ClarkCapital MANAGEMENT GROUP

Portfolio Commentary

Navigator® Taxable Fixed Income

Portfolio Manager

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Where Do We Go from Here?

Market Review

The 10-year U.S. Treasury finished the first quarter yielding 1.74%, which was a swift rise from the 2020 closing yield of 91 basis points. U.S Treasuries experienced one of the worst performing quarters since 1980 according to Bloomberg.

Fiscal stimulus and higher expectations for a rapid economic recovery combined with strong vaccine momentum, which caused the 2 to 10-year Treasury bond yield curve to steepen to 162 basis points. This was good for value stocks such as banks, but not so pleasant for those exposed to the long end of the yield curve.

On the fiscal side, one of biggest news headlines during the quarter was Congress passing a $1.9 trillion coronavirus relief package. Rates moved up quickly based on this news. What appeared to be support for 10-year rates at 1.60% did not hold, and rates quickly went into the 1.70% area on the charts.

On the monetary side, global central bank liquidity was viewed as a sizeable tailwind for risk assets as the Fed continued to grow its balance sheet and provided cautious communication towards any slowdown in asset purchases for the foreseeable future.

During the third week of March, the rapid rise in rates appeared, in our opinion, to finally cause some exhaustion and hesitation for buyers. Investors that did not fully anticipate the swiftness of the yield curve steepening were penalized. Bonds that were issued just a few months ago with 1-2% coupons started to trade at discounts of 5 to 6 points relative to par. It will be interesting to track how these new discount bonds trade should rates continue to move higher.

First Quarter Performance Highlights

- Duration remained slightly short of the benchmark at 4 years. BB credits, such as a steel and metal manufacturer we own, were called away in the quarter.
- The portfolio continued to pursue economic recovery themes as we expanded our holdings in REITS.
- Cyclical names including a mining company and an international energy company were added to the portfolio. We believe the mining company we added during the quarter is undervalued and could be a credit upgrade candidate as copper prices continue to move higher.
- Technology and Housing continue to be staples of the portfolio, and we added to, or increased our positions in these sectors.
- A Texas energy company acted as a drag on performance during the Texas power outage this winter. The company's shortfall in earnings delayed a possible upgrade to investment grade, which also weighed negatively on the credit's returns. However, we are not concerned over the credit as we are confident our premium holdings will be re-financed near the 2021 and 2022 call dates.

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

We recognized several months ago that the biggest risk to fixed income strategies would be a swift steepening in the yield curve. The new presidential administration introduced both an infrastructure bill and a new pandemic stimulus package, which caused the 10-year bond yield to return to pre-pandemic levels at the 1.60-1.80% range.

For the quarter, the Bloomberg Barclays U.S. Aggregate Bond Index was down 337 basis points. The Bloomberg Barclays Intermediate Corporate Total Return Index was down 219 basis points. The Navigator® Taxable Fixed Income strategy, while negative for the quarter, outperformed both indices on a relative basis.

We avoided a portion of the negative returns suffered in bonds by keeping our BB re-finance names in the short duration buckets and keeping our investment grade exposure right around 4 years. Currently, the 2026-2027 maturity range appears to be the most valuable part of the curve to invest in, with shorter-term rates anchored below 20 basis points and the curve continuing to steepen.

The question is, "where do we go from here?" We are starting to see themes that the Fed is behind the curve and that the 2-year yield is going to rise to 50 basis points. A move to 50 basis points may be fighting the Fed, and that is not something the strategy is willing to do just now.

We will continue to monitor the curve and rates. 2026 and 2027 appear to be the sweet spot for now, and we will continue to focus our allocations inside this maturity range. We like BB credits that have a high potential for credit upgrades during an economic recovery. If the 10-year Treasury bond moves back toward the 2% level, then adding some duration could be warranted.