Clark Capital Management Group

Portfolio Commentary

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Technology Triumphs and Mega-Cap Growth Leads

Market Review

After a strong first quarter, equities continued their advance in the second quarter, but the group of winners narrowed dramatically in late May and June. Markets experienced their first 5% correction of the year in April as higher interest rates began to bite, but after the 10-year Treasury yield halted at 4.75% at the end of April, markets promptly took off again.

While May's rally was led by mega-cap Technology and growth stocks, broader segments of the market also participated in the same fashion. However, at the end of May, the market's character changed, and large-cap growth continued higher as they delivered strong earnings. Buying fervor also continued towards members of the AI ecosystem.

Meanwhile, large-cap value, mid-cap, and small-cap stocks peaked in price. While in aggregate their prices have only stalled, their relative performance collapsed. Between May 15th and June 30th, while the NASDAQ 100 gained 6.0%, the S&P 500 (which has three times as much large-cap growth as large-cap value) was up 3.1%; in contrast, both mid-cap and small-cap stocks both declined 3.5%.

All of this occurred while interest rates were generally declining, a condition that is often positive and necessary for market breadth. Lower interest rates coincided with a moderating job market and weakening consumer data. While many industrial and consumer-driven industries struggled to deliver earnings, Technology delivered again, and investors in search were only left to pursue mega-cap growth and little else. Thus, while the S&P 500 delivered a strong 4.3% gain for the quarter and 15.3% for the year, other areas of the U.S. equity markets were much in line with muted broad international equity returns.

Second Quarter Portfolio Highlights

- After peaking at the end of May, interest rates began a decline, breaking the upward trend of the 10-year Treasury for the first five months of 2024. Subsequently, interest rates have continued to trend lower, with market expectations now pricing in two interest rate cuts by the end of the year.
- In response, our models favor U.S. Treasuries as our defensive investment of choice.
- While U.S. large-cap stocks have displayed dominant performance driven by mega-caps, U.S. mid-caps and small-caps have been large flat in price and lagging on a relative basis.
- We should remember that this underperformance could be resolved bullishly, as they could play catch up as the rate environment becomes more dovish.

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Positioning and Outlook

The quantitative models that drive the portfolio's allocations examine trends in credit markets to determine whether risk-taking is being rewarded or punished. The corporate credit backdrop has been very positive for all of 2024, and spreads have been below 3% at historically tight levels for much of the first half and remain well controlled.

As a result, our models have remained risk-on and we would expect to maintain that stance over the intermediate-term. The great majority of market gains have been concentrated among mega-caps to the extent that at the end of the second quarter the ten largest S&P 500 companies comprise 37% of the index. The market's three growth sectors: Technology, Telecommunications Services, and Consumer Discretionary now comprise 52% of the S&P 500 – the most since early 2000.

This has pushed mega-cap valuations to stretched and concerning levels, while broader market valuations are within broadly normal historical ranges. Looking forward, one question will be whether the market has rallied earlier than in past election years.

Either way, markets have enjoyed a sustained rally since the end of 2022, and this long period of optimism has left them vulnerable to disappointment. This may be particularly true among the recent leaders and stellar performers. Earnings growth for the third and fourth quarters are expected to be 20%, and such lofty levels could be revised downward, an event that is very frequent in September and October as companies provide their initial outlooks for the upcoming year.

Recent election years have featured sustained periods of weakness up into election day, and our best guess is that this year will be no different. Large-caps, in particular, have surged and are more vulnerable to a sizeable correction. It may even take some time for the final election results to be known, and volatility could ensue. However, it is important to remember that such a decline has historically been fear and sentiment-based, and not based on weakening fundamentals. Once the election results finally became known, markets have staged vigorous and sustained rallies.

That could well be the case again. Our models focus on credit markets and the underlying fundamentals that drive them to assess the broader risk environment. Right now, we see very few problems on the horizon. We would not be surprised that weakness could turn our models defensive as autumn approaches. However, market history surrounding elections and our broad macroeconomic view would hold that any volatility that we see in the second half of the year would be driven by sentiment and fear and therefore tactical in nature. Thus, volatility could very well could present a buying opportunity.

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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.

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Equity stocks of small and mid-cap companies carry greater risk, and more volatility than equity stocks of larger, more established companies.

The S&P 500 measures the performance of the 500 leading companies in leading industries of the U.S. economy, capturing 80% of U.S. equities.

The Nasdaq-100 is a stock market index made up of 101 equity securities issued by 100 of the largest non-financial companies listed on the Nasdaq stock exchange.

A small-cap ETF is a type of exchange-traded fund that invests in small companies whose value is less than $2 billion

The 10-year Treasury yield is the yield that the government pays investors that purchase the specific security. Purchase of the 10-year note is essentially a loan made to the U.S. government.

The Bloomberg Barclays U.S. Corporate High-Yield Index covers the U.S. dollar-denominated, non-investment grade, fixed-rate, taxable corporate bond market. Securities are classified as high-yield if the middle rating of Moody's, Fitch, and S&P is Ba1/BB+/BB+ or below.

The Bloomberg Barclays U.S. Aggregate Bond Index is a broad base, market capitalization-weighted bond market index representing intermediate term investment grade bonds traded in the United States. The Index is frequently used as a stand-in for measuring the performance of the U.S. bond market. In addition to investment grade corporate debt, the Index tracks government debt, mortgage-backed securities (MBS) and asset-backed securities (ABS) to simulate the universe of investable bonds that meet certain criteria. In order to be included in the Index, bonds must be of investment grade or higher, have an outstanding par value of at least $100 million and have at least one year until maturity.

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A chartered market technician (CMT®) is a professional technical analyst that holds the CMT designation organized by the CMT Association (formerly the MTA), a global credentialing body with nearly 50 years of service to the financial industry.

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