Clark Capital Management Group

Portfolio Commentary

Navigator® Fixed Income Total Return

Portfolio Manager

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Risk Assets Power Ahead

Market Review

It was a great quarter for the markets as the cyclical advance that began last year carried major indices to new all-time highs. The S&P 500 Index was positive for the 5th straight month to end the quarter and finished higher for the 10th time in the past 13 months. Market breadth improved during the quarter as we witnessed broader gains across the market capitalization and industry landscape. The major factors influencing the markets during the during the quarter were:

- 1. Strong momentum, which helped the market power higher in the face of higher interest rates.
- 2. A re-pricing of the number of rate cuts expected. Coming into the year, the market was expecting six rate cuts. By the end of the quarter, less than three rate cuts were priced into expectations.
- 3. Credit remained resiliant while duration suffered losses stemming from higher rates. Yields across the curve have risen, reflecting the predominant theme of "higher for longer." Within credit, lower quality paper outperformed higher quality for the quarter.

Disinflation, a less hostile Fed, reduced recession risks, and solid earnings growth have created a goldilocks backdrop for risk assets. Fed Chairman Powell recently spoke at Stanford University on the topics of the economy and monetary policy where he said, "I think we've gotten to what is, knock on wood, a pretty good place." He added, "We're using our tools to try to bring inflation down the rest of the way to 2%, while all the while keeping the economy strong as well."

The widespread expectation that the Fed will lower interest rates this year is linked to the widespread expectation that the labor market will weaken. Both of these scenarios seem to have been pushed out a bit.

Equity markets enjoyed strong gains led by large-cap U.S. indices with the S&P 500 gaining 10.55%, the Russell 2000 Index of small-cap stocks gaining 5.17%, and the MSCI ACWI ex-US gaining 4.69%. Fixed income returns were mixed, with credit enjoying gains and duration suffering losses as rates advanced and the curve shifted higher.

The Bloomberg Barclays U.S. Corporate High Yield Index gained 1.47% while the Aggregate Bond Index lost 0.78% and the 7-10 Year Treasury Index declined by 1.43%. Rates moved higher as Fed officials squashed immediate rate cut expectations. The 10-year Treasury note yield rose by 34 basis points during the quarter.

First Quarter Portfolio Highlights

The primary drivers of Fixed Income Total Return over time are its macro allocations that are driven by our relative strength credit 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 year allocated to high yield; given the strength of risk assets and weakness in duration, the strategy remained in a risk-on position throughout the quarter.

- High yield bond indicies ended the quarter at new all-time highs.
- Credit spreads narrowed meaningfully during the quarter, ending the quarter below 3%. This was solidly in the bottom 10% of their historical range, indicating a lack of stress in the credit markets.
- Lower-rated bonds outperformed higher quality across the credit spectrum.
- Bonds CCC and below were the best performing across credit with a 2.93% gain for the quarter, followed by B-rated bonds at 1.48%, BB-rated bonds at 1.09%, and BBB-rated investment grade corporate bonds at 0.19%. The 7-10 Year Treasury Index recorded a loss of 1.43% for the quarter.
- High yield bonds performed well in the face of rising yields with higher coupons and leverage to the solid economic growth during the quarter providing a tailwind to credit.
- Sticky inflation, strong economic growth, and the repricing of when and how many times the Fed will cut rates in 2024 pressured Treasury returns. Long duration Treasuries were the biggest losers during the quarter.

Positioning and Outlook

The market is approaching overbought levels consistent with a pullback, but momentum suggests the long-term trend remains bullish even if we have a correction. In addition, elevated valuations, higher interest rates, and frothy investor sentiment are risks that suggest at least a pause in the uptrend.

A lot of attention has been focused on when the Federal Reserve will begin cutting overnight interest rates. The timing of expected rate cuts has been pushed forward due to strong economic growth, stickier inflation, and solid employment gains. The Fed has room to hold policy steady and to be data dependent. Whether the first rate cut happens in May, June, July, or later is largely irrelevant to the path of economic growth and inflation. However, the longer the Fed stays put, the more difficult it may be to adjust monetary policy as the election draws near.

Since 1994, the Fed has been more likely to stay on hold as Election Day gets closer. The Fed has hiked rates in an election year during the months of May through November just 16% of the time compared to 21% for all other years. The only time the Fed cut rates in May or later during an election year was in October 2008 when the economy was in freefall and neither candidate was up for re-election.

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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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CCM-508