ClarkCapital MANAGEMENT GROUP

Cliff Notes on the Economy

Economic Review & Outlook

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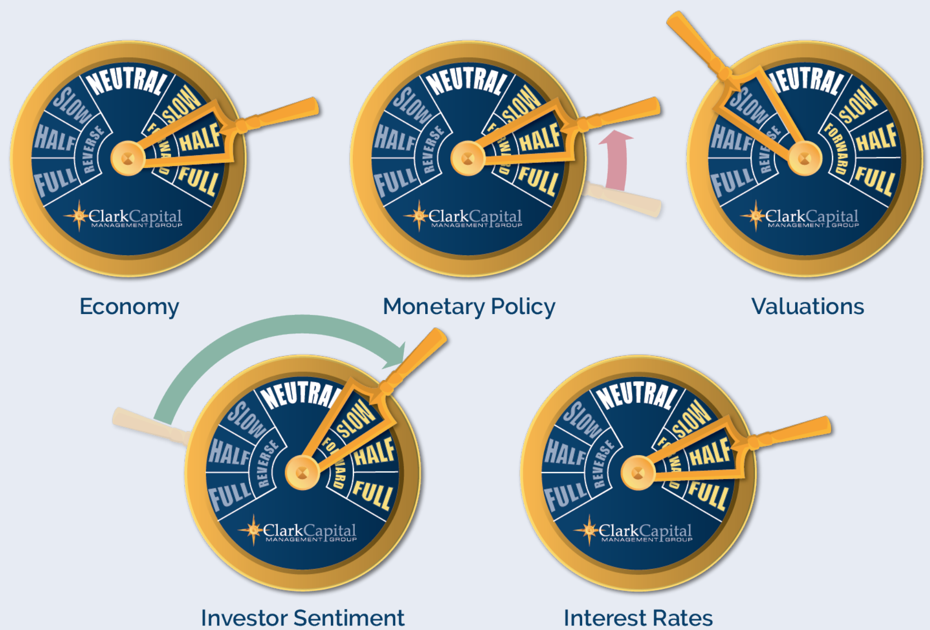
Third Quarter 2021

These 5 gauges in turn drive our expectations for the stock market. Recall 12:00 is neutral, anything to the right of 12:00 is positive for stocks, anything to the left of 12:00 is negative. Moving into the final quarter of 2021, we are adjusting two of our five gauges – reducing the Monetary Policy gauge by one step, but improving the Investor Sentiment gauge from a half backward to a slow forward position. Let's recap the gauges and review why we have them in their current positions.



U.S. Economy

The first gauge covers the U.S. economy. We continue to keep this gauge at a half forward position heading into the final quarter of the year, which reflects our expectations for strong economic growth to close out 2021. Growth is slowing, but we expect above trend growth to continue as we end the year and move into 2022. Q1 GDP growth was 6.3% and the third reading of Q2 GDP stands at 6.7% annualized growth.

However, the Atlanta Fed's GDPNow gauge (as of 9/27/21) is estimating a 3.2% annualized gain for Q3. The surge in the Delta variant, supply chain issues, and challenges hiring workers seem to have taken some of the steam out of the economic rebound. Although second half growth will likely be slower than the first half of the year, the 3.2% would still be above trend, which is considered to be in the low 2% range. The "V-shaped" portion of this economic recovery might be changing to a square root as we have moved past peak economic growth and are heading toward the longer-term trend.

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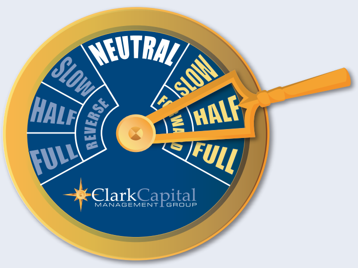
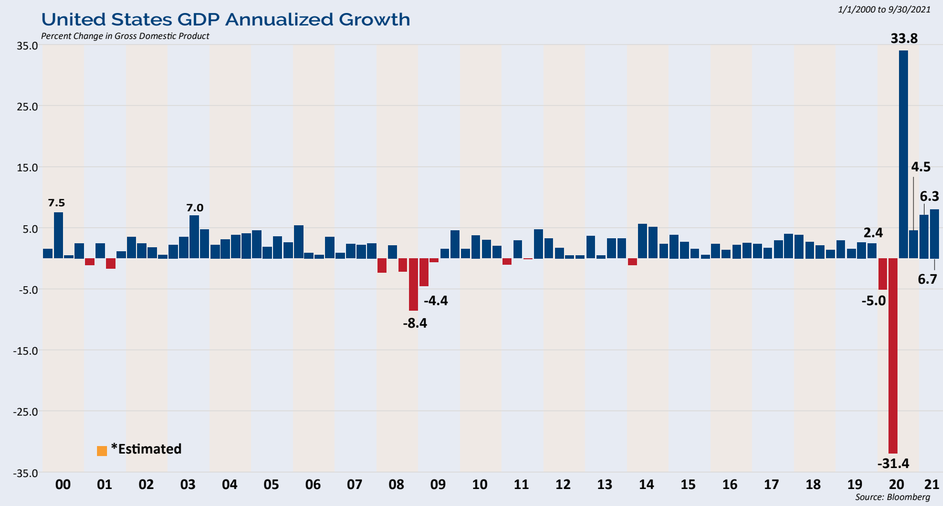


Economy



Projections or other forward looking statements regarding future financial performance of markets are only predictions and actual events or results may differ materially.

The expected infrastructure spending bill (estimated to be about $1 trillion) has been held up in Washington as passing the budget and increasing the debt-ceiling limit have taken center stage of late. If this infrastructure plan does become law, and a final vote on it is expected at any time, this fiscal measure should provide a solid tailwind to the U.S. economy through the balance of 2021 and into 2022. However, similar to being past peak economic growth, we are moving past peak stimulus growth as well when considering fiscal and monetary policy. Stimulus is still strong, but the trend will be for less stimulus in the months and quarters ahead.

The job market has bounced back strongly from layoffs suffered early in the pandemic crisis and progress continues to be made on this front. The unemployment rate fell to 5.2% in August, the lowest level since prior to the pandemic. Recall, the unemployment rate was 3.5% in February of 2020, so there is still ground to make up in the job market. We are in a unique position where there are more job openings than there are job seekers in the marketplace. We believe that as the extended unemployment benefits expire and children go back to in-person school, more workers will rejoin the labor force and start to fill those jobs. Consumer spending is roughly 70% of the U.S. economy, so ongoing job gains will be an important driver of economic progress.

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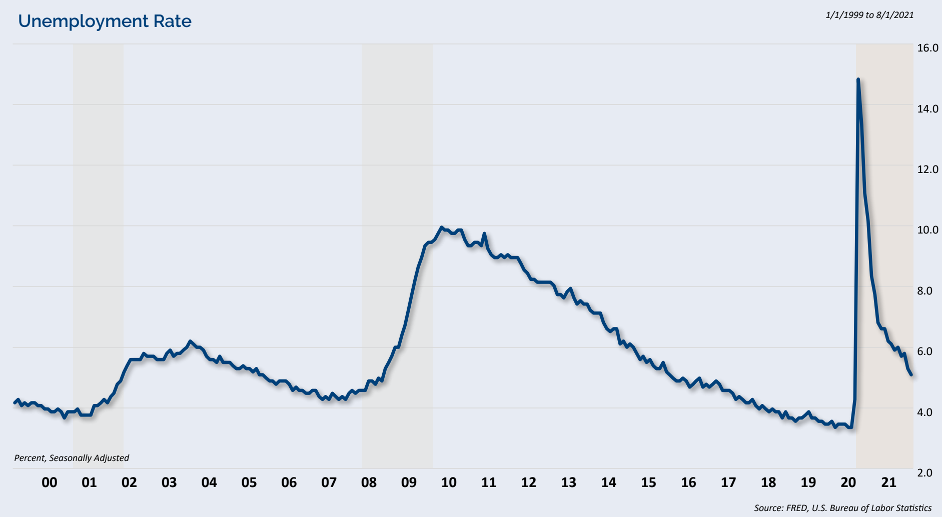

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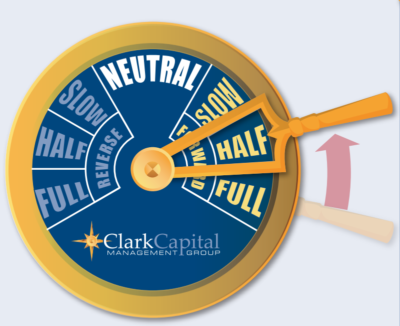
Housing has been a source of strength in the economic rebound (quite a contrast to the Credit Crisis period in 2008). Although interest rates went up markedly in the first quarter of 2021, they declined from those elevated levels through the second quarter. Yields climbed once again in the third quarter, ending September at 1.52%. Housing prices continue to rise driven primarily by low inventories and high consumer demand.

We will continue to monitor construction, sales and permits, particularly as home prices rise at record rates to see if that starts to cool off some of the housing momentum. We will closely monitor interest rates, particularly as they creep higher, to see how that impacts mortgage costs and consequently, sales.

We believe the economic recovery will continue through the end of 2021 and into 2022. We anticipate the recovery will encounter some bumps along the way, but we believe the U.S. economy is headed in the right direction. As the reopening progresses and consumers feel more confident going back to some regular activities, the economy should enjoy above trend growth through this year and into next.

If the surge in Delta cases slows the economic recovery, it could have the effect of extending the recovery as well – not as strong of growth in the near term, but more growth further down the line. Additionally, if the Delta surge has peaked, economic momentum might pick up as we move into the holiday shopping season. The headwinds of the pandemic might also influence the Federal Reserve and how it operates monetary policy, our next gauge, in the months ahead.



Monetary Policy

Monetary Policy

Monetary Policy remains stimulative, but the tapering or slowing of the bond purchases will likely be announced before the end of the year. We therefore decrease this gauge by one notch to a half forward position.

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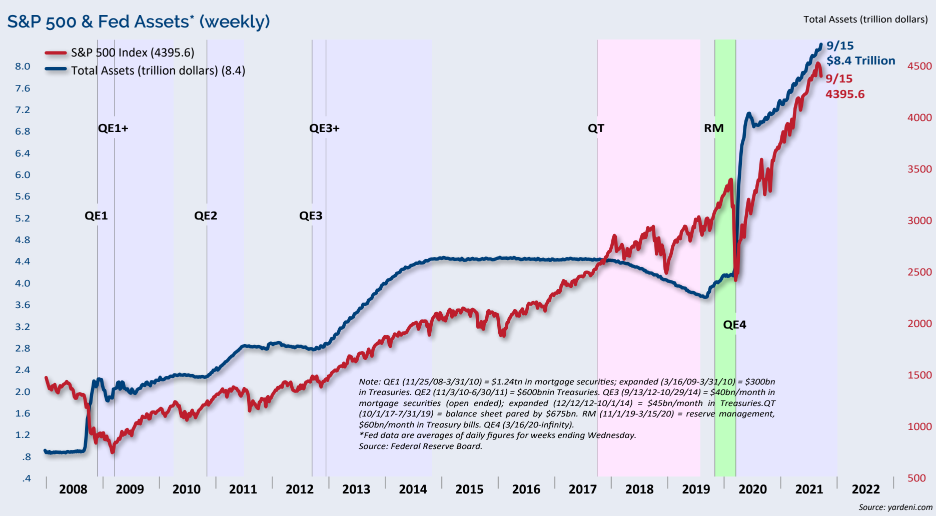
We are likely past peak monetary stimulus as it relates to this pandemic period. Currently, the Fed is still providing massive monetary support, but that will likely slow over the next several months. The Fed is buying $120 billion a month in bonds and it has pegged its policy rate (the Fed Funds Target Rate) to between 0% to 0.25%. The bond buying is expected to slow later this year and might conclude sometime in the middle of 2022.

After the bond purchasing has concluded, the next target will be interest rates and the market will look for clues from the Fed as to when it might start increasing policy rates. In the interim, even as the bond buying winds down, the Fed will still be providing extraordinary stimulus to the economy and that posture will persist well into 2022. This is why we keep this gauge in a strong, positive position. The Fed's balance sheet, which had been slowly declining prior to the pandemic, doubled from about $4 trillion dollars since the pandemic began. As of the end of September, the Fed's balance was approaching $8.5 trillion.



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Ultimately, this massive stimulus by the Fed helped support capital markets and the economy from the early days of the pandemic crisis. The economy and capital markets have responded accordingly with strong growth. We have seen over the past several years that when the Fed is increasing its balance sheet, stocks have reacted favorably. That same formula played out from the March 2020 lows through the first three quarters of 2021.

Inflation has become a bigger topic of late driven in part by the massive increase in public debt and spending in response to the pandemic crisis. Furthermore, the reopening of the economy has led to some supply/demand imbalances, which has caused prices to rise sharply in some areas. The FOMC acknowledged at its September meeting that inflation might be higher over the next couple of years, and it increased its forecast for inflation for 2021 from 3.4% to 4.2%. However, the Fed still believes the higher prices are more transitory and officials expect inflation to move back toward the 2% policy target over the next couple of years.

We know this will be a choppy reopening process, but the Fed is still providing tremendous support and we therefore keep this gauge in a positive position. However,

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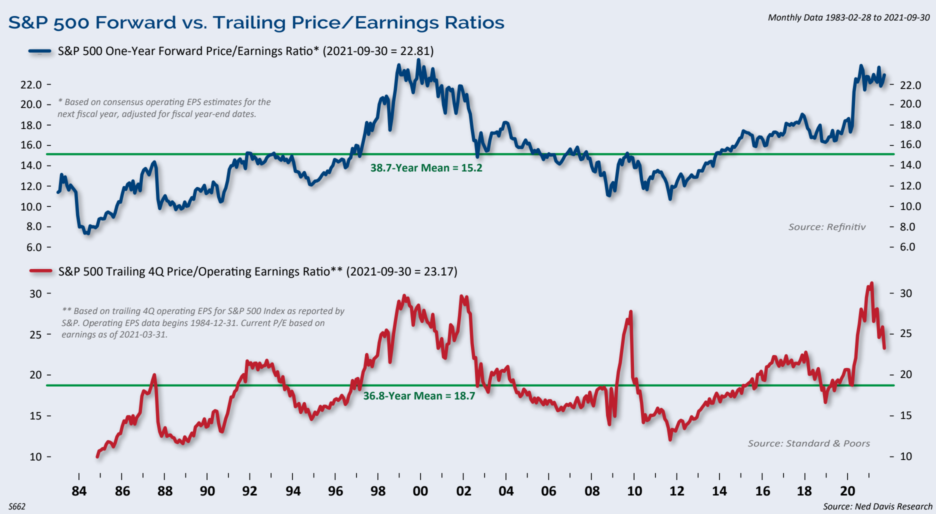
Valuations

we move it down one notch from prior quarters as monetary stimulus will start to slow. We still believe an increase to policy rates is several quarters away and would not occur until the Fed has completed its tapering program, which has not yet begun. Finally, should the surge in the Delta variant or issues out of Washington DC regarding the debt ceiling or a government shutdown spook the Fed, it could always slow down the reduction of monetary stimulus and keep the spigot running for a while longer.

Valuations

Next are valuations, which we keep in a slow reverse position. Needless to say, the rally in the stock market from the lows in March has been strong, pushing the forward price to earnings or P/E ratio of the S&P 500 to its highest level in about 20 years.



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Although valuations remain elevated, the P/E ratio of the S&P 500 has not changed much in 2021. Stock prices have clearly moved higher, but earnings have been the primary driver of stock market progress, not valuation expansion. The S&P 500, NASDAQ Composite, and Dow Jones Industrial Average all hit new all-time highs in the third quarter of 2021, but general stock market weakness developed in September. The Russell 2000 Index hit a new high in the first quarter, but it has yet to achieve a new high in the second half of the year.

Earnings have bounced back strongly since the shutdown period last Spring. In fact, operating earnings for the S&P 500 grew by over 140% in Q1 2021 compared to the pandemic low earnings level in Q1 2020, but this will be the peak earnings growth period from a year-over-year perspective. The second quarter saw earnings grow more than 90% on a year-over-year basis, but growth rates will continue to come down in the quarters ahead and earnings growth will normalize.

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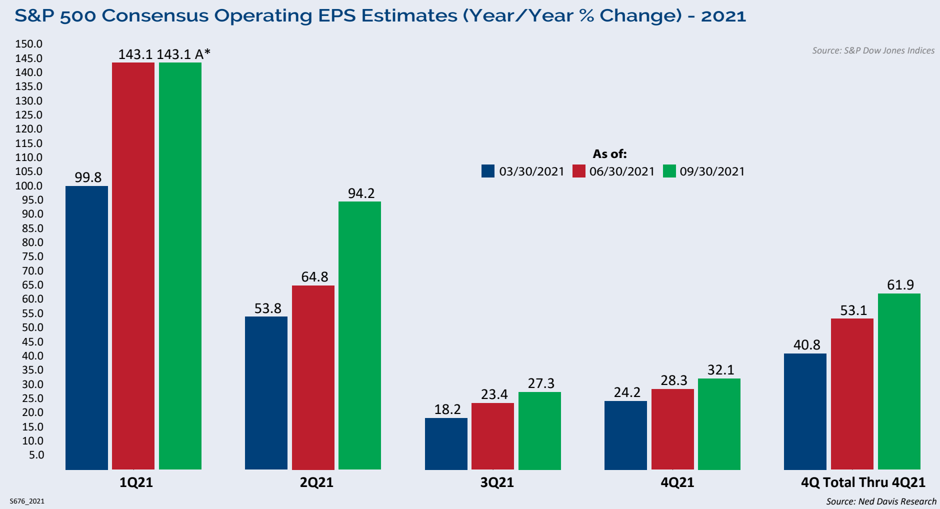

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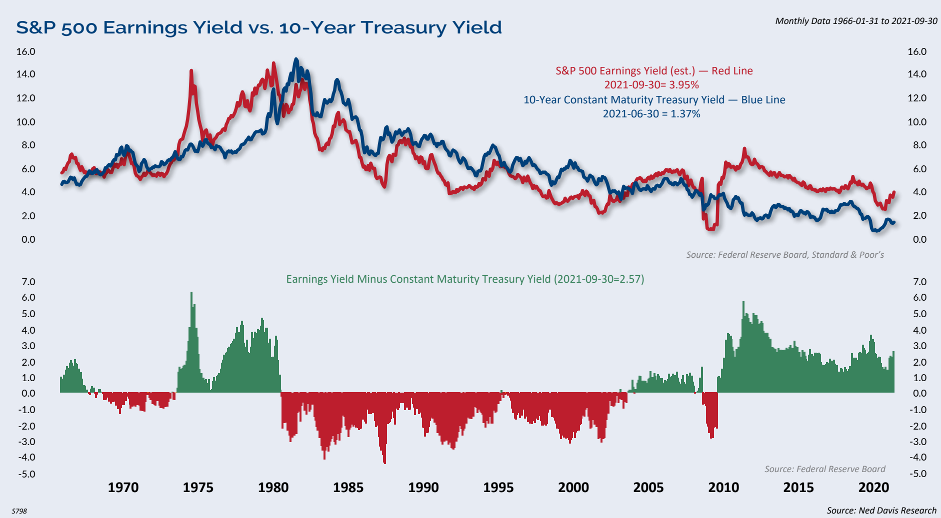
While valuation multiples are high, low interest rates help offset that. Interest rates moved sharply higher in the first quarter, but from a longer-term perspective, rates are still at low levels and the yield on the 10-year U.S. Treasury moved lower each month of the second quarter. The 10-year U.S. Treasury yield was at 0.93% at year end, but it closed the first quarter at 1.74% and it closed June at 1.45%. In the third quarter, yields moved lower initially, but they ended the quarter higher at 1.52%. We compare the earnings yield of the S&P 500 (which is the inverse of the P/E ratio) to the yield on the 10-year Treasury and it shows on a relative basis, stocks are more attractive than bonds even with the move higher in rates in 2021.



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When interest rates are low, it supports higher stock market valuations. Simply said, the low yields of bonds are not providing a lot of competition to stocks. So, ultimately, we decided to keep this gauge in the slow backward position with valuations still elevated and peak earnings growth behind us. Interest rates remain low, so on a rela-

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Investor Sentiment

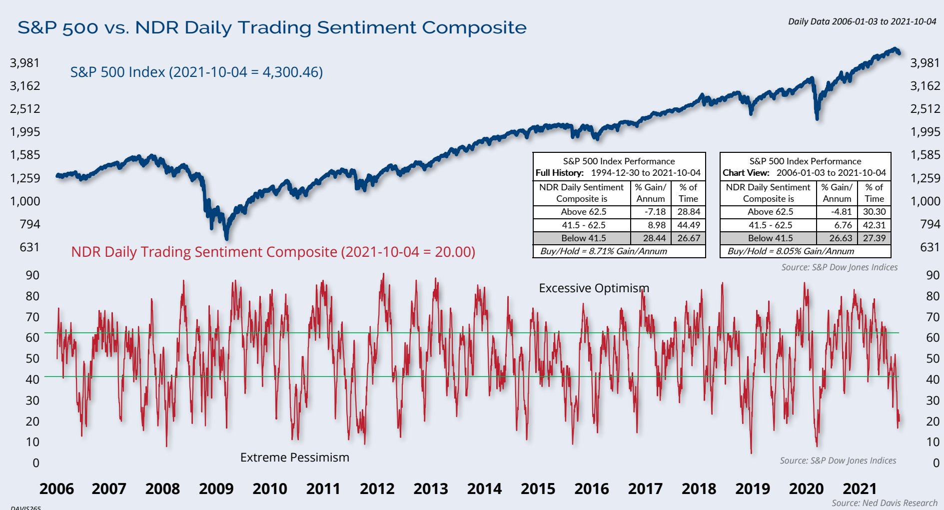
tive basis, stocks are still attractive compared to bonds, but we will monitor if rates continue to rise and whether that begins to impact bond attractiveness relative to stocks. We think rates have a ways to go before bonds truly start to pose a significant threat to stocks.

And remember, as an active manager, we look at valuations on a company-by-company basis. As the market rally has broadened, it has provided us at Clark Capital an opportunity to seek out high quality companies at good prices and we continue to make very purposeful investments in both stocks and bonds.

Investor Sentiment

The next gauge is Investor Sentiment, which can be thought of as a measure of speculation or pessimism in the market. Recall, this gauge is a contrarian indicator, so extreme pessimism is a positive from a market perspective and extreme optimism is just the opposite. We make our largest change to any gauge this quarter to the investor sentiment reading. We move this from a half backward, negative position, to slow forward, positive position.

This gauge is very sensitive and can change quickly, and after the market seemed a bit too optimistic and somewhat complacent during the first part of the year, some pessimism has come back into the market, and we therefore improve this gauge. For example, we have seen large volumes of money flow into money market funds, which points to more pessimism by investors. Also, trading sentiment has moved from extreme optimism to extreme pessimism, again a positive contrarian indicator.



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Another indicator, which we discuss often as a measure of fear in the market, is the CBOE Volatility Index or VIX Index. The VIX Index, which can be volatile, spiked above 25 a couple of times in September. It settled the month just about 23. After the VIX Index was near its lowest levels since the pandemic began, putting in a 52-week intra-day low of 14.1 in late June, volatility has increased.

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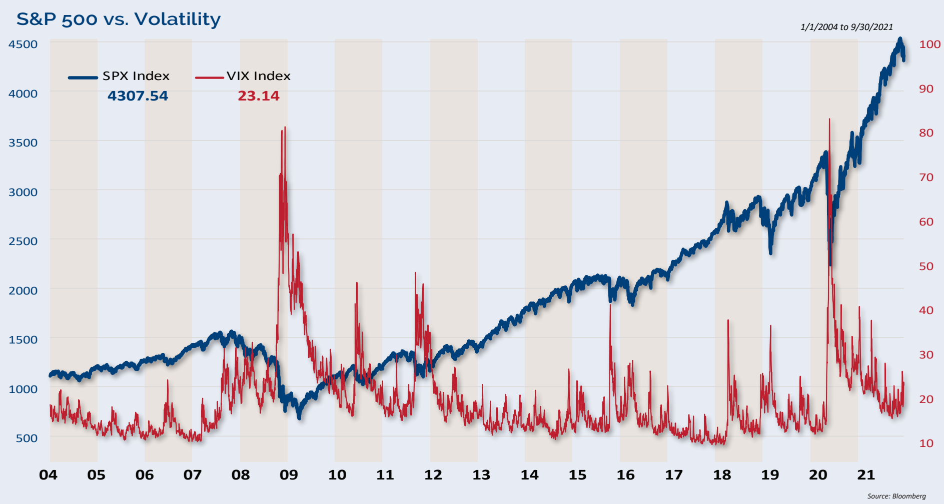
Remember, as a contrarian indicator, that is a positive as complacency has been replaced to some degree with some healthy market skepticism. While nowhere near levels of pessimism we saw in March of 2020 (which compelled us to put this gauge in a full forward position moving into the second quarter of 2020), negative sentiment has built up enough to make us shift this gauge to a slight positive position.



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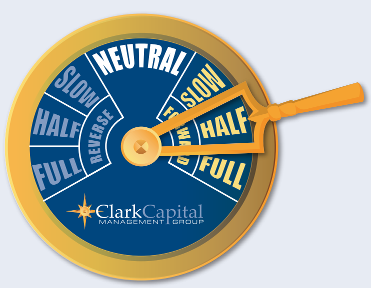
Based on the cumulative data we analyze for investor sentiment; we believe the gauge is positioned correctly as we move into the last quarter of 2021. We had been anticipating a more volatile second half of 2021 and we started to see that late in the third quarter. We continue to believe it is important for investors to be prepared for volatility to remain more elevated moving into the fall and winter months.

Interest Rates



Interest Rates

Interest rates are the final gauge, and we keep this in the half forward position. We believe this position remains appropriate as the Fed continues to keep policy rates low, which is supportive of economic activity. We have believed that rates would be range-bound this year (in the range of 0.75% and 1.75%) and while rates moved higher particularly in the latter part of September, they remain in this range. Comments by the Fed, along with actions it is taking in the market, lead us to believe we will be in a lower for longer interest rate environment for the foreseeable future.

Although the Fed will likely start tapering bond purchases later this year, we believe a rate increase will not occur until the tapering has concluded. The Fed will communicate its intentions well in advance of a rate hike, whether that occurs late next year or in 2023. As the Fed continues to be heavily involved in the market, we believe it is imperative to have an active approach to bond management. This environment is supportive of tilting towards credit in the portfolio and away from pure interest rate risk as rates seem to be trending higher. We believe we are positioned well at Clark Capital to navigate through this more dynamic time in the bond market.

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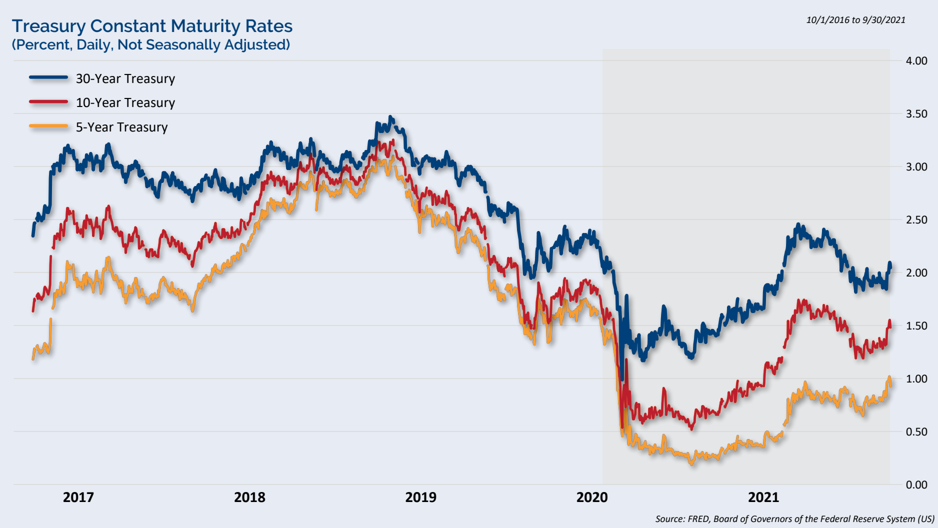

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Despite rates moving higher so far in 2021, we are still in a low interest rate environment from a historical perspective. Ultimately, lower rates should be helpful to the economy as it reduces the cost of capital. This gauge remains comfortably in the positive zone from our perspective, but not at the full forward position because of the rise in rates in 2021.

Conclusion

We know these remain challenging times, but the good news is that the U.S. economy has rebounded strongly from the pandemic lows and earnings and equity markets have followed. Vaccines are available for those who want them and with the surge in the Delta variant, more people seem to be willing to get the vaccine. And, hopefully, the surge in the Delta variant has peaked and we will see numbers continue to decline moving into the fourth quarter.

We believe the U.S. economy and corporate America will continue to fight through this crisis. We also acknowledge there could still be some bumps in the road to recovery from both an economic and stock market perspective, but we think we are heading in the right direction. The pandemic clearly persists, but as the Delta wave passes, hopefully we make a leap forward as a country to get ahead of and past this crisis. We continue to urge clients to stick to their financial plans and not make decisions based on short-term movements in the market.

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Investing involves risk, including possible loss of principal. The value of investments, and the income from them, can go down as well as up and you may get back less than the amount invested.

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.

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 VIX Index is a popular measure of the stock market's expectation of volatility based on S&P 500 index options.

The 10-year U.S. Treasury yield is used as a proxy for mortgage rates. It's also seen as a sign of investor sentiment about the economy.

The NASDAQ Composite is a stock market index that includes almost all stocks listed on the Nasdaq stock Exchange.

The Dow Jones Industrial Average is a stock market index that measures the stock performance of 30 large companies listed on stock exchanges in the United States.

The Russell 2000 is a small-cap stock market index of the smallest 2,000 stocks in the Russell 3000 Index.

The S&P 500 is a stock market index that measures the stock performance of 500 large companies listed on stock exchanges in the United States.

The price-earnings ratio, also known as P/E ratio, P/E, or PER, is the ratio of a company's share price to the company's earnings per share.

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