



CLARK CAPITAL
MANAGEMENT GROUP, INC.

Second Quarter 2007

THE navigator™ REPORT

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IT'S ABOUT TIME

After the very boring, except for the one 419 point down day, and slightly down first three months of the year, the markets finally came to life during the second quarter. The Dow Jones Industrial Average began the quarter with an eight session winning streak, the longest in four years. April was the best month for the Dow since December 2003 and it gained 5.7% for the month. April and May saw some of the strongest action of the past two years as the Dow Jones and S&P 500 reached new all time highs and continued setting new highs until June 4th. While the NASDAQ gave a good account of itself it would still have to almost double to reach a high above the March 2000 level. June 4th proved to be the high (for the time being) as during June the Dow Jones slid 1.6%, the S&P 500 fell 1.8%, but the NASDAQ only gave up 0.05%. Still, a very good quarter with gains of over 6.27% for the S&P 500; 7.7% for the NASDAQ; and 9% for the Dow Jones. **It was the best quarterly gain for the Dow Jones since the fourth quarter of 2003.**

"Who do you think might be right; small speculators reducing their holdings and expecting the worst or large professional hedgers increasing their holdings to a record level expecting the best?"

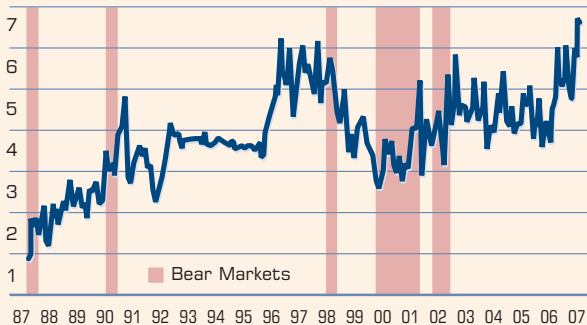
As we all know, the present economic expansion and bull market are both getting pretty long in tooth. But, as they say, "a bull market climbs a wall of worry." And the worries are plentiful! The sub-prime mortgage debacle, the very serious housing slump, two Bear Stearns hedge funds almost blowing up, interest rate fears, inflationary fears, geo-political fallout, Iraq, etc., etc., etc., are all combining to give the public pause when it comes to investing hard earned cash into the equity markets. **The investing public is notoriously missing these days** with institutions and large traders accounting for most of the current activity.

Even though the major indexes are at new all-time highs, public participation is lagging badly. **The average investor is only 33% invested** compared to the level in early 2000. This level of underinvestment has historically put a floor on market declines as the public waits for market pullbacks before

buying. **In addition, most individual investors are actually very bearish or unbelieving of the validity of this current market environment.** The chart, from the H.S. Dent Foundation, shows that everyday investors are more bearish than they have been in many years.

Unprecedented Bearishness

The ratio of shares sold short (by investors expecting a decline) to average volume on the NYSE has reached levels not seen in a generation.



The chart shows the ratio of shares sold short (by investors expecting a market decline) to average stock exchange volume. This bearishness is at absolute record highs! You can see that during the period from 1998 into 2000, the average investor was getting less and less bearish as the market was getting much more speculative into the March 2000 high. I expect that this time will be no different with the average investor eventually becoming fully invested and much less bearish, prior to the next major market peak. **The significance of this chart may mean that a major top is nowhere in sight.** In addition, a recent report in the "Commitments of Traders" shows that small speculators, who have been consistently wrong at market turning points, have been reducing their holdings to the point that they now have the smallest net positions since the market bottom of early 2003. When these small speculators have reduced their holdings to this level over the past seven years, the S&P 500 has rallied sharply with the three-month return averaging better than 7%. On the other side of the equation, professional commercial hedgers have increased their holdings to the largest net positions in 20 years. The current level of holdings has only been anywhere near

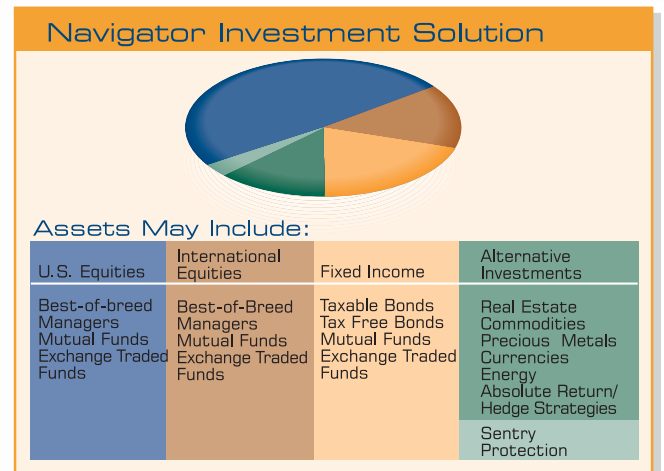
this high on two prior occasions, May 1994 and October 1999 – both periods when the S&P 500 put in a low and then rallied smartly over the next several months. **Who do you think might be right; small speculators reducing their holdings and expecting the worst or large professional hedgers increasing their holdings to a record level expecting the best?**

The big news these past months has been the level of activity in leveraged buyouts. The pace has been fast and furious which leads one to wonder: that with all these companies being taken off the market what will be left for the average investor? The more important realization is that with interest rates fairly attractive and liquidity plentiful, companies are very undervalued compared to where the private equity firms believe they should be. After all, private equity is not buying companies to hold forever. Yes, in some cases, private equity believes that they can run a company better, thus increasing profits, and get an excellent return on their investment. But in most cases companies are being taken off the market (by going private) because they are cheap. Cheap now, less cheap and worth much more down the road as these companies are offered back to the public in the future. Buy low, sell high, applies here!

In addition to leveraged buyouts, corporate America is buying back stock in record amounts. IBM is buying back \$16 billion and Microsoft \$27 billion of their own stock just to name two. Fifty-seven percent of companies in the S&P 500 have bought back stock over the past 12 months. Corporate insiders, who usually have a pretty good handle on the future of their company and stock, have virtually stopped selling. These are very knowledgeable people who are usually selling all the time. The fact that they have basically stopped is a very good sign for future market gains. All this plus one more tid-bit: U.S. stock mutual fund inflows are down to anemic levels. **The Wall Street Journal issue of May 7th reported that the past 11 months had seen the largest selling of Aggressive Growth mutual funds in history.** When no one wants ‘em, its time to buy ‘em!!! More on the markets’ prospects later.

Introducing *navigator*[™]
INVESTMENT SOLUTIONS
 A Unified Managed Account (UMA)

Those clients who are invested with our Navigator Master Program have seen changes in the way their account is reported. Until recently, each individual investment manager was required to use a separate account at our custodian, Pershing. If a client had a Master account with four investment managers, there were five separate accounts: one for each manager and one for our put strategy and cash. With the advent of our UMA (unified managed account) rollout, all these are now in one account at the custodian. Instead of receiving five statements, one for each manager and one for puts/cash, everything is now in one account with one statement. This technique is known as “sleeve technology.” That is, one account with several sleeves. Each sleeve can be viewed separately to see holdings and performance. While this is a nice feature for those with our Master account program; it has far more implications for designing programs, or “investment solutions” going forward.



Therefore we are introducing the “Navigator Investment Solutions,” which are unified managed accounts.

CCMG IN THE NEWS



CNBC “Morning Call” – May 31, 2007

Founder Harry Clark talks to host Mark Haines about the fact that we can go higher. The old adage about “not fighting the tape” rings true and that it’s too strong to do so. He is concerned about how far this bull market run can go. He also notes that a long-term investor should wait to buy and that there might be some problems coming this fall.



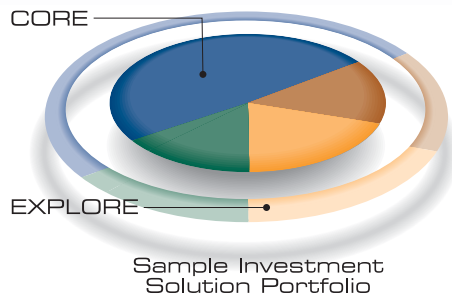
Bloomberg TELEVISION

Bloomberg Television’s “Market Focus” – June 1, 2007

Chief Investment Officer Sean Clark is bullish on the market for a few reasons. For starters, valuations show that stocks are cheap compared to bonds at present. Sean feels that stocks have room to move higher and that the liquidity boom globally is helping markets. Mr. Clark favors Boeing as a stock, noting that the company has more than \$250 billion in backlogged orders for its customers.

There are six solution levels which can be customized to meet any investment objective with well over 100 variations. These are next generation institutional investment solutions being made available to investors with a minimum of \$250,000.

Assets will include U.S. equities, international equities, and alternative strategies. Levels one, two, and three will also include varying levels of fixed income strategies. One account holding multiple, diversified assets allowing for implementation of comprehensive asset allocation strategies.



A Core and Explore philosophy is utilized throughout these solutions in various percentage ranges depending on the classification of the investor. As investors' tolerance for a more aggressive stance increases, the percent of the solution utilizing the explore portion of each asset class is increased.

As an example, a \$1 million account at Level III (moderate), would allocate 47% to U.S. equity, 17% to international equity, 20% to fixed income, and 16% to alternative strategies.

The 47% in U.S. equities would include 2/3 in the core and 1/3 in the explore area. Therefore \$310k would be allocated between three world class separate account managers in the core, while \$160k would be allocated between our style and sector rotation strategies in the explore area.

The international equity piece would be allocated \$170k of which \$85k would be managed by a world class separate account manager in the core and \$85k would be managed with our international country rotation solution in the explore area.

The 20% allocation to fixed income would be split evenly between the Core and Explore sections. The core would be invested in a portfolio of separate bonds with intermediate term maturities and would be comprised of either high-grade corporate/government bonds or tax-free municipal bonds. The explore portion is a fixed-income strategy which rotates between high-yield bonds, government bonds or cash.

The alternative portion would allocate \$160k to various alternative strategies that could include items such as:

- Diamond Hill Long-Short Hedge
- Absolute Strategies Fund.
- Street Tracks Gold Trust
- iShares Silver Trust
- PowerShare Energy Fund
- CGM Realty Fund
- CCMG Currency Rotation
- Various Commodity Funds

In addition, a portion, 2 to 3% may be carved out to utilize our Navigator Sentry Strategy of put protection.

Accounts that are larger or smaller will have the same allocation and share the same Core and Explore philosophy. The difference is in the funding, as larger accounts will have more individual managers while smaller accounts will have less. Accounts below \$500,000 will use mostly mutual funds and ETFs as the investment vehicles. The Core and Explore philosophy has the emphasis on diversity in the core allocation while pursuing opportunity in the explore allocation. If you would like to learn more about this strategy please contact your financial consultant or call us for a brochure.

SO WHERE IS THIS MARKET GOING?

Would you believe 16,000 to 18,000 on the Dow? Sounds kind of far fetched doesn't it? Well let's see how we could get there. Don't forget, this is a pre-election year and next year is the election year. The



CNBC Squawk on the Street – June 29, 2007

Pre-election years historically have been good ones for the stock market, and Clark Capital predicts the market will appreciate 22% by the end of the year. Energy services stocks are likely to do well because that industry's infrastructure needs to be rebuilt. Companies such as Boeing and Caterpillar also should thrive; in the former's case, there's huge demand for airplanes, while in the latter's case, the ongoing worldwide construction boom produces heavy demand for construction equipment.



CNNMoney – June 14, 2007

Following a tame inflation reading and signs of stability in the Treasury market and energy sectors along with a handful of other upbeat economic readings, Maira Thompson, a Senior Market Portfolio Manager at Clark Capital Management Group, notes to readers of the popular Web destination that "oil and metals stocks are leading the market." She added that while some are calling for a slowdown, it might not happen for some time.

Presidential Election Cycle is, by far, the most important cycle in the equity markets. The last four pre-election years returns averaged **26%** and all election years since WW II have averaged a **19%** return. I am on record with CNBC Morning Call predicting a **22%** return this year. Remember the one-year cycle projection that I showed you in the last issue of this report. It showed a big decline coming this fall. And while this is still a possibility, I believe the chances for such a decline are diminishing. Let me tell you why!

Inflation and Interest Rates: The Federal Reserve has had an inflation bias, it seems, forever. There is always the fear that if they sense a hint of inflationary pressure they might raise interest rates. Of course the market hopes they reduce interest rates! Most economists are now saying that the Fed will not reduce rates this year. I believe that they will begin to cut rates by this Fall!! The Fed has told us several times that their favorite inflation gauge is the Personal Consumption Expenditure (PCE) price index. And we know that the Fed has a target of 2% for the rate of inflation. Well, the PCE has just gone below 2%; a good indication that headline inflation will be there soon. Ninety-day T-bills are also an indication of future Fed policy with a 97% correlation to the rate of Fed funds. The 90-day T-bill rate has been dropping steadily over the past several weeks. I believe the Fed will cut rates by Fall and that alone could start the fireworks for the market.

Earnings: In addition to Fed policy, the engine that drives the market in both directions is corporate earnings. Last quarter was the first time in 14 quarters that earnings gains did not reach double digits. Analysts expected earnings gains of less than 4% in the first quarter and they came in at 8.3%, still pretty good. They are predicting gains for the second quarter of 4.4% and I believe that they will be wrong again and that earnings gains will again be in the high single digits. **It is very hard for a market not to go up when earnings remain this strong.** Global corporate profits have soared in the past five years at the **annual average compound rate of 25%** per year; an astounding rate.

Valuation: Most valuation models compare stocks to bonds as a way of valuing the relative merits of both

investments. As mentioned in the last report, the difference between the earnings yield on the S&P 500 and the return on the 10-year T-note is the highest it has been in almost 30 years. The earnings yield is the inverse of the P/E multiple and today is about 6.4%. This compares to the bond yield of about 3%. This is what is fueling the massive leveraged buyout boom of today. At the bottom of the market after the bear of 2000-02, the market was undervalued by 39%. **Today, even after the gains of the past four years, the market is still undervalued by 25%!** Why? Because corporate earnings have risen by over 130% since the market bottom in 2002.

Conclusion: It appears that economic activity is rebounding from the low levels of the first quarter despite the housing slump and sub-prime mortgage problems. The consensus for second quarter GDP runs from 2.8 to 4%. This is a clear rebound from expectations of the past few months. It is possible to return to the “Goldilocks” atmosphere of the past where the economy stays sound, inflation remains contained, the consumer keeps on consuming and the market keeps on pushing ahead. A good rule of thumb to value the market is a Price/Earnings Ratio (P/E) of 18 to 22 from which the inflation rate is subtracted. With inflation running at 2% or so, that gives us a potential ratio of 16 to 20 times earnings. According to Don Hayes of the Hayes Advisory, the earnings for the year should be about \$104 per share for the S&P 500. At 16 times earnings that gives us an S&P 500 of 1664 and a Dow Jones of 14,600. My projection was for a 22% gain, which equates to an S&P 500 of 1730 and a Dow Jones of 15,200. At an earnings goal of \$104, 1730 for the S&P 500 is a multiple of 16.64, clearly at the lower end of possible multiples. **So I will stick to the 22% return for the year and if the market does better, I will gladly be wrong.**

Let’s not get carried away though, **problems do remain.** But as things look today, those potential problems, while not having gone away, are being put in their place by the market. Liquidity is still exerting its influence and if the public decides to become less bearish and join the fray, we could see a very healthy market push later this year.

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