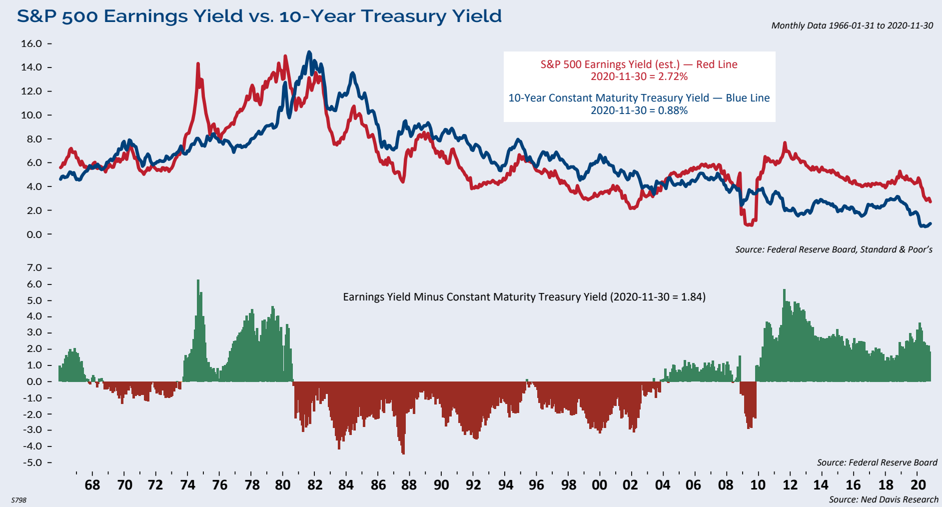
We are in a period where earnings or "E" have rebounded significantly from the lows hit in Q1, but they have not yet surpassed their prior highs. The reopening will take some time for businesses to get operations back up to full speed, but operating margins have snapped back as revenues have increased and costs have been contained. Recall that the stock market is forward looking, and investors are looking beyond the shorter-term earnings challenges and at the improvements taking place broadly in the economy and corporate America. Businesses performed better than analysts expected through the worst parts of the pandemic crisis and investors have rewarded these companies with the S&P 500, NASDAQ Composite, Dow Jones Industrial Average and Russell 2000 Indices all hitting new all-time highs in the fourth quarter.

So, why not bring this gauge further back into reverse territory with valuations so high? We need to analyze stocks in relation to other asset classes, with the primary alternative asset class for most investors being bonds. While valuation multiples are high, very low interest rates help offset that.

With the Fed pushing interest rates down, fixed income yields across most maturities are being suppressed. The 10-year U.S. Treasury yield has moved up rather steadily since August, but it still sits below 1% at year end. We can compare the earnings yield of the S&P 500 (which is the inverse of the P/E ratio) to the yield on the 10-year Treasury and it shows on a relative basis, stocks are more attractive than bonds.

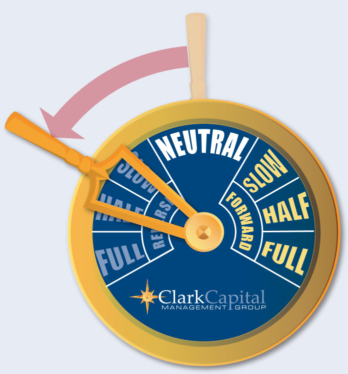
Cliff Notes on the Economy

Economic Review & Outlook



When interest rates are low, it supports higher stock market valuations. Simply said, the low yields of bonds are not providing a lot of competition to stocks and investors will pay a premium for earnings. We would expect the P/E multiple to contract somewhat as earnings continue to recover, but we do anticipate them to remain above historic levels due to the low interest rate environment.

As an active manager, we look at valuations on a company-by-company basis. Although a few large-cap growth companies have powered index levels to all-time highs and their valuations might be extended, the average stock has not had as strong of a rally. So, that provides us at Clark Capital an opportunity to seek out high quality companies at a good price and we continue to make very purposeful investments in both stocks and bonds.



Investor Sentiment

Investor Sentiment

The next gauge is Investor Sentiment, which can be thought of as a measure of speculation or pessimism in the market. For the second quarter in a row, this is the only gauge we are adjusting, and we bring it backwards and put it right between slow and half reverse. Recall, this gauge is a contrarian indicator, so extreme pessimism is a positive from a market perspective and extreme optimism is just the opposite.

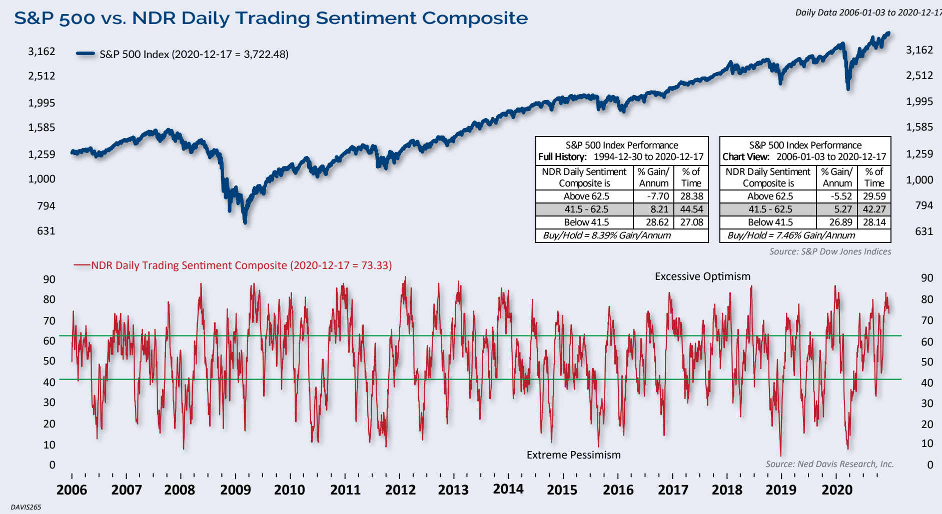
Optimism has increased as the market has reached record highs. We have had some significant swings in investor sentiment over the course of 2020. At this point, sentiment is leaning too optimistic in our opinion, which compels us to bring this gauge into the reverse zone. Trading sentiment is one indicator we look at and after swinging into extreme pessimism in March, this measure has moved back into that extreme optimism zone, which could set up some near-term market weakness.

ClarkCapital MANAGEMENT GROUP

Cliff Notes on the Economy

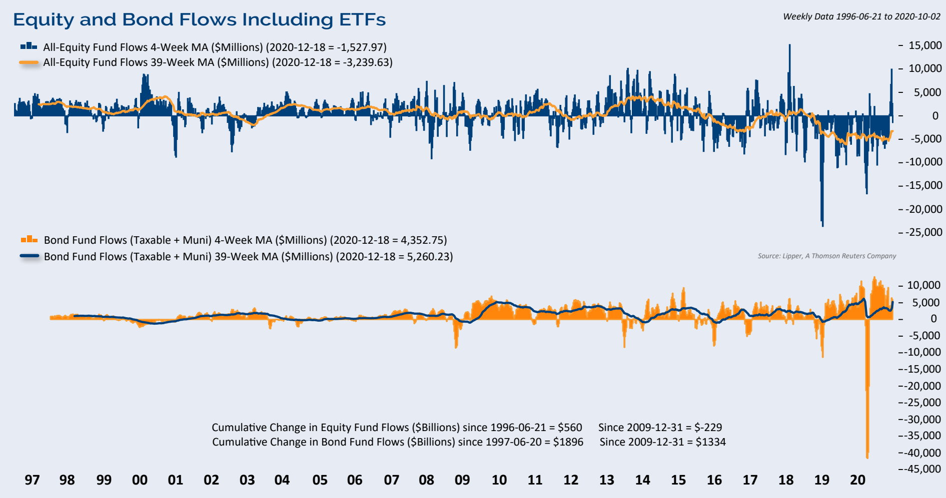
Economic Review & Outlook

S&P 500 vs. NDR Daily Trading Sentiment Composite



Put/call ratios have become extreme again as well with investors taking a much more bullish stance on the market based on option activity. Another indicator we look at to determine investor sentiment is fund flows, which track what investors are doing with their money versus simply surveying what they say. Although bond funds have dominated inflows over the last several months, equity funds have seen some recent periods of inflows as well. While not at an extreme, the steady flow of money out of equity funds has seen more mixed results in recent weeks.

Equity and Bond Flows Including ETFs

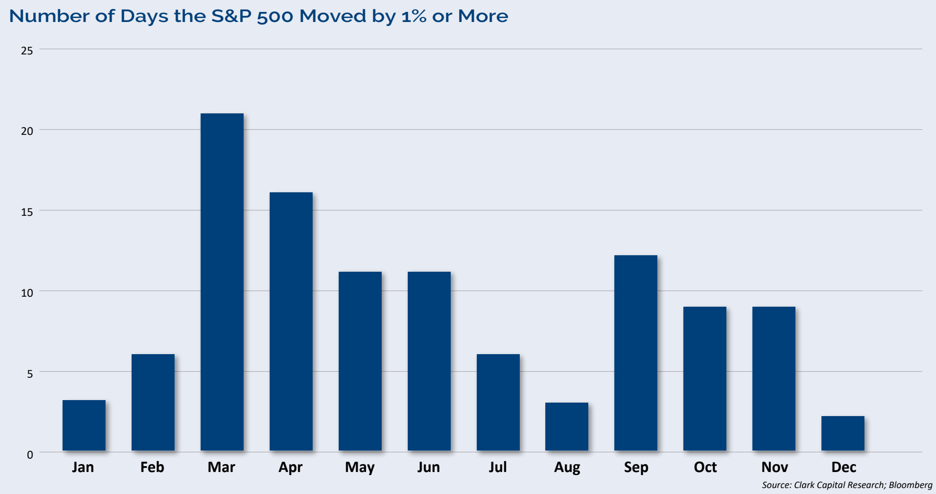


Another indicator is the CBOE Volatility Index or VIX Index, which is often referred to as the Fear index. The VIX Index spent late November and early December in the low 20s, its lowest levels since the pandemic began. Fear is still elevated from a historical perspective, but it is down to levels last seen prior to the pandemic, which might be indicating some complacency in the market. In fact, December was the least volatile month of the year with the market only moving up or down 1% or more on 2 days.

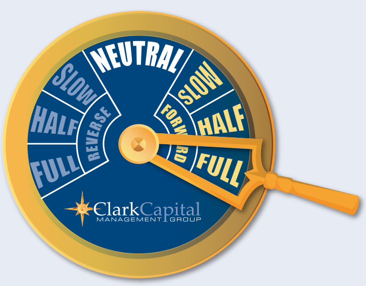
ClarkCapital MANAGEMENT GROUP

Cliff Notes on the Economy

Economic Review & Outlook



Based on the cumulative data we analyze for investor sentiment, we believe an adjustment back into the reverse position is appropriate moving into 2021 and we put this gauge on the line between slow and half reverse.

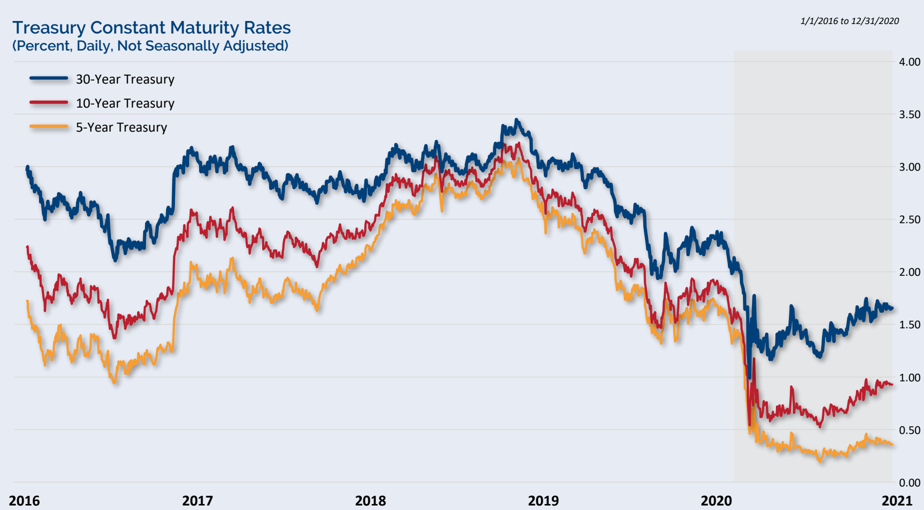


Interest Rates

Interest Rates

Interest rates are the final gauge, and we maintain a full forward position, which mirrors our monetary policy gauge. Recent comments by the Fed, along with actions it is taking in the market, lead us to believe we will be in a lower for longer interest rate environment for the foreseeable future.

It might be hard to believe that the yield on the 10-year U.S. Treasury ended 2019 at 1.92%, but driven by the Fed and a flight to quality from nervous investors, rates hit new all-time lows in 2020 across many parts of the yield curve. We close out 2020 with the 10-year yield below 1%.



Cliff Notes on the Economy

Economic Review & Outlook

With the Fed's return to its zero interest rate policy and shorter-term yields anchored so low, the yield curve has steepened as the longer end has moved a bit higher. The yield on 30-year U.S. Treasuries remains subdued, but it at times hit 1.7% in November and December, well off its closing low of 0.99% on March 9. Although U.S. government debt levels are increasing, which is being exacerbated by pandemic spending, the cost to service this debt remains low.

Ultimately, lower rates should be helpful to the economy as it reduces the cost of capital and it appears rates will remain low for the foreseeable future driven in large part by the Fed. Therefore, we keep this gauge in the full forward position.

Conclusion

We know these remain challenging times, but the good news is that the U.S. economy has rebounded strongly, and the vaccine has started to roll out across the United States. The election is now over and investors can focus on other matters.

We continue to believe that the U.S. economy and corporate America will come through this crisis, although it will take some time. We also anticipate a bumpy road to recovery from both an economic and stock market perspective, particularly in the near term, but we believe we are heading in the right direction.

We expect economic improvement to continue as the vaccine becomes more widely available. As is often the case, the worst periods of market performance, like Q1, are often followed by some of the best times in the market, like Q2, Q3 and Q4. That is why we continue to urge clients to stick to their financial plans and not make decisions based on short-term movements in the markets.

Disclosures