Portfolio Commentary

# Navigator® MultiStrategy

Portfolio Manager

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# Extreme Pessimism Makes a Fourth Quarter Rally, Likely, but Potential 2023 Recession Looms

## Market Review

Soaring inflation and rising interest rates drove markets into a deep June swoon, but a strong recovery began soon after and continued into mid-August, as the S&P 500 enjoyed a 17% gain while the NASDAQ soared by 23%. The rally was driven, however, by investors' misguided belief that the Fed would soon pivot and back off its hawkishness. As Powell's pivotal speech at Jackson Hole approached, the S&P 500 stalled at its 200-day moving average and stronger-than-expected CPI and PPI reports -- along with strong hiring data -- forced markets to wake up to the truth. After Powell delivered an ardently hawkish Fed forecast, markets took a turn for the worse. The pain was magnified by the fact that both stocks and bonds plunged – and with magnitude. The 10 Year Treasury yield rose from 2.6% in August and peaked at over 4.0% in late September. This concluded the three worst quarters in the history of the U.S. Aggregate Bond Index, which is now down 14.6% year to date. The S&P 500 declined 16.5% from its August peak, and value, mid, and small-cap indices broke through the June lows. Commodities were not spared either, as they fell 14% for the quarter. Cash was king, as it often is during rising rate environments.

## Third Quarter Portfolio Highlights

- Growth stocks outperformed value on the quarter, but all of that outperformance was achieved during the July-August rally. After the peak, large-cap growth and Technology underperformed by about 3%. The S&P 500 Index declined by 4.9% and is now down 23.9% on the year. Large value fell 5.8%, but is outperforming large growth by 14% year to date. Small-cap value declined 6.8%, and small growth fell 3.1%. Factors and themes were mixed, as high dividend suffered under higher rates and energy weakness, falling 7.9%, while minimum volatility slightly underperformed. Strangely, momentum outperformed as long-term performance trends favored defense, as did high beta, while quality suffered.
- While cyclical commodity prices declined and inflation fears ebbed, the Federal Reserve was unmoved and remained concerned with the overheating labor market and surging wages. As a result of ongoing tightening, the Barclays Agg. tumbled 4.7%. 7-10 Year Treasuries, usually a safe harbor, fell even more, while high yield fell by a more modest 1.7%. Cash was king, as all bond segments underperformed the 3 Month Treasury Bill.
- Multi-Strategy now devotes two thirds of its fixed income exposure to tactical high yield and one third to tactical investment grade fixed income. Our tactical investment grade position bought into investment grade corporates at the end of June, but the fears of a hawkish Fed drove us into cash equivalents in late August. We remain in cash today, preserving capital in a rising rate environment. Our tactical high yield strategy was defensive until July, but bought into high yield in mid-July as the rally expanded. However, the positive action only lasted three weeks before credit trends reversed. We sold out of high yield at the end of August and moved into cash equivalents, which our models favored most, as cash provides both a modest yield and capital preservation.

*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

At the beginning of the quarter, we indexed the portfolio and waited for market leadership trends to emerge. As the rally took hold, our relative strength-based models moved us into large-cap growth and later mid and small-caps. We gradually liquidated our growth-oriented and cyclical holdings in mid-August, moving into the S&P 500 Index as investors began to realize the Fed would not pivot from its hawkish stance. As the decline widened, we moved a modest 15% into minimum volatility, with the remainder parked in the S&P 500. With intermediate-term sentiment surveys at levels last seen at major 2011 and 2020 bottoms, we remain indexed and believe that keeping a neutral portfolio beta is warranted. We believe conditions point towards an intermediate-term rally similar to July and August's. We are short-term bullish, but believe a recession or extreme slowdown in growth is possible in 2023.

2022 has been acutely painful for investors because bonds endured their worst nine-month period in history as the S&P 500 declined 23.9% year to date. However, despite the dramatic selloff, we believe bonds have compelling value. They provide higher yields, and their real yields exceed 1% across much of the curve – their highest levels since 2010. Going forward, this should provide tactical opportunities for the fixed income portion of Multi-Strategy. With regard to equities, growth stocks could be resurgent, since their longer duration makes them sensitive to interest rates. However, the economy remains the bigger question, which is hamstrung by a Federal Reserve focused on cooling labor markets. The hawkish backdrop will likely feature recessionary or low growth conditions, meaning corporate profit margins and top line sales could come under fire. Valuations were at such extremes in late 2021 that this year's decline only brings us back to slightly above long-term averages. More pain and volatility could be in the cards, particularly in 2023. In the short-term, we are more prone than normal to passively index and enjoy a potential market rally. Looking out into 2023, we expect more volatility as the economy likely needs more time before the clouds clear.

### MultiStrategy 25-75 Top Contributors as of September 30, 2022

| Company Name | Average Weight (%) | Contribution to Return (%) |
|---|---|---|
| iShares Core S&P Total U.S. Stock Market ETF | 7.78 | 0.94 |
| Navigator Tactical Investment Grade Bond Fund - Class I | 23.88 | 0.26 |
| iShares Core High Dividend ETF | 0.76 | 0.00 |

### MultiStrategy 25-75 Top Detractors as of September 30, 2022

| Company Name | Average Weight (%) | Contribution to Return (%) |
|---|---|---|
| iShares Core S&P 500 ETF | 3.57 | -1.16 |
| Navigator Tactical Fixed Income Fund Class I | 48.73 | -0.56 |
| SPDR S&P 400 Mid Cap Growth ETF | 2.25 | -0.41 |

*Source: Factset. For illustrative purposes only. Past performance does not guarantee future results. The holdings identified do not represent all of the securities purchased, sold or recommended for advisory clients. In the chart above, "weight" is the average percentage weight of the holding during the period, and "contribution" is the contribution to overall performance during the period. To obtain the calculation methodology and a list showing every holding's contribution to the overall composite during the period, contact: PortfolioAnalytics@ccmg.com.*

### MultiStrategy 50-50 Top Contributors as of September 30, 2022

| Company Name | Average Weight (%) | Contribution to Return (%) |
|---|---|---|
| iShares Core S&P Total U.S. Stock Market ETF | 14.72 | 1.88 |
| Navigator Tactical Investment Grade Bond Fund - Class I | 16.04 | 0.19 |
| iShares Core High Dividend ETF | 1.74 | 0.01 |

### MultiStrategy 50-50 Top Detractors as of September 30, 2022

| Company Name | Average Weight (%) | Contribution to Return (%) |
|---|---|---|
| iShares Core S&P 500 ETF | 8.87 | -2.88 |
| SPDR S&P 400 Mid Cap Growth ETF | 4.49 | -0.82 |
| SPDR S&P 400 Mid Cap Value ETF | 2.24 | -0.74 |

*Source: Factset. For illustrative purposes only. Past performance does not guarantee future results. The holdings identified do not represent all of the securities purchased, sold or recommended for advisory clients. In the chart above, "weight" is the average percentage weight of the holding during the period, and "contribution" is the contribution to overall performance during the period. To obtain the calculation methodology and a list showing every holding's contribution to the overall composite during the period, contact: PortfolioAnalytics@ccmg.com.*

### MultiStrategy 75-25 Top Contributors as of September 30, 2022

| Company Name | Average Weight (%) | Contribution to Return (%) |
|---|---|---|
| iShares Core S&P Total U.S. Stock Market ETF | 21.30 | 2.43 |
| Navigator Tactical Investment Grade Bond Fund - Class I | 7.51 | 0.09 |
| iShares Core High Dividend ETF | 2.73 | 0.01 |

### MultiStrategy 75-25 Top Detractors as of September 30, 2022

| Company Name | Average Weight (%) | Contribution to Return (%) |
|---|---|---|
| iShares Core S&P 500 ETF | 12.78 | -4.17 |
| SPDR S&P 400 Mid Cap Value ETF | 3.76 | -1.24 |
| SPDR S&P 400 Mid Cap Growth ETF | 7.18 | -1.19 |

*Source: Factset. For illustrative purposes only. Past performance does not guarantee future results. The holdings identified do not represent all of the securities purchased, sold or recommended for advisory clients. In the chart above, "weight" is the average percentage weight of the holding during the period, and "contribution" is the contribution to overall performance during the period. To obtain the calculation methodology and a list showing every holding's contribution to the overall composite during the period, contact: PortfolioAnalytics@ccmg.com.*

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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).

The manager utilizes a proprietary investment model to assist with the construction of the strategy and to assist the manager with making investment decisions. Investments selected using this process may perform differently than expected as a result of the factors used in the model, the weight placed on each factor, and changes from the factors’ historical trends. There is no guarantee that Clark Capital’s use of a model will result in effective investment decisions.

Nasdaq is a global electronic marketplace for buying and selling securities.

Non-investment-grade debt securities (high-yield/junk bonds) may be subject to greater market fluctuations, risk of default or loss of income and principal than higher-rated securities.

The Producer Price Index (PPI) program measures the average change over time in the selling prices received by domestic producers for their output. The prices included in the PPI are from the first commercial transaction for many products and some services.

The S&P 500 measures the performance of the 500 leading companies in leading industries of the U.S. economy, capturing 75% of U.S. equities.

The iShares 7-10 Year Treasury Bond ETF (IEF) seeks to track the investment results of an index composed of U.S. Treasury bonds with remaining maturities between seven and ten years.

The 10-year Treasury note is a debt obligation issued by the United States government with a maturity of 10 years upon initial issuance. A 10-year Treasury note pays interest at a fixed rate once every six months and pays the face value to the holder at maturity.

The Consumer Price Index (CPI) is a measure of the average change over time in the prices paid by urban consumers for a market basket of consumer goods and services.

Investing involves risk, including loss of principal.

The 3 Month Treasury Bill Rate is the yield received for investing in a government issued treasury security that has a maturity of 3 months. The 3 month treasury yield is included on the shorter end of the yield curve and is important when looking at the overall US economy.

The securities of mid-cap companies may be subject to more abrupt or erratic market movements and may have lower trading volumes.

One of the most effective smart beta strategies for achieving a reduction of risk are known as ‘minimum volatility’ strategies, which are specifically designed with this goal in mind, seeking to deliver market-like returns with less volatility by targeting lower volatility stocks.

Minimum volatility ETFs (commonly referred to as “min vol” ETFs) attempt to reduce exposure to stock market volatility. Min vol ETFs do not ensure against losses.

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