Portfolio Commentary

Navigator® Fixed Income Total Return

Portfolio Manager

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Pivot and Rip

Market Review

It turned out to be a great year for risk assets, which was contrary to popular opinion coming into 2023. Many analysts and economists were predicting a recession, continued pain on the inflation front, and another year of losses for both stocks and bonds. 2023 confounded many as the economy remained strong. Despite the Fed continuing to hike overnight rates into the middle of the year, inflation came down and stocks soared.

In our 2023 Market Outlook, there were several themes we highlighted that prompted us to be bullish on stocks and hold out hope for a soft landing. For example, we expected the 2022 macro headwinds to turn into tailwinds in 2023, and therefore we had a bit more of an optimistic view of the potential for the markets in 2023 with economic momentum carrying over into 2023. We said it is rare for the S&P 500 to post back-to-back negative years of return. Also, pre-election years have historically been the strongest of the presidential election cycle, with median gains in the S&P 500 of 16.8%. Inflation was set to continue moderating and we said that the year-over-year Consumer Price Index (CPI) should fall to 3% with the potential for a downside surprise.

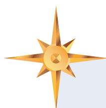
Most of the year was characterized by a concentrated equity market rally with the elite eight stocks dominating. The tides shifted once it became clear that the Fed was done hiking rates. Market participation broadened to include value, small-cap, and mid-cap stocks. For the year, the S&P 500 gained 26.26%, the Russell 2000 gained 16.88%, and the MSCI ACWI ex-US added 15.62%. Growth led the way with the Russell 1000 Growth Index up 42.67% and the Value Index up 11.41%.

Shifting interest rate expectations and decelerating inflation were a boon for bonds over the past two months of the year. The bond market avoided an unprecedented third year in a row of declines and posted gains. High yield led the way, up 13.45% and Treasuries gained 4.05%. We believe the markets enter the New Year overbought with overly optimistic investor sentiment. Our credit-based risk management models remain firmly risk-on, and therefore we would expect any weakness as we turn the calendar to be short lived.

Fourth Quarter Portfolio Highlights

The primary drivers of Fixed Income Total Return over time are its macro allocations that are driven by our credit-based risk management models. Those models dictate the strategy's allocation to high yield bonds, U.S. Treasuries, and cash equivalents. Fixed Income Total Return entered the fourth quarter allocated to cash equivalents. However, the tenor of the markets improved in early November and Fixed Income Total Return allocated into high yield bonds at that time. The strategy remained in high yield through the end of the year.

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



- As it became increasingly clear that the Fed was at the end of the rate hike cycle, the market responded favorably to a deep oversold condition coupled with pessimistic investor sentiment. Yields reversed course, credit spreads contracted, and risk assets experienced a surge in November and December.
- Yields across the curve declined from multi-year highs and credit spreads reached their lows of the current cycle. The 10-year Treasury yield peaked on 10/16 at 4.99% and closed the year at 3.86%. Ironically, that level was almost exactly where the 10-year Treasury yield ended 2022, which was at 3.88%.
- The Bloomberg Barclays 7-10 Year Treasury Index gained 6.65% during the quarter, its best quarterly gain since the second quarter of 2020. It wasn't just duration that rallied strongly in the fourth quarter, but also credit, which notched impressive gains with the Bloomberg Barclays High Yield Index up by 7.16% (also its best quarter since 2020).
- Credit spreads collapsed to 323 basis points, the low for this cycle, and nearing the lowest levels of the post COVID era.
- CCC and below-rated bonds slightly underperformed the broad high yield market during the quarter, gaining 6.76% vs. 7.16% for the broader High Yield Index. However, these bonds outperformed for the calendar year, gaining 20.18% compared to 13.45% for the broader High Yield Index.

Positioning and Outlook

As we turn the calendar and look toward 2024, we are cautiously optimistic on the economy and the markets, and see potential for continued gains, but at a much more moderate pace than we had in 2023. The economy certainly defied the naysayers last year and remained strong in the face of recession calls.

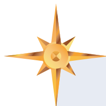
Through Q3 2023, the economy grew at better than a 3.0% annualized rate. While the recession versus soft landing debate continues, we think the evidence is building in favor of a soft landing, and therefore expect the economy to grow by 2.25% in 2024. To be sure, economic indicators including Leading Indicators, the yield curve, and the cumulative effect of monetary tightening remain recession concerns. But solid labor market conditions, economic momentum, a more dovish Fed, and decelerating inflation counter these concerns. In our 2023 Outlook we said, "until meaningful weakness is revealed in the labor market, calls for recession seem premature." We believe that remains the case today.

Overly bullish investor sentiment as we entered the New Year highlights the potential for consolidation in the first half of the year. Presidential election year trends suggest a positive year for the market, with gains loaded in the back half of the year. Our target for the S&P 500 based on election year trends, continued earnings growth, and some modest multiples expansion is 5300. We believe there are signs of broadening participation; small-cap stocks look attractive relative to large-caps.

Inflation is set to continue moderating with supply chains healed. Used car prices and the lagged effect of housing suggest disinflation is set to continue. We believe inflation is on a glide path lower toward 2%. The Federal Reserve has finished rate hikes with multiple rate cuts being priced into the markets. We view this as a recalibration of Fed policy. Historically, the Fed cuts rates seven months after the last hike. The market pricing in a total of six cuts in 2024. However, we believe that is likely too aggressive and instead, we are projecting a total of four cuts.

The 10-year Treasury Note yield peaked in October at 4.99% and did a round trip ending the year at 3.86%, just 2 basis points from where it started the year. We expect the 10-year yield to be rangebound between 3.25% - 4.5% and for the yield curve to steepen, which is consistent with historical precedent after the last Fed rate hike.

Every year there are risks to our market outlook, and this year is no different. Those risks include a hard economic landing, the U.S. presidential election (if a clear winner is not decided on Election Day), geopolitics (Russia/Ukraine, the Middle East, China/Taiwan), and the tenuous U.S. government fiscal position.



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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.

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).

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 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 Bloomberg Barclays US Treasury: 7-10 Year Index measures US dollar-denominated, fixed-rate, nominal debt issued by the US Treasury with 7-9.9999 years to maturity.

The Bloomberg Barclays US Aggregate Bond Index is a broad-based flagship benchmark that measures the investment grade, US dollar-denominated, fixed-rate taxable bond market. The index includes Treasuries, government-related and corporate securities, MBS (agency fixed-rate pass-throughs), ABS and CMBS (agency and non-agency).

The MSCI ACWI ex USA Index captures large and mid cap representation across 22 of 23 Developed Markets (DM) countries (excluding the US) and 26 Emerging Markets (EM) countries*. With 2,206 constituents, the index covers approximately 85% of the global equity opportunity set outside the US.

A CCC bond rating is considered to be speculative or junk grade, indicating that the issuer has a high risk of defaulting on its debt obligations. CCC credit ratings are often given to companies that are experiencing financial difficulties or have a high level of debt.

The US High-Yield Market Index is a US Dollar-denominated index which measures the performance of high-yield debt issued by corporations domiciled in the US or Canada.

The Russell 2000 Index is a small-cap U.S. stock market index that makes up the smallest 2,000 stocks in the Russell 3000 Index.

The iShares Russell 1000 Value ETF seeks to track the investment results of an index composed of large- and mid-capitalization U.S. equities that exhibit value characteristics.

The iShares Russell 1000 Growth ETF seeks to track the investment results of an index composed of large- and mid-capitalization U.S. equities that exhibit growth characteristics.

The Consumer Price Index (CPI) measures the overall change in consumer prices based on a representative basket of goods and services over time.

A Leading Economic Indicator is a measurable set of data that may help to forecast future economic activity.

A Treasury yield is how much investors can earn when they purchase one of those government debt obligations.

The ICE U.S. Treasury 7-10 Year Bond Index is part of a series of indices intended to assess the U.S. Treasury market. The Index is market value weighted and is designed to measure the performanceof U.S. dollar-denominated, fixed rate securities with minimum term to maturity greater than seven years and less than or equal to ten years

The volatility (beta) of a client's portfolio may be greater or less than its respective benchmark. It is not possible to invest in these indices. Index returns include the reinvestment of income and dividends. The returns for these unmanaged indexes do not include any transaction costs, management fees or other costs. It is not possible to make an investment directly in any index.

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