THE NAVIGATOR® REPORT

CLARK CAPITAL MANAGEMENT GROUP INC.

SECOND QUARTER 2003

Is This For Real?

What a quarter; what a year; so far! After the past three years of pain, these past six months have seemed like a breath of fresh air. Will the fresh air continue, evolve into a stiff breeze, or develop into another storm as in 2000, 2001 and 2002?

During those three years investors lost $7.41 trillion. Since the market bottomed on October 9th of 2002, investors have recovered $2.21 trillion as measured by the Willshire 5000 index of all actively traded stocks. But there is a long way to go before all losses are recovered. Will the present market rally persevere or will we be heading back down anytime soon?

> "Optimism remains the only long term realism; long term bearishness on history's most vibrant, most transparent economy remains a form of mental illness"
>
> NICK MURRAY

The consensus among those who I consider to be the best market mavens is that we are experiencing a bull market move within a broader bear market. In technical terms, they believe that we are in a *cyclical bull* market within a *secular bear* market. Another way to say this is that during every major down market, there are one or more up markets (cyclical bull markets). Most *secular bear trends* last from ten to fifteen years while *cyclical bull trends* last from one to one and one-half years. One of the best-known proponents of this theory is Ned Davis of Ned Davis Research. His studies reveal that there have been *seventeen cyclical bull* markets within *four secular bear* markets since 1900. **The cyclical bull markets averaged gains of 50.6% over 371 days.** The secular bear market of 1966 to 1982 included six cyclical bull markets, among them the very profitable bottoms of 1970, 1974, and 1978. These cyclical bull markets produced gains of 50.6%, 75.7%, and 22.3% respectively.

During the secular bear market of 1929 through 1942, there were six cyclical bull markets and two produced gains in excess of 120%. During the secular bear market of 1906 to 1921 there were four cyclical up-markets where two exceeded 80% and one 100%. Japan has been in a secular bear market since 12/29/1989 with a loss of 80.5% to a bottom on 4/28/2003. During those years there have been ten cyclical bull markets.

Ned Davis feels that we are in the second cyclical bull market of the secular bear market that began in 2000. The first cyclical bull market began on September 21, 2001, shortly after the World Trade Center disaster, and lasted until 3/19/2002. That market produced a gain of 29% before the bear market of 2002 resumed. The market then declined 31% to October 9, 2002 where the current cyclical bull market was born.

Fortunately, bull market gains comfortably exceed bear market losses. Therefore the markets have had a long term up trend of between 9% and 11% per year. What made the past three years especially painful was that investors were not accustomed to loss. The longest and most profitable secular bull market in history began on August 12th of 1982 with the Dow Jones at 776.92 and peaked on January 14th, 2000 with the Dow Jones at 11,722.98. (Please note that not all averages bottom or peak at the same time.) That is a gain of 1,410%. **The second most profitable cyclical bull market occurred during that secular bull between 1990 and 1998 with a gain of 296%** (keep this in mind for later in this letter). No wonder we were all so spoiled!

If all this stuff does not confuse you, you're pretty attuned to the market and its gyrations. Most of the investing public is not tuned into the rhythm of the market and therefore allows emotion to control their actions. That means they become frightened when the market declines, enough to scare them and then they sell. Sworn never to invest again, the majority waits until the next up move is well underway and again they succumb to emotion and buy near the next top. Investors that have learned to control their emotions are the ones who succeed over the long term.

The recent bear market (2000-2002) produced a decline of 38% (based on the Dow Jones Average) from the peak to October 9th. This amounted to over 4,200 points! It will require a 61% gain to recoup that decline. The Nasdaq, of course, lost considerably more; 78%. That loss will require close to a 400% gain to recoup. No wonder the investing public has been hesitant to jump back in this time. The loss on the Nasdaq almost matches the loss for the Dow Jones between September 1929 and July 1932 of 89%. *But, you guessed it! There was a cyclical bull market of 48% during that 89% decline.* Go figure! What was that 48% gain called? It was a "cyclical bull market" within a "secular bear market", which is most probably what we are witnessing today.

We Are Bullish

After reading the portion above, relating to secular and cyclical bull and bear markets, you must be wondering where we stand on the markets prospects. Well, we are bullish; at least for the foreseeable future although we do expect a bit of seasonal weakness to begin about mid-July as the summer doldrums take hold. We want to be a bit cautious here because the seasonal pattern of weakness over the next few months is fairly strong. In four of the past five years, a mid-July peak was followed by sharp declines, which, in most cases, did not bottom until early October. After that pause we expect the market to be higher later in the year. **"Optimism remains the only long term realism; long term bearishness on history's most vibrant, most transparent economy remains a form of mental illness,"** said Mr. Nick Murray, a long time market writer. He also stated, "Worry, instead, about the rising potential for missed opportunity."

A reason for Bullishness! What are the alternatives? Money market rates are at historic lows, bond yields are at 45 year lows, the bond market will be the next bubble to pop, and real estate has already gone through the roof and will be another bubble to burst in the future.

The ten-year note is yielding about 3.4%, near a 45 year low. Short-term rates are at about 1%. The after tax yield on treasuries is below 2%. Anyone holding these notes or bonds is being locked into low, or no, return for many years to come with no upside potential. If interest rates move up by 1%, the value of a 10-year note will drop by at least 8%. Moreover, U. S. fiscal, monetary, and tax policy all favor the equity markets. The Dividend Tax Relief Bill virtually guarantees that money will continue to flow out of bonds and into stocks. Why? Because interest is still taxed as ordinary income and as high as 35%, while dividends are taxed at 15%. In addition, the capital gains tax cut to 15% will be a tremendous shot in the arm for the stock market.

Another reason for bullishness! You have seen the chart of the Federal Reserves' market valuation in earlier issues of this Navigator Report. That chart still shows the market to be 48% undervalued. That model does not take into effect the benefit that dividends now have over interest. With the addition of the tax cut on dividends the market is now undervalued by 62% compared to bonds. Money will fly out of bonds at some point but probably not until the Federal Reserve begins to raise interest rates. Of course by then, the bond bubble will have burst and the public will again suffer large losses when they sell their bonds. *A recent survey by Harris Interactive, on behalf of Pro Funds Advisors, found that even though 57% of U.S. bond investors believe that interest rates will rise in the next two years, 65% are unaware that rising rates have a negative impact on the value of their bond investments.*

And another reason to take the bull by the horns! One of the most potent messages now is that money market reserves total almost 28% of the total stock market value. In 1981 reserves were at 18% and that is where the largest secular bull market began with eventual gains of 1,400%. **In 1991 reserves reached 17% just as the second largest cyclical bull move began.** There is $6.3 trillion in cash on the sidelines plus the trillions of dollars in the bond market of which a portion will move to stocks as rates eventually stop declining and begin to inch up.

An old Wall Street adage says, **"Never bet against the Fed or the Wall Street Pros."** The Fed is now in the 21st month of easing and pushing on the economic gas pedal. Meanwhile, the Wall Street Pros, the Commercial traders of the S&P 500 futures contracts, are now net-long (expecting an up market) after being net-short (expecting the worst) for the past three years. The Commercial traders went net-short in March 2000 and just recently reversed their position to net-long. Another good sign of things to come!

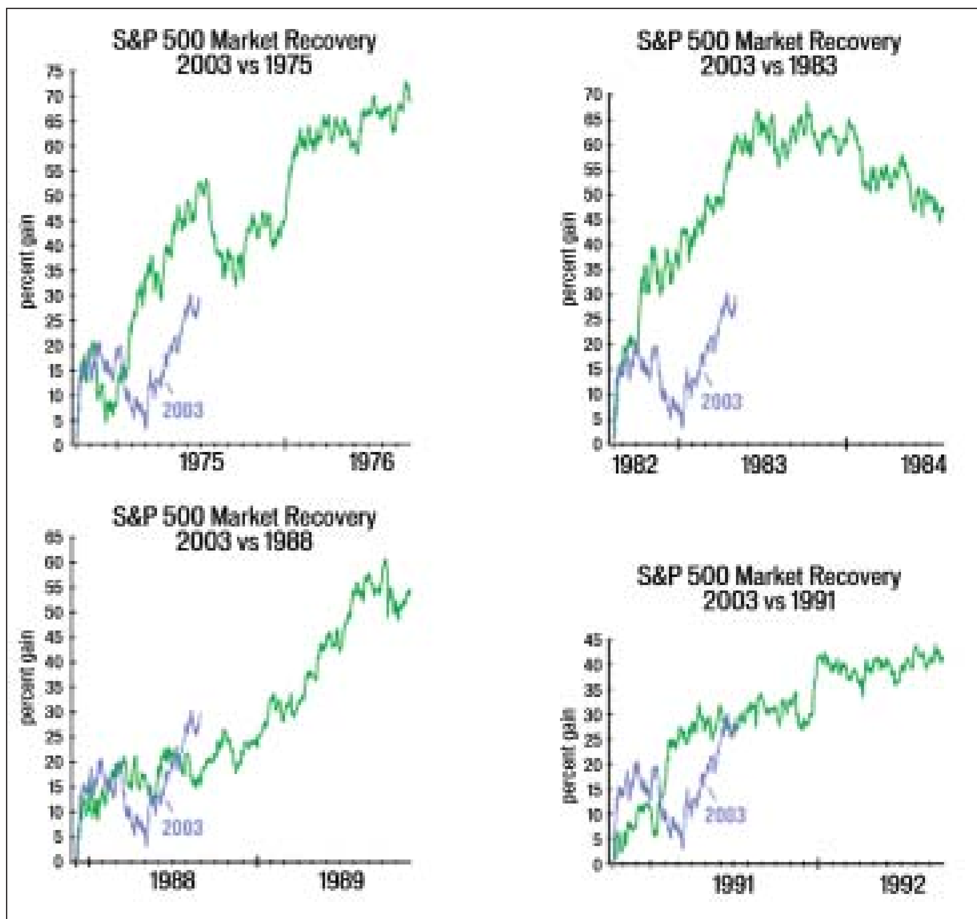
The four charts below show how the current market recovery compares to previous market bottoming periods. These charts are courtesy of Mr. James Stack of InvesTech Research. Jim is one of the most consistent and thoughtful market writers in the business today and if you are looking for one publication to help you keep your emotions under control, this is the one. It is full of data and historical facts.

The chart of 1975 & 1982 show that we are behind those recoveries while we are a little bit ahead compared to the chart of 1988. They all show that this cyclical bull has a long way to go to catch up with those three prior cyclical bull markets.

The chart of 1991 seems to be the one that fits today's environment the best. This shows the result of the 1990 bottom, which is where the second best cyclical bull market of the century began. Mr. Stack says that then as now, there was widespread doubt about the economic recovery, unemployment was still a problem and there was talk of deflation. The available cash situation was very similar to today (see discussion above) with record cash reserves in Money Market funds. Even here you can see that there is a way to go to equal that recovery from the bottom in 1991.

Program Notes

In each Newsletter we will highlight items we believe to be of interest in our various programs in this section.



Source: InvesTech Research

Navigator Asset Allocation Programs:

Classic, STAR, Strategic World: these programs utilize mutual funds, ETFs (exchange traded funds), or annuities as the funding vehicles. All accounts in these programs were moved to their maximum allowable money market allocation on June 16th and remain there as of this date, July 9th. The prior allocation to money market occurred on January 6 with the Dow Jones at 8773 and the reallocation back to the invested position occurred on January 27th with the Dow Jones at 7990.

Navigator Asset Management Programs:

The Master Program utilizes world-class money managers with an overlay of a protection strategy, which we call Navigator Sentry. The Sentry portion is sub-advised to us by Rampart Investment Management of Boston, who we believe to be the premier option overlay strategists of today. Rampart advised us to raise the level of the hedge protection to 900 on the S&P 500. All clients in this program are now hedged into 2004.

Our large-cap Growth of Dividend Income manager, Groesbeck Investment Management has been named the #1 U.S. Large-cap Growth manager over the past three years by Nelsons Money Manager Rankings. Money Manager Review also named Groesbeck the #1 manager for the past three and seven years in the Return/Risk category.

Summary

This has been a very rewarding year to date and we believe that this market has further upside potential. The market has risen 25.5%, based on the Dow Jones, from the October 9th bottom and has further to go to reach the 50.6% level of the average cyclical bull market both in time and price. In addition, the average gain from the bottom of last year to the top of this year should be 51% based on the Presidential Election Cycle study. This is the average in this cycle, which dates back to 1934. The smallest gain in this series was 28% in 1978 and the largest was 87% in 1955. Again, it seems that there is more room on the upside.

As stated earlier, there could not be a better environment for the market with the Federal Reserve being very accommodative, fiscal and tax policy

favoring stocks, and the economy looking better all the time. Notice the chart to the right of the Weekly Leading Index!

Investors everywhere are sitting on the sidelines, sitting on their hands, waiting for that magic moment where something jumps out at them, some headline catches their attention, and makes them finally invest. Of course the magic moment never comes until their emotions get the best of them and they invest near a market top again. We believe that our programs will give you the peace of mind to stay the course, keep you in sync with the markets, and not let your emotions rule your investment dollars.

Quarterly Statements

During 2002 we conducted a survey of selected clients that asked if they preferred to receive their quarterly statement by mail or via the internet. That survey indicated that a large number preferred internet receipt because they were attempting to limit the amount of paper they received via mail. Because of this survey we discontinued sending paper statements and instead arranged for statements to be posted to our Internet site, which was reported in several newsletters. Since then we have received numerous requests for paper statements.

Beginning this quarter, we will resume sending paper statements by mail. We will also send a letter to each client asking if they wish to receive electronic statements via the Internet. This letter will be sent in early August. If you do not wish to receive paper statements by mail, and would prefer electronic statements via the Internet, you will be asked to return the letter in the enclosed envelope informing us of that fact. To continue to receive paper statements the letter need not be returned. We will be providing paper statements by mail each quarter unless you request otherwise. This quarterly statement will show deposits, withdrawals, fees, distributions, investments held, asset allocation, and return for the quarter, year to date, and past twelve months. The year-end statement will show all transactions for the entire year. In any case, every client has the ability to view statements on line if desired. We hope that this course of action satisfies all concerned.

CLARK CAPITAL MANAGEMENT GROUP INC.

Investment Advisory • Mellon Bank Center
34th Floor • 1735 Market Street • Philadelphia, PA 19103
(215) 569-2224 • (800) 766-2264 • Fax (215) 569-3639
navigator@ccmg.com • www.ccmgnavigator.com

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All CCMG performance figures in this Report are net of fees and expenses. Past performance is not a guarantee of comparable results in the future. The sited data have been prepared utilizing a methodology consistent with industry standards.

*CCMG accounts are managed through the use of tactical and strategic asset allocation methods and utilize the buy and sell indications produced by these methods to determine when clients should be invested in equity securities. When a buy signal is generated clients' accounts are invested in equity securities, and, conversely, when a sell signal is generated their accounts' equity positions are liquidated and invested in money market accounts and other cash equivalents. The performance data cited above reflects the effects such buy and sell signals would have had on an investment in the market indices and mutual funds discussed for the time periods indicated for all CCMG clients invested in the Navigator Classic Program. The buy and sell signals used in such information are actual signals generated by CCMG's methods during the periods portrayed. Client accounts may or may not have been invested in the referenced indices or funds during the periods portrayed. The cited performance data assumes the reinvestment of all dividends and capital gains distributions, and reflects the deduction of the maximum management fee charged by CCMG for the referenced program and actual mutual fund expenses. Historical performance is available upon request.

Photos by: Don Pearse Photographer