ClarkCapital MANAGEMENT GROUP

2021 Market Outlook

Hope on the Horizon: Where Do We Go From Here?

Author

K. Sean Clark, CFA®
EVP, Chief Investment Officer

Navigate Your Future. Enjoy the Journey.

Highlights

We believe:

- There is good reason to enter 2021 with an optimistic view of economic growth in the U.S. and abroad, and the equity markets are primed for additional gains. As a result, our target for the S&P 500 is 4150.
- Valuations are stretched, but earnings growth and relative valuations mitigate some of those concerns.
- We will continue to see monetary and fiscal policy support to prop up asset prices globally.
- The weak U.S. dollar will support international outperformance, especially in emerging markets.
- In fixed income, interest rates will remain low and we believe credit will perform well given the favorable macro landscape.
- The main risks to the outlook include excessive short-term investor sentiment, lofty equity market valuations, an unexpected rise in inflation, a slower than expected vaccine rollout, and potential policy changes from a unified Democratic control in D.C., including tax hikes.

A Tale of Two Markets

We came into last year with the economy on solid footing. Jobless claims were low, the unemployment rate was at a 50-year low, housing starts were hitting cycle highs, and global PMIs were turning higher. It looked like we would extend the record-long economic expansion. However, that all changed quickly as the global pandemic landed a crushing blow to both the global economy and markets.

Figure 1. | **A Recap of 2020**

Domestic Equity	12/31/2019 – 3/23/2020*	3/23/2020 – 12/31/2020*	2020
S&P 500	-30.43%	70.17%	18.39%
Russell 1000	-31.07%	75.48%	20.95%
Russell 2000	-39.74%	99.02%	19.93%
Russell 3000	-31.64%	76.82%	20.88%
Russell 1000 Value	-37.41%	64.21%	2.78%
Russell 1000 Growth	-25.11%	84.93%	38.49%
International Equity			
MSCI Emerging Market	-31.80%	73.47%	18.31%
MSCI All Country World (ex US)	-33.33%	65.96%	10.65%
Fixed Income			
BBgBarc U.S. Aggregate Bond	1.04%	6.40%	7.51%
BBgBarc U.S. Treasury	7.81%	0.18%	8.00%
BBgBarc U.S. Corporate	-9.95%	22.03%	9.89%
BBgBarc U.S. Corporate High Yield	-19.78%	33.53%	7.11%
BBgBarc Municipal	-7.62%	13.89%	5.21%

*Source: Morningstar Direct. *3/23/2020 was the lowest point in the market for 2020.*

The markets crashed, and the S&P 500 sank over 33% in just 23 trading days. It was the fastest market decline in history and it set the stage for the fastest recovery in history. Our year-end target for the S&P in 2020 was 3500, and it ended the year at 3756. We did not alter our target even when the S&P 500 sank toward 2200 (unlike most of Wall Street that change their targets when the winds blew in the other direction). We were confident that the rebound would be strong.

We experienced massive moves, with the markets riding an elevator down and back up again. We believe the rebound has been spectacular, driven by massive coordinated central bank and fiscal policy actions. From the March 23rd lows, the gains were staggering, with major equity indices up between 64% and 99%. Large-cap growth outperformed large-cap value by over 35%, its widest annual amount of outperformance on record. The record amount of stimulus drove all major asset classes higher, with assets with the longest duration benefitting the most.

Growing up as a huge fan of The Who, I'm reminded of the song 1921. It was about a time one hundred years ago that may hold some similarities to now. In the story it was a song of hope and unity following the end of the Spanish Flu global pandemic and preceded the Roaring 20's. The lyrics start with, "Got a feeling '21 is going to be a good year, especially if you and me see it in together." Sitting at the beginning of 2021, I too think '21 is going to be a good year.

We enter 2021 with an optimistic view of economic growth in the U.S. and abroad and the equity markets primed for additional gains. We expect the U.S. economy to grow at a 5% pace in 2021 with global growth pushing 5.5%. If anything, we see potential upside surprises to those expectations. Economic momentum, a rebound in earnings growth, and continued massive stimulus should support the equity markets, countering concerns over lofty valuations.

Our target for the S&P 500 in 2021 is 4150. Again, we see the potential for an upside surprise here, too. Gains in the market could be front loaded as trends in the four-year Presidential Cycle suggest a consolidation in the second half of the year. International markets have underperformed the U.S. in 8 of the past 10 years. The weakening U.S. dollar, more cyclically exposed international markets, the economic rebound, and strong commodity trends support the case for international market outperformance, especially in emerging markets given their natural resource exposures.

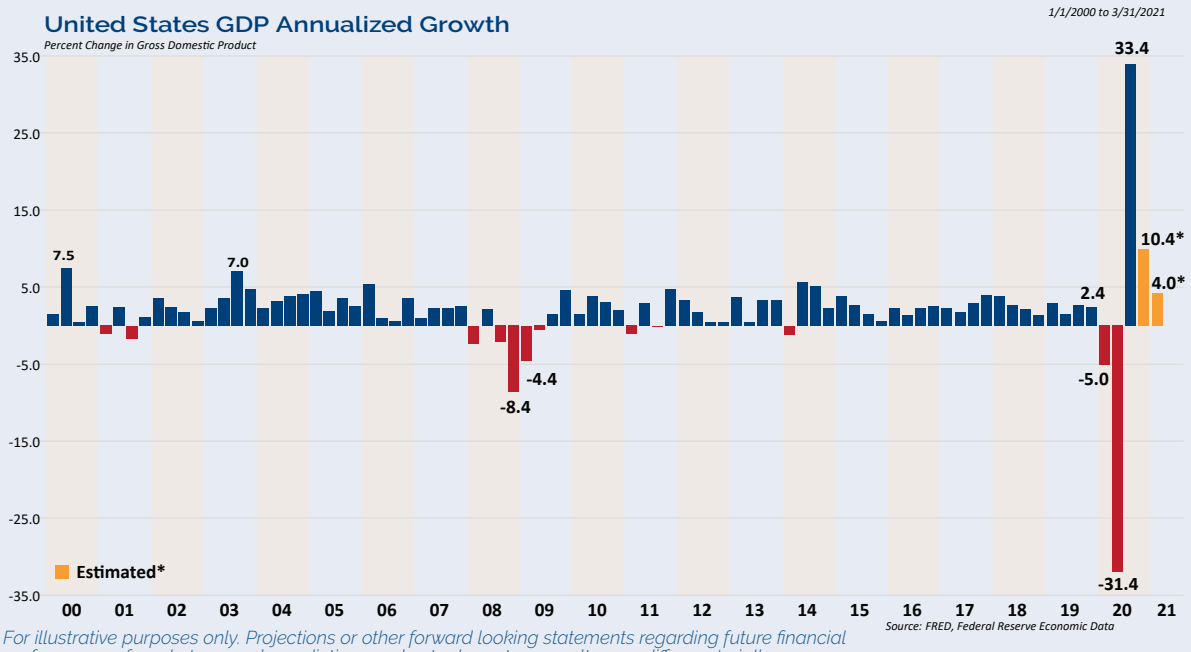
In fixed income, longer-term yields look primed to gradually rise alongside a steepening yield curve, while the Fed keeps short-term rates anchored. The Fed will continue to pump in liquidity, which should lend support to the economy and markets.

In our opinion, the main risks to the outlook include excessive short-term investor sentiment, lofty equity market valuations, an unexpected rise in inflation, a slower than expected vaccine rollout, and potential policy changes from a unified Democratic control in D.C., including tax hikes. Our sense is that concerns about higher tax rates and increased regulation will likely start to weigh on the market at some point, but the economy and market will get a cyclical boost from additional fiscal spending.

Economic Momentum Remains Strong

A global recession and bear market took hold in March as governments around the world implemented social distancing and "shelter-in-place" restrictions. Second quarter GDP was the weakest on record at a 31.4% annualized drop. Quick action on monetary and fiscal policy have helped bridge the economic gap, and the economy has staged a "V"-shaped recovery. The worst quarter on record was followed by the best quarter on record, with a 33.4% growth rate. Fourth quarter GDP is expected to come in about 10%, and next year's consensus is calling for 4% GDP, which we think is too low.

Figure 2. | **GDP Growth Shows V-Shaped Recovery**



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

We believe there are a lot of positive influences on the economy right now including strong economic momentum, an unprecedented amount of monetary and fiscal stimulus, the booming housing market, pent up demand for spending, inventory rebuilding, and COVID vaccine rollouts. We expect 5% economic growth in 2021; and given the potential for additional fiscal spending with Democrats controlling D.C., we could see an upside surprise.

How does Democratic control in Washington affect our outlook? With the slimmest margin possible in the Senate, we believe it will be difficult to push the entire Biden agenda. The Democrats can't afford to lose any votes, and it seems unlikely that the moderate Democrats will go for the extreme liberal agenda items. We expect to see more COVID relief, with $2,000 checks again back in play. Tax hikes will also be on the table, but they may prove difficult to accomplish with the slimmest of majorities. The benefactors of a Democratic majority include cyclical sectors, reflation themes on infrastructure, and clean energy spending. Net-net, this is a short-term positive, and the market has responded in kind. However, this is also a potential longer-term negative given a further deteriorating fiscal situation.

The housing market stands out as a bright spot in 2020 and is supportive of economic activity as we head into 2021. Single family home numbers remain the engine of home construction, with permits to build new homes surging to new decade-plus highs with housing starts also rising quickly.

Low mortgage rates, fiscal stimulus, demographic factors, the COVID work-from-home environment, and rural migration from cities are driving housing demand. At the same time, supply has failed to keep up with demand, resulting in a significant housing shortage. Record low housing inventory is boosting home prices and we expect these trends to continue. In addition, housing starts and the business cycle are closely linked. A housing start is a metric that shows the number of new residential construction projects begun in a month. In essence, housing starts are a sign of pent-up spending that hasn't happened yet, indicating a wave of economic activity to come.

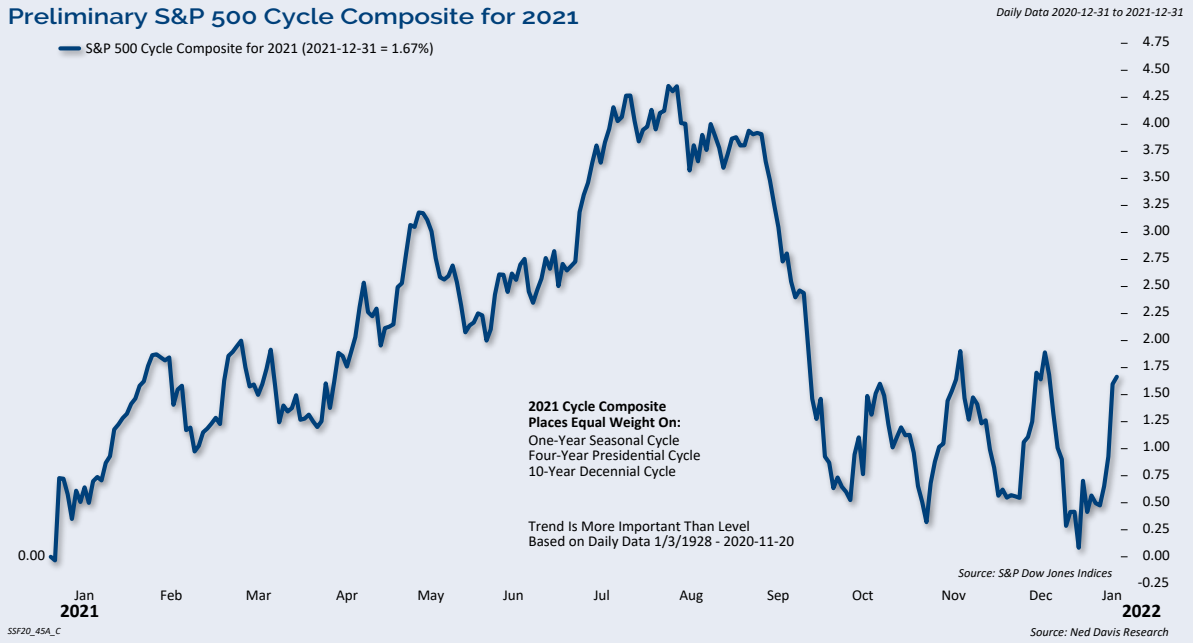
Despite the economic resurgence and solid housing fundamentals, consumer confidence remains under pressure as COVID caseloads continue to surge. Upcoming readings in consumer confidence will largely depend on the course the pandemic takes from here, the effectiveness of the vaccine rollout, and the extent of further economic restrictions. From a macroeconomic standpoint, the recovery remains intact, but it would be difficult for the economic rebound to be sustained if consumer confidence fails to reengage. We believe confidence will rise as we move toward the middle of 2021.

A Historical Perspective

Turning to the markets, the returns for the calendar year following election years have generally underwhelmed compared to returns in other years. In the post-WWII era, the S&P 500 has averaged a 7% price gain in the post-election year, with gains only 61% of the time. It's important to note that post-election years tend to be on the more volatile side, with both double-digit gains and double-digit losses observed in post-election years.

However, that doesn't paint the whole picture. Given the economic lockdowns, the recession in 2020, the subsequent economic and market recovery, and the vaccine rollout, we think 2021 will be a constructive year for the economy and equity markets, but that gains could be front loaded in the first half of the year. Our target for the S&P 500 is 4150, but it wouldn't surprise us if it trades higher than that at some point in 2021, before a second half of the year consolidation. In addition, looking a little further out, the market has historically traded in a sideways consolidation pattern from the middle of post-election years until just before the mid-term elections.

Figure 3. | **Cycle Composite Suggests a Strong First Half of 2021**



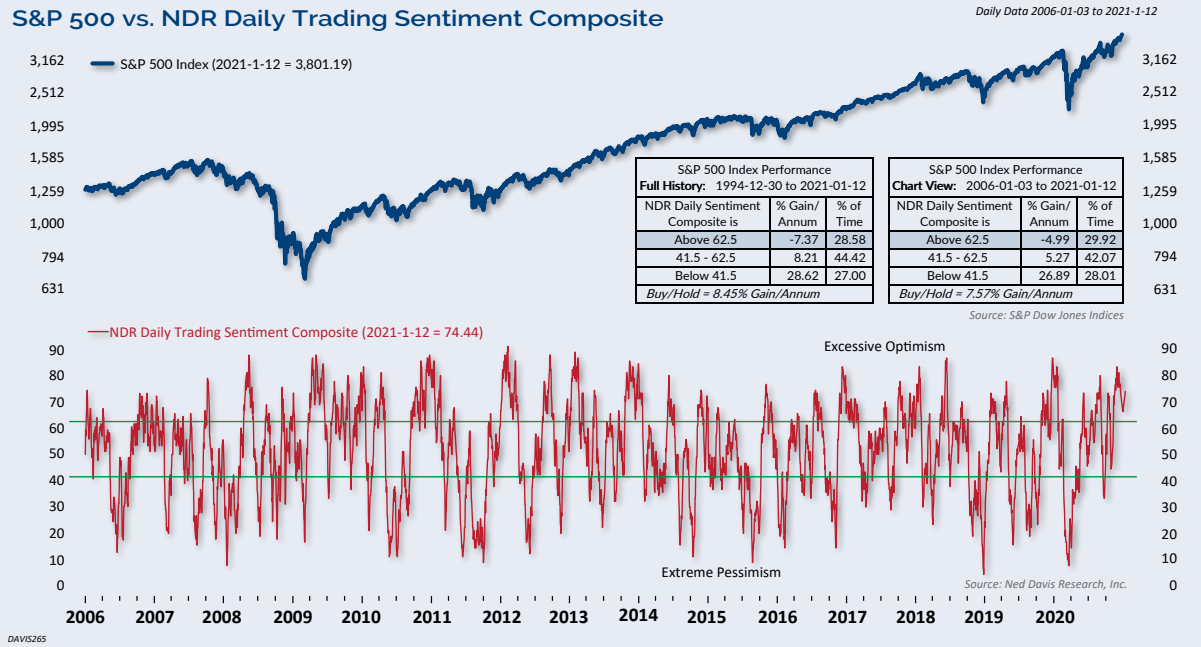
For illustrative purposes only. Projections or other forward looking statements regarding future financial performance of markets are only predictions and actual events or results may differ materially.

Figure 3 above shows the Ned Davis Research S&P 500 Cycle Composite for 2021. It combines the one-year cycle, the four-year cycle (election years), and decennial cycle (years ending in 0) into a composite. We use this Cycle Composite as a guide to how the market may trade directionally in the upcoming year. This composite has had a very good track record in previous years. For example, last year it suggested a decline in the first half of the year, primarily due to the Presidential Cycle, but nothing quite like what we had, and then it called for a strong rally into the election and new highs into year end.

The Cycle Composite for 2021 suggests a strong first half of the year, followed by a correction and a more challenging market during the second half of the year. According to Ned Davis Research, cyclical bull markets following recessions tend to be powerful, but relatively short. The median post-recession bull market lasts 16 months, aligning roughly with the early third quarter peak in the 2021 Cycle Composite. This is also consistent with the normal Presidential Election Cycle, with the market posting solid gains from the election year low into the post-election year, before consolidating those gains.

Sentiment Swings

Figure 4. | **Investor Sentiment Showing Extreme Optimism**



For illustrative purposes only. Past performance is not indicative of future results.

The news of successful vaccines is a game changer for the economy, and the market has responded in kind rallying to record highs. As we enter the New Year, investor sentiment is overly optimistic and therefore a short-term concern for the market.

Extremes in investor sentiment are normally contrarian indicators, with optimistic sentiment leading to corrections or pullbacks, and pessimistic extremes leading to rebounds. We have now experienced several round trips in sentiment since the beginning of 2020. Investor sentiment hit one of its most pessimistic extremes in years during the March lows, and the 70% surge higher in the S&P 500 has pulled investor sentiment back into extreme optimism again.

In addition, call-to-put ratios also indicate a complacent market environment. Options investors have grown increasingly confident over the course of the recovery, with the CBOE Equity Call/Put Ratio recently reaching its most optimistic level in more than 20 years (since the tech bubble in 2000).

Since the low in March, the buying of puts has slowed while the buying of calls has exploded. Euphoria on the part of speculators has been driven largely by new retail traders, Robinhood, and the flood of monetary and fiscal stimulus. We believe market optimism is well-founded with stocks at record highs, but this level of speculation oftentimes leads to at least short-term corrections.

Contrary to the short-term sentiment statistics we just looked at, fund flows paint a different picture. For the first time in a long time, we are now seeing inflows into equities, after having been persistently negative for the past three years. At the same time however, other than the massive panic in March, there is still an insatiable demand for bonds as evidenced by the strong and persistent flows into fixed income mutual funds and ETFs. The fund flow data tells us that a good portion of the massive amount of money from fiscal and monetary policy is likely finding its way into the financial markets.

Margin debt has been a coincident indicator of the stock market. It tends to amplify bull markets as investors borrow more money to leverage up their investments and it tends to exacerbate bear markets when investors are piling out of stocks. Historically, a steep decline in margin debt once it has reached an extended level has preceded or coincided with peaks in the stock market. At the onset of the COVID-19 pandemic, margin debt fell to its lowest point in seven years, but it took a mere eight months for margin debt as a percent of GDP to rebound and hit a new record high. Today, such high readings are an indication that investor psychology and the market may be getting overheated.

Figure 5. | **NYSE Advance-Decline Line Hitting New Highs**

For illustrative purposes only. Past performance is not indicative of future results.

Source: yardeni.com

While sentiment measures suggest the possibility of a short-term correction, market internal conditions support the continuation of the rally and suggest that any potential weakness should be treated as a buying opportunity. Sentiment is stretched, but trends are positive, momentum is strong, credit remains well-behaved, and there is plenty of monetary and fiscal support for the market. We have witnessed participation broadening in the market. The NYSE Advance-Decline Line is hitting new highs along with the major averages. We believe that offers strong confirmation of the trend.

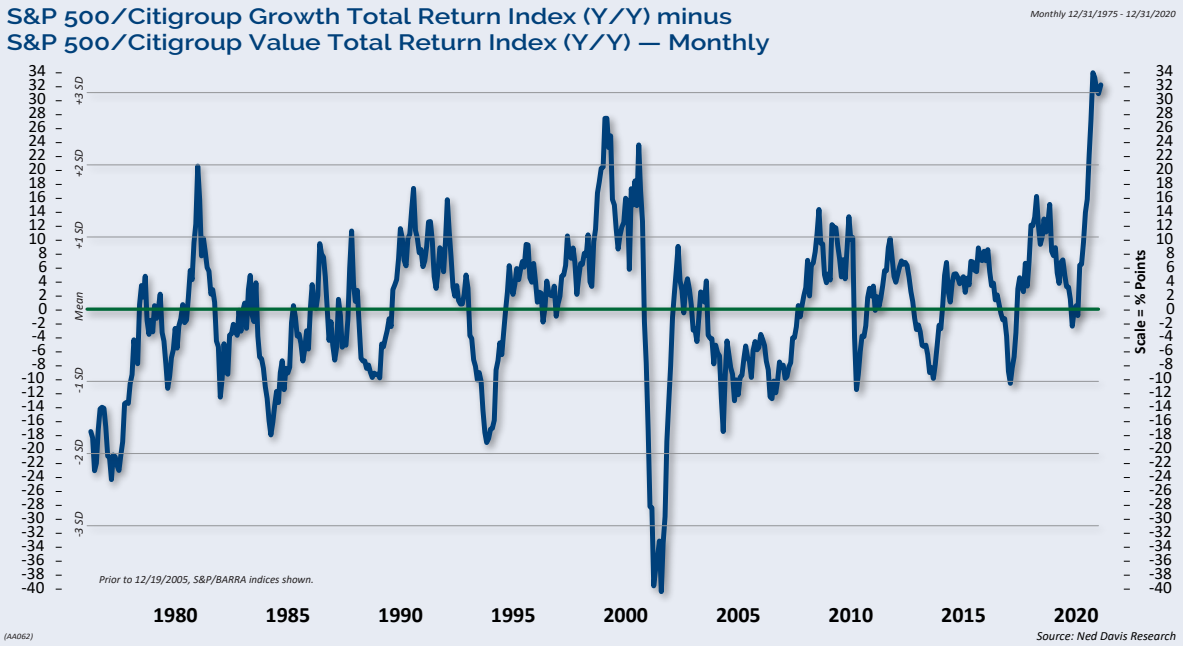
We have long been advocates for owning stocks that pay and grow their dividends consistently over time. While dividend stocks underperformed the mega cap growth stocks and major benchmarks in 2020 as dividends were not a factor that was rewarded last year, we still believe that owning good, high quality dividend growth stocks is a valuable strategy given the low interest rate environment and investors' desire for yield. Close to 65% of the stocks in the S&P 500 have dividend yields greater than 10-year Treasuries. So, while traditional valuation metrics suggest high risks, there are some factors offsetting this, which should provide a tailwind for dividend paying stocks.

The Haves and the Have Nots

A major story of 2020 was one of the haves and the have nots. Growth/value was a big part of the market dynamics in 2020 as growth outperformed value by the widest margin in history. There was also a size effect with mega caps outperforming everything else. Existing trends that were accelerated by the pandemic were in Technology and online retail, with a winner takes all environment. The benefactors of the stay-at-home theme have dominated, which are in large part, the FAANG stocks.

The S&P 500 has become less of a diversified index. The top five stocks by market cap in the index (Microsoft, Apple, Amazon, Google, and Facebook) rose to 22% of the index. That eclipses the early 2000s top five peak. It just goes to show how concentrated the market became with winners.

Figure 6. | **Market Trends Beginning to Broaden Out**



For illustrative purposes only.Past performance is not indicative of future results.

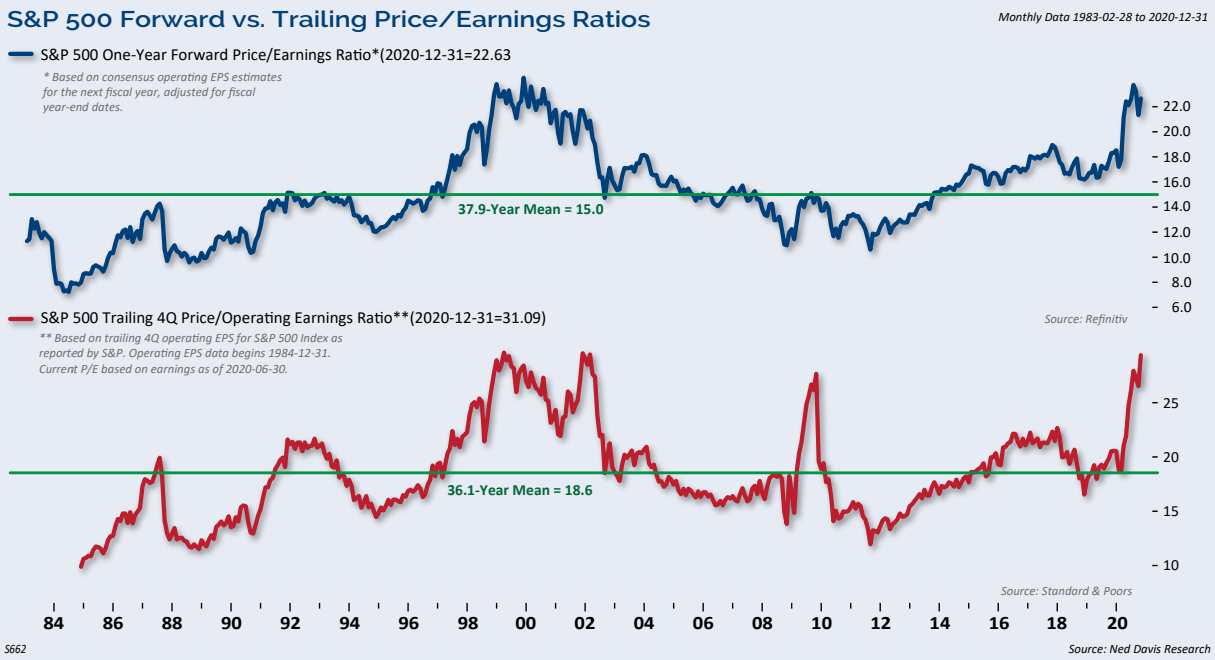
As mentioned earlier, we have seen market trends begin to broaden out, with cyclical and value sectors beginning to outperform following the optimistic news about vaccines. There is a lot of mean reversion potential in the growth versus value trade. For example, as recently as August, growth outperformed value in the previous twelve months by the most on record. Since then, value has outperformed growth as the mega cap Technology stocks have been treading water.

In the calendar year 2020, the Russell 1000 Growth outperformed the Russell 1000 Value by 35.69%, a three standard deviation event. However, since September 1st, value has outperformed growth by 725 basis points. The mean reversion potential is not just a short-term one-year issue. Growth has now outperformed value since 2006, a 14-year trend.

Small-caps are also starting to recover from their largest underperformance compared to large-caps in over two decades. In April, the Russell 2000 was the most oversold versus the Russell 1000 since 1999 on a year-over-year basis. From the bear market lows on March 23rd, small-caps have handily outperformed large-caps, with the Russell 2000 gaining 99% compared to 75.5% for the Russell 1000— still nothing to shake a stick at. Even so, small-caps are nowhere near being overbought relative to large-caps, so we could see some continued small-cap outperformance.

For now, the bullish macroeconomic backdrop remains in place, the economy is recovering and posting strong growth, fundamentals are improving, credit spreads are contracting, and the technical evidence is indicating continued small-cap outperformance. In our tactical equity strategies that use relative strength to determine allocation, we have a strong overweight position in small-cap stocks. On a longer-term basis, we believe that large-cap/small-cap relative performance trends will depend on the strength and durability of the economic rebound.

Figure 7. | **Valuations Remain Stretched**



For illustrative purposes only. Past performance is not indicative of future results.

The Valuations Landscape

Turning to valuations, stocks are not cheap when looking at P/E multiples. P/E ratios spiked in 2020 as the market recovered at the same time as earnings declined. This is fairly common coming off of a major market bottom like we saw in March. In our 2020 Mid-Year Outlook we said that "the market is forward looking and looking beyond the economic and earnings chasm this year and into 2021. In order to support the lofty valuations, earnings growth will have to materialize moving forward."

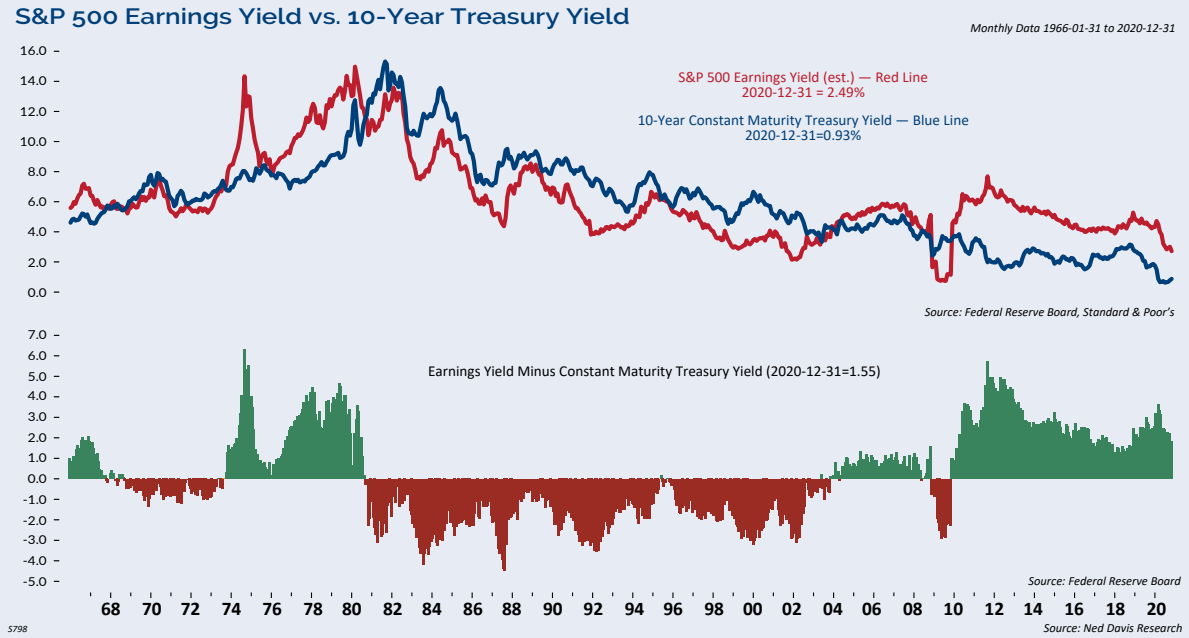
The forward and trailing P/E ratios for the S&P 500 are trading in nosebleed territory, 22.63 and 31.09 respectively. In fact, the trailing P/E and price/sales ratios are at their highest levels in history. Does that really matter in an environment where the Federal Reserve is actively buying securities and pumping liquidity into the system? In the short-term, probably not. The stock market leads fundamentals, so the first year of a bull market is defined by rising prices and falling earnings. The result is rising P/E multiples, like we had. In the second year, earnings growth typically accelerates, but price gains moderate, leading to multiple compression, which we expect to see in 2021.

We have said before that valuations can, and have, remained stretched for extended periods, so they are not timing tools, but more a measure to assess potential risks. The valuation landscape is a risk that we are closely monitoring.

When the economy shut down in March, the bottom fell out of corporate profits. Earnings plunged at an unprecedented rate. Consensus earnings for the calendar year 2020 are expected come in down 23.5%, with most of the earnings damage occurring in the first and second quarters. However, earnings are on the rebound as the economy has sharply recovered. Real GDP soared 33.4% in the third quarter and growth could come in near 10% in the fourth quarter. Looking out to calendar year 2021, we expect real GDP growth to come in at 5% or better.

We believe earnings are set to continue their strong rebound. Consensus estimates for 2021 are 36.7% earnings growth. That rate of earnings growth may be a bit too optimistic, but nonetheless, earnings are set for a strong recovery, which the market needs to support the high valuations.

Figure 8. | Relative Valuations Favor Equities



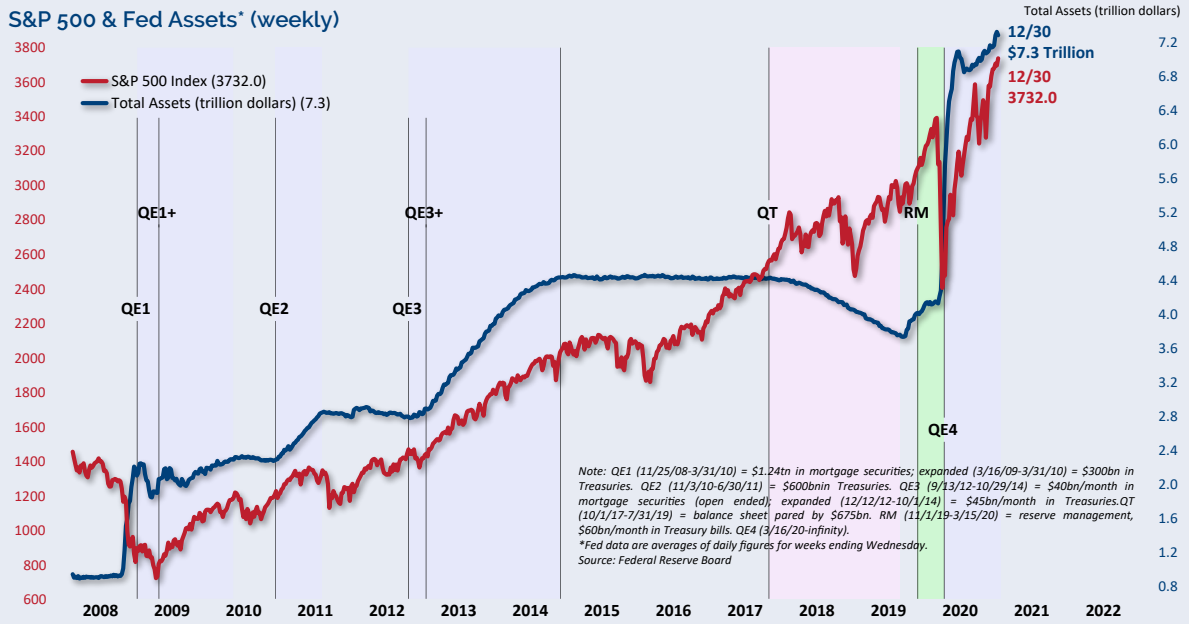
For illustrative purposes only. Past performance is not indicative of future results.

Relative valuations paint a different picture, and are much more favorable toward equities given the very low interest rate environment.

During a press conference after the December 16th FOMC meeting, Fed Chairman Powell said that relative to risk-free rates, a reference to Treasury yields, shares probably aren't as overpriced as they appear at first blush. He went on to say, "Admittedly P/Es are high but that's maybe not as relevant in a world where we think the 10-year Treasury is going to be lower than it's been historically from a return perspective."

The fact that the Federal Reserve admitted they are watching the "Fed model" is important because the Fed holds the cards here and seems willing, ready, and able to continue supporting the markets, no matter what the various valuation tools tell us. And remember the old saying, "Don't fight the Fed."

Figure 9. | Fed's Balance Sheet Continues to Soar



For illustrative purposes only. Past performance is not indicative of future results.

The Fed: Staying in the Game

The Fed's easy monetary policy can be seen by the growth of its balance sheet. The Fed has a $7.3 trillion balance sheet— that's up $3.2 trillion since February. Combined, the Federal Reserve, the European Central Bank, and the Bank of Japan have expanded their balance sheets by about $8 trillion since the COVID crisis began.

In a recent speech titled "The Federal Reserve's New Framework: Context and Consequences," Federal Reserve Vice Chairman Richard Clarida said, "It is important to note that, as our new consensus statement emphasizes, the Federal Reserve is committed to using all of our available tools—not just the federal funds rate and forward guidance, but also large-scale asset purchases—to achieve our dual-mandate goals."

The Fed is staying in the game, and they have no choice. The liquidity is massive and has driven up asset values across the board and kept interest rates artificially low. A question that central banks will have to answer in the years to come is, "how do they exit extreme stimulus without disrupting financial stability?"

In September, the Fed introduced its new policy framework regarding the future liftoff of interest rates. Part of the framework said, "With inflation having run persistently below 2%, the Committee will aim to achieve inflation moderately above 2% for some time." So, the Fed has changed their goal to allow inflation to run higher to make up for the shortfall over the years. The Fed has admitted that they will keep short-term interest rates bounded near zero through 2023. The FOMC statement released in December stated that the Fed would, "continue to increase its holdings of Treasury securities by at least $80 billion per month and of agency mortgage-backed securities (MBS) by at least $40 billion per month until substantial further progress has been made toward the Committee's maximum employment and price stability goals."

The 10-year Treasury yield ranged as high as 1.9% at the beginning of last year, fell to an all-time low of 0.50% on March 9th, and closed the year at 0.92%. Even though the Fed may be on hold for the next several years, the bond market may not be. We can easily see a scenario where market yields gradually rise given continued economic growth and pent-up demand for spending once the pandemic is behind us. Now, with the 10-year yield breaking through 1.0%, we could see a run towards 1.5%, which is the next level of technical resistance.

The yield curve has steepened, with short rates anchored and longer-term rates drifting higher. The 2-10 Treasury curve is now the steepest since August 2017. We expect more curve steepening as the economy reopens and the 10-year yield approaches 1.50%.

Figure 10. | **Inflation – Not the End of the World**

	Stocks	Bonds	Cash	Inflation
1930s	-0.9%	4.0%	1.0%	-2.1%
1940s	8.5%	2.5%	0.5%	5.5%
1950s	19.5%	0.8%	2.0%	2.0%
1960s	7.7%	2.4%	4.0%	2.3%
1970s	5.9%	5.4%	6.3%	7.1%
1980s	17.3%	12.0%	8.8%	5.5%
1990s	18.0%	7.4%	4.8%	3.0%
2000s	-1.0%	6.3%	2.7%	2.6%
2010s	13.4%	4.1%	0.5%	1.8%

Source: Awealthofcommonsense.com. For illustrative purposes only. Past performance is not indicative of future results.

There is definitely concern about the potential for rising inflation. Once the inflation genie is out of the bottle, it is hard to contain. There are some factors supporting the inflationary case including the post-vaccine recovery, a massive surge in money supply aggregates with M2 money supply up 25% year-over-year, the weak U.S. dollar, and industrial metals and commodities surging higher.

Breakeven inflation rates are approaching 200 basis points, and have pushed real yields under -100 basis points. Negative real rates continue to be a major theme supporting risk assets. We don't think inflation is an issue for this year. While we could see inflation approach 2.5% this year, it will likely be temporary, and the Fed said that they would allow it to remain above their target for some time before hiking rates. In addition, the 5-year/5-year forward breakeven rate is still suggesting only a 2% inflation rate five to ten years out. Looking at history, stocks have performed reasonably well in times of higher inflation.

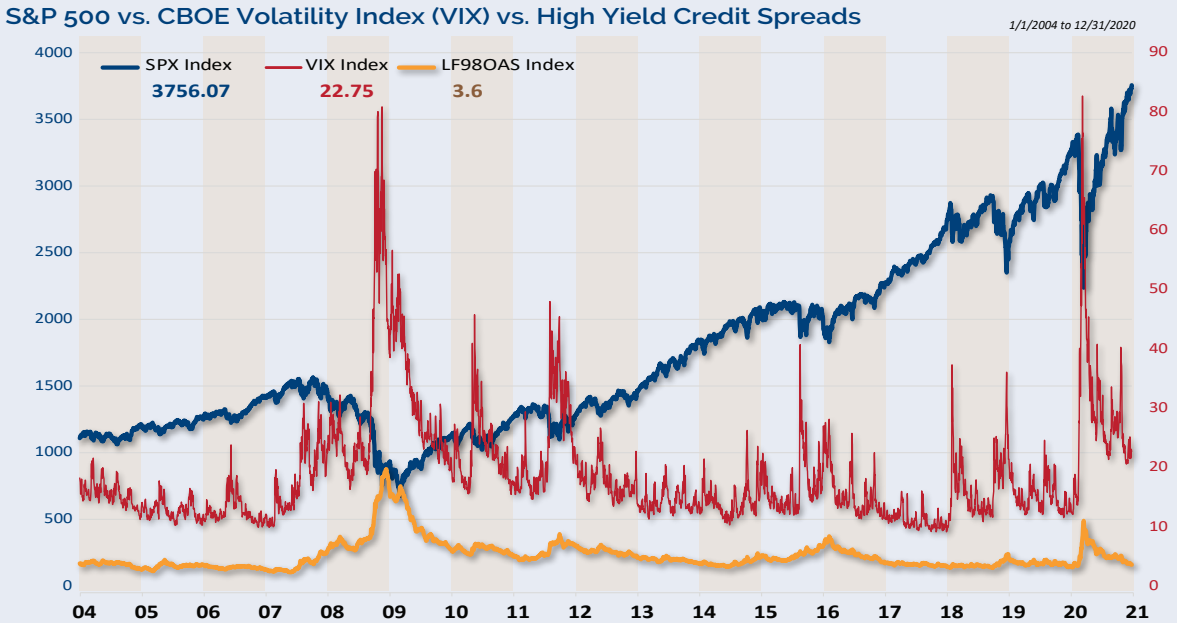
Lower for Longer?

Turning to credit, we came into the New Year overweight in high yield in our tactical fixed income strategies. Last year, we became defensive in late February and fully exited high yield in early March, and reestablished a high yield overweight position in late March, avoiding most of the downside. High yield spreads ended the year at 360 basis points, a post-pandemic low, and a strong improvement from the 1100 basis points spread at the depth of the declines in March.

The steady grind lower in corporate credit spreads has continued virtually unabated since the March lows. We expect that credit spreads will continue to inch toward their pre-pandemic levels. Low macro volatility following recent positive vaccine developments and the accommodative stance of monetary policy should support credit risk appetite. Valuations limit long-term upside relative to the stellar performance since late March, but credit will likely deliver decent excess returns and solid Sharpe ratios in 2021.

We expect corporate credit fundamentals will recoup a considerable portion of the damage inflicted by the sudden stop in the economy, which should translate into a benign backdrop for rating migrations and defaults. The biggest risk to this view is a more severe deterioration in the virus situation than we expect and/or a long delay in the vaccine timeline.

Figure 11. | **Using Credit as an Indicator for Managing Risk**



For illustrative purposes only. Past performance is not indicative of future results.

Stocks and volatility are negatively correlated. For example, in times of panic, volatility rises, and stocks decline. In addition, high yield credit spreads are highly correlated with volatility. Credit spreads widen in times of elevated volatility, and contract as volatility declines. Therefore, credit tends to be a very good indicator for managing risk in the market.

Right now, both the VIX Index and credit spreads have declined steadily from the March panic levels, but are a little elevated compared to pre-COVID levels given the fact that stocks and high yield bonds are trading at record highs. The VIX Index is trading above 20, having fallen from a record high of 82.69 in March. In pre-COVID times, when the market was trading at record highs, the VIX Index traded as low as 11.5. Given our bullish market outlook, we can see both the VIX and credit spreads tightening further as the market advances in the first half of the year.

Our position has been lower for longer on interest rates, and the Fed confirmed they will keep rates low on the short end. That has significant implications for fixed income. There is no yield at the short end of the curve. Or as we used to say, "cash is trash."

Corporate bond issuance, both investment grade and high yield new issuance, set record highs last year. Companies are taking advantage of the low rates and Fed backstop, issuing debt and refinancing existing debt at lower rates, and levering up their balance sheets. From a corporate finance standpoint, CFOs are doing the right thing given the yield environment and the insatiable demand from investors for bonds.

Given the record issuance of new debt at longer maturities with lower interest rates, we now have record duration across fixed income sectors. Record duration highlights the risk currently embedded in bonds. Our position is that investors need to be active and tactical in fixed income now more than ever before. Particular attention needs to be paid to credit risk, duration risk, and liquidity risk. We believe our fixed income solutions, which manage each of those risks by being active and tactical, are very well-positioned for the current fixed income environment.

Debt levels have soared this year with the massive stimulus packages enacted to bridge the economic chasm from the pandemic lockdowns. At present, total credit market debt is over 400% of GDP. Historically, as the amount of debt as a percent of GDP has risen, the rate of growth in inflation, GDP, productivity, and payrolls have all declined. Debt crowds out today's savings which are tomorrow's investments, as it takes resources away from productive economic uses in order to service the debt. Fortunately, we have very low interest rates which makes servicing the debt manageable. However, we do have concerns longer-term about potential lower structural economic growth given the weight of the debt burden.

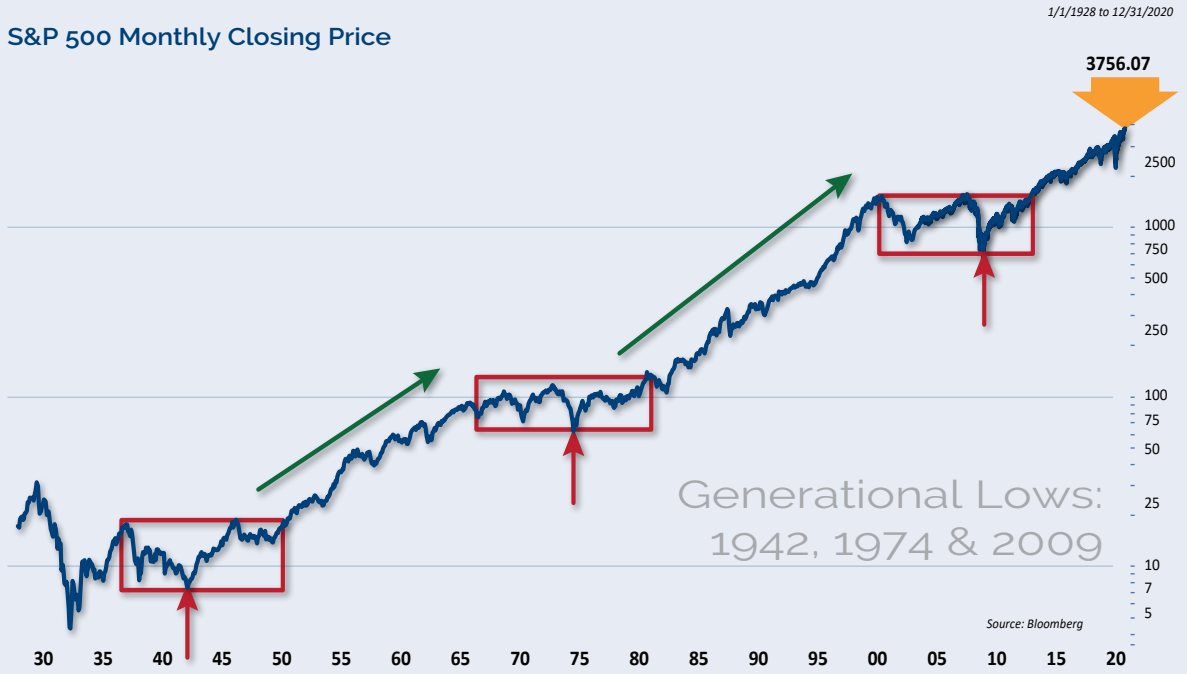
Conclusion

Over the past decade, the S&P 500 has returned 13.86% annualized, and investors have come to expect healthy returns. In last year's Market Outlook, we discussed the capital market's long-term return potential. We said, "Capital market expectations need to be ratcheted lower. Our expectation over the next decade is for mid-single digit annualized equity returns." As a percent of household financial assets, stocks currently represent 55% of holdings. That is in the top quintile of stock allocations over time, and suggests that a lot of long-term optimism may be already in the market.

We think it will be important to prepare clients for the possibility of lower capital market returns in the next decade. A focus on risk adjusted returns and blending tactical strategies into portfolios that can actively manage and step away from risk will be important. We believe the tactical strategies we manage using our relative strength methodology can add value and enhance risk-adjusted returns, and have the ability to actively manage risk. We have concluded the past several annual Market Outlooks with Figure 12 on the following page, which shows the very long-term perspective of the equity markets.

The below chart of the S&P 500 dates back into the 1920s. The three boxes in red highlight the last three secular bear markets. Note that once the market eclipsed its prior secular peak, it continued higher for many years. We are still in the secular bull market that began after the Credit Crisis. The fact that the COVID recession and market decline was so short, and the rebound has taken the major indices to new highs, suggests that the secular bull market is still intact.

Figure 12. | **Secular Bull Market Remains Intact**



For illustrative purposes only. Past performance is not indicative of future results.

In conclusion, we come into 2021 with a lot of hope and optimism for a better year. I know most of us are looking forward to being able to socially connect with friends, loved ones, and co-workers. As the vaccine rolls out, we expect to see continued economic growth, not at the torrid recovery pace of the past two quarters, but definitely above trend (we expect 5% real GDP growth in 2021).

The equity markets should perform well, and we are encouraged by the broadening trends. Valuations are stretched but earnings growth and relative valuations mitigate some of those concerns. Our target for the S&P 500 is 4150, and the returns might be front loaded. We will continue to see monetary and fiscal policy support to prop up asset prices globally. In our view, the weak U.S. dollar will support international outperformance, especially in emerging markets. In fixed income, interest rates will remain low and we believe credit will perform well given the favorable macro landscape.

About the Author

K. Sean Clark, CFA®
EVP, Chief Investment Officer

K. Sean Clark, CFA®

EVP, Chief Investment Officer

As Clark Capital's Chief Investment Officer, Sean oversees all of the Firm's investment activities and heads the firm's portfolio team. Sean joined the firm in 1993 and is responsible for asset allocation and investment selection for Navigator Investment Solutions as well as directing ongoing market research and contributing to the development of proprietary products. Sean is a member of the Clark Capital Investment Team and the Executive Team. He graduated from the University of Delaware, earning a B.S. and an M.A. in Economics. Sean holds the Chartered Financial Analyst® designation and is a member of the CFA Institute (formerly AIMR) and the Financial Analysts of Philadelphia, Inc. Sean is considered an industry expert and is often asked to appear on CNBC and Bloomberg television to share his views on the market. In addition, Sean has been featured in a number of articles in nationally distributed business journals and newspapers.

CFA® and Chartered Financial Analyst® are registered trademarks owned by CFA Institute.

The views expressed are those of the author(s) and do not necessarily reflect the views of Clark Capital Management Group. The opinions referenced are as of the date of publication and are subject to change due to changes in the market or economic conditions and may not necessarily come to pass. There is no guarantee of the future performance of any Clark Capital investments portfolio. Material presented has been derived from sources considered to be reliable, but the accuracy and completeness cannot be guaranteed. Nothing herein should be construed as a solicitation, recommendation or an offer to buy, sell or hold any securities, other investments or to adopt any investment strategy or strategies. For educational use only. This information is not intended to serve as investment advice. This material is not intended to be relied upon as a forecast or research. Past performance does not guarantee future results.

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 10-year Treasury note is a debt obligation issued by the United States government with a maturity of 10 years upon initial issuance. A 10-year Treasury note pays interest at a fixed rate once every six months and pays the face value to the holder at maturity.

The Dow Jones Industrial Average is the most widely used indicator of the overall condition of the stock market, a price-weighted average of 30 actively traded blue chip stocks, primarily industrials. The 30 stocks are chosen by the editors of the Wall Street Journal (which is published by Dow Jones & Company), a practice that dates back to the beginning of the century. The Dow is computed using a price-weighted indexing system, rather than the more common market cap-weighted indexing system.

NDR (Ned Daily Research) Daily Trading Sentiment Index is based on the S&P 500 Daily Sentiment Index which shows a short-term sentiment view of the S&P 500 Index

Created by the Chicago Board Options Exchange (CBOE), the Volatility Index, or VIX, is a real-time market index that represents the market's expectation of 30-day forward-looking volatility. Derived from the price inputs of the S&P 500 index options, it provides a measure of market risk and investors' sentiments.

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.

This document may contain certain information that constitutes forward-looking statements which can be identified by the use of forward-looking terminology such as "may," "expect," "will," "hope," "forecast," "intend," "target," "believe," and/or comparable terminology (or the negative thereof). Forward looking statements cannot be guaranteed. No assurance, representation, or warranty is made by any person that any of Clark Capital's assumptions, expectations, objectives, and/or goals will be achieved. Nothing contained in this document may be relied upon as a guarantee, promise, assurance, or representation as to the future.

The Composite Index of Leading Indicators, otherwise known as the Leading Economic Index (LEI), is an index published monthly by The Conference Board. It is used to predict the direction of global economic movements in future months. The index is composed of 10 economic components whose changes tend to precede changes in the overall economy. The Conference Board is an independent research association that provides its member organizations with economic and financial information.

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.

The price-to-earnings ratio (P/E ratio) is the ratio for valuing a company that measures its current share price relative to its per-share earnings (EPS). The price-to-earnings ratio is also sometimes known as the price multiple or the earnings multiple.

Russell 1000 Index measures the performance of the 1,000 largest companies in the Russell 3000 Index, which represents approximately 92% of the total market capitalization of the Russell 3000 Index.

The Russell 2000 Index measures the performance of the 2000 smallest U.S. companies based on total market capitalization in the Russell 3000, which represents approximately 11% of Russell 3000 total market capitalization.

Russell 1000 Growth Index measures the performance of those Russell 1000 companies with higher price-to-book ratios and higher forecasted growth values.

Russell 1000 Value Index refers to a composite of large and mid-cap companies located in the United States that also exhibit a value probability.

Clark Capital Management Group, Inc. is an investment adviser registered with the U.S. Securities and Exchange Commission. Registration does not imply a certain level of skill or training. More information about Clark Capital's advisory services and fees can be found in its Form ADV which is available upon request. CCM-672