



Cliff Notes on the Economy

Economic Review & Outlook

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Second 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.



Economy



Monetary Policy



Valuations



Investor Sentiment



Interest Rates

U.S. Economy

As we move into the second half of 2021, we believe that our gauges are positioned appropriately, and as a result, we are not making any changes to the gauges this quarter. However, we will recap the current positioning and why we feel these positions remain appropriate.

The first gauge covers the U.S. economy. We continue to keep this gauge at a half forward position heading into the second half of the year, reflecting our expectation of above trend economic growth in 2021, and we expect GDP growth around 5% for the second half of the year. This follows Q1 growth of 6.4% and an estimated 8.6% growth rate in the second quarter based on the Atlanta Fed's GDPNow gauge (as of 7/1/21).

We believe we are still in the "V-shaped" portion of this economic recovery, but the outsized growth numbers in recent quarters will likely be the high point in this recovery and we therefore keep the gauge in a half forward position. We are moving past peak economic growth. As the vaccine becomes more widely available in 2021, and the economy moves ahead with the reopening process, we expect above trend economic strength to continue well into next year, but at a slower pace than experienced in the first half of 2021.

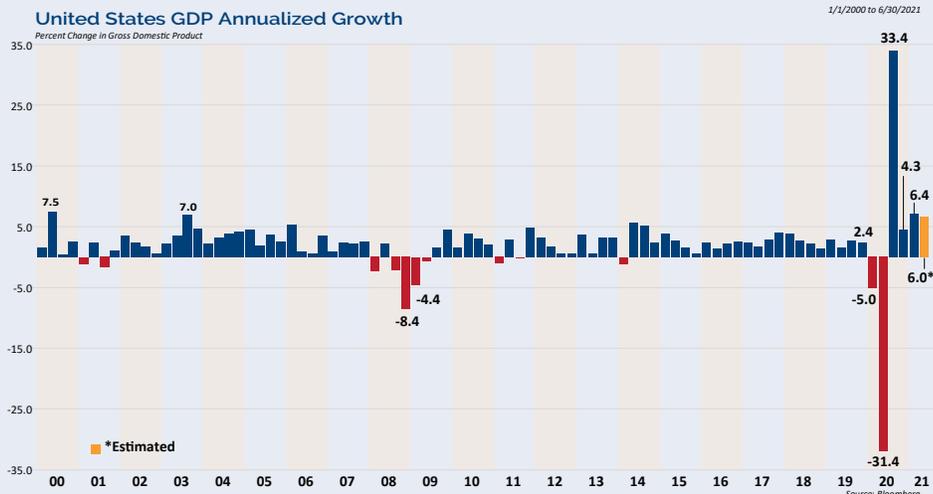


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Economy



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

Ongoing challenges persist such as supply chain disruptions as well as the new Delta variant of the virus. It looks like we might get a final fiscal stimulus boost with a tentative agreement between the White House and both parties in the Senate on an infrastructure plan valued around \$1.2 trillion. If this plan does come to fruition, this fiscal measure should continue to provide a solid tailwind to the U.S. economy through the balance of 2021 and into 2022.

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 was at 5.9% in June, near the lowest level since prior to the pandemic.

Hopefully, as the reopening gains momentum in the summer, more workers will be hired, and job market progress will continue to regain some momentum. Record job openings exist, and we believe that as the extended unemployment benefits expire, more workers will rejoin the labor force. 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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Unemployment Rate



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Housing has been a real 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. Housing prices continue to rise, driven primarily by low inventories and high consumer demand. We will continue to monitor the housing market, particularly as home prices rise at record rates to see if that starts to cool off some of the housing momentum. Furthermore, monitoring the general interest climate and how that impacts mortgage costs will be an important factor to watch as well.

We believe the economic recovery will continue throughout 2021 and well 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 well into 2022.

Monetary Policy

The economic recovery continues to be supported by ongoing, stimulative Monetary Policy, which is our next gauge. We keep this gauge in a full forward position.

The massive support from the Fed that began in March 2020 with unlimited quantitative easing and a whole host of other programs has continued in 2021. The Fed has reiterated repeatedly that it will continue to support the proper functioning of the financial markets and their actions have backed this up.

Currently, 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 Fed's balance sheet, which had been slowly declining prior to the pandemic, increased by nearly \$4 trillion dollars in the last year and a half. As of the end of June, the Fed's balance has just crossed above \$8 trillion.

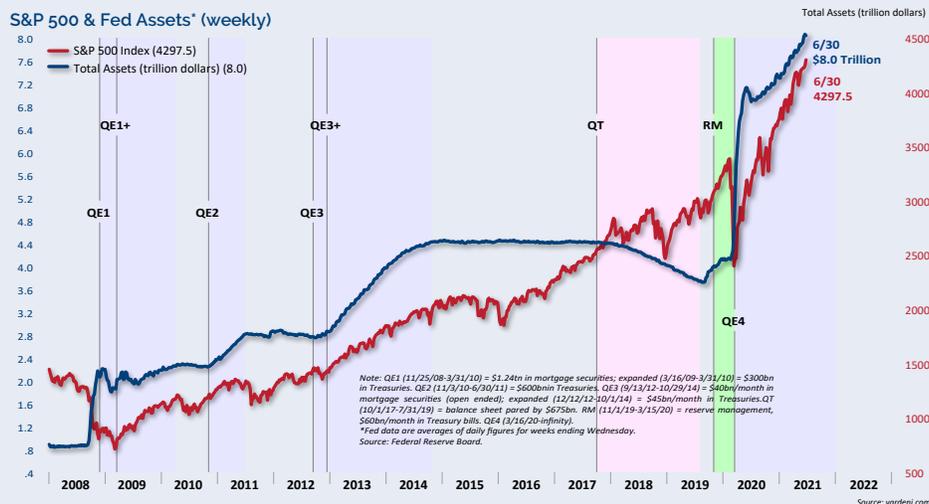


Monetary Policy



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Ultimately, this massive stimulus by the Fed helped support capital markets from the early days of the pandemic crisis period. We have seen over the past decade that when the Fed is increasing its balance sheet, stocks have reacted favorably and subsequently, both stocks and bonds enjoyed a powerful rebound from the crisis lows through year-end and well into 2021.

Inflation has become a bigger topic of late driven in part by the massive increase in public debt responding 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 June meeting that inflation might be higher over the next couple of years, and it increased its forecast for inflation for 2021 from 2.4% to 3.4%. 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 few years.

We know this will be a choppy reopening process, but the Fed is providing unwavering support and we therefore keep this gauge in the full forward position. We will pay close attention to the annual Jackson Hole Wyoming Symposium for some deeper insight on when the Fed might begin to reduce or taper its bond buying program—big announcements have historically been made at this August event. We still believe an increase to policy rates is still several quarters away and would not occur until the Fed is well into a tapering program, which has not yet begun.



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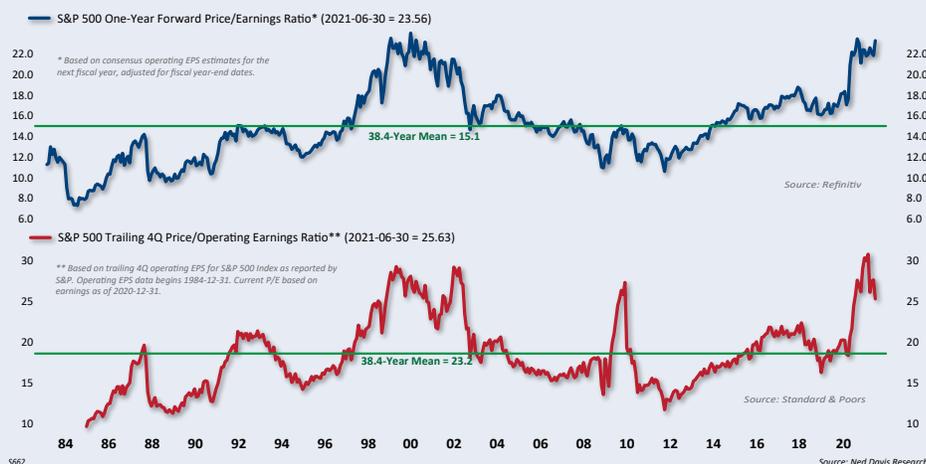
Valuations

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.

S&P 500 Forward vs. Trailing Price/Earnings Ratios

Monthly Data 1983-02-28 to 2021-06-30



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

Although valuations remain elevated, the P/E ratio of the S&P 500 has improved modestly, with earnings strength outpacing price gains on a relative basis during 2021. The S&P 500, NASDAQ Composite, and Dow Jones Industrial Average all hit new all-time highs in the second quarter of 2021 as the economy rebounded and business recovered. The Russell 2000 Index hit a new high in the first quarter, but it was not able to top that level in the second quarter.

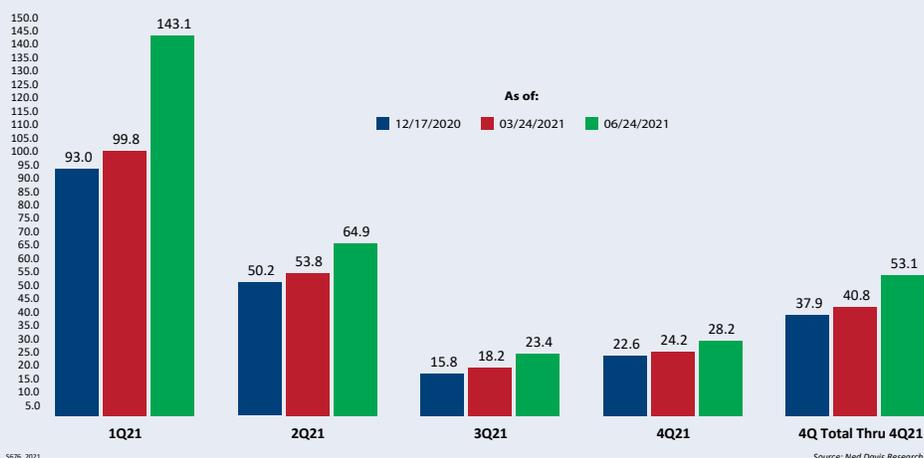
While stock prices have continued to rise in 2021, earnings have bounced back strongly since the shutdown period last Spring. In fact, Operating earnings for the S&P 500 more than doubled in Q1 2021 since the pandemic low in Q1 2020, but this will likely be the peak earnings growth period from a year-over-year perspective. Earnings growth will still be strong over the next few quarters in 2021, but not to the same degree as from the pandemic low. We believe we are likely moving past peak earnings growth.



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S&P 500 Consensus Operating EPS Estimates (Year/Year % Change) - 2021



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In 2021, we have seen a broader stock market rally with small and mid-cap stocks outperforming large-caps, and value outperforming growth. The large-cap, growth rally, which dominated much of 2020, has paused somewhat in 2021 as other pockets of the equity market improve. The NASDAQ Composite has lagged so far in 2021, but it ended the second quarter strongly with among the best index returns for the month of June as growth made a comeback.

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.

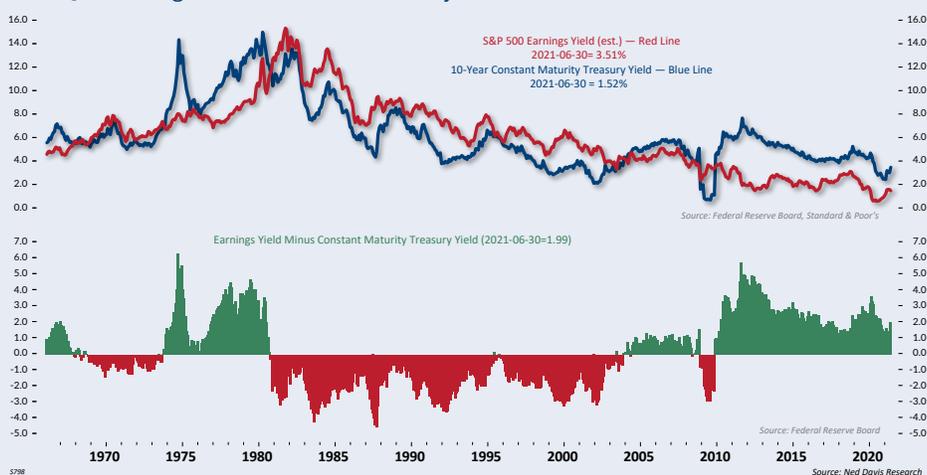
The 10-year U.S. Treasury yield was at 0.93% at year end, but it closed the first quarter at 1.74% and it closed June at 1.45%. When comparing the earnings yield of the S&P 500 (which is the inverse of the P/E ratio) to the yield on the 10-year Treasury, it shows us that on a relative basis, stocks are more attractive than bonds even with the move higher in rates in 2021.



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S&P 500 Earnings Yield vs. 10-Year Treasury Yield



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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 likely behind us. Interest rates remain low, so on a relative basis, stocks are still attractive relative to bonds.

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 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 keep this gauge in the half backward position as there still appears to be some speculation in the market as equities continue to put in new all-time highs.

This gauge is very sensitive and can change quickly, but at this point the market has shifted back toward the excessive optimism zone when looking at trading sentiment.



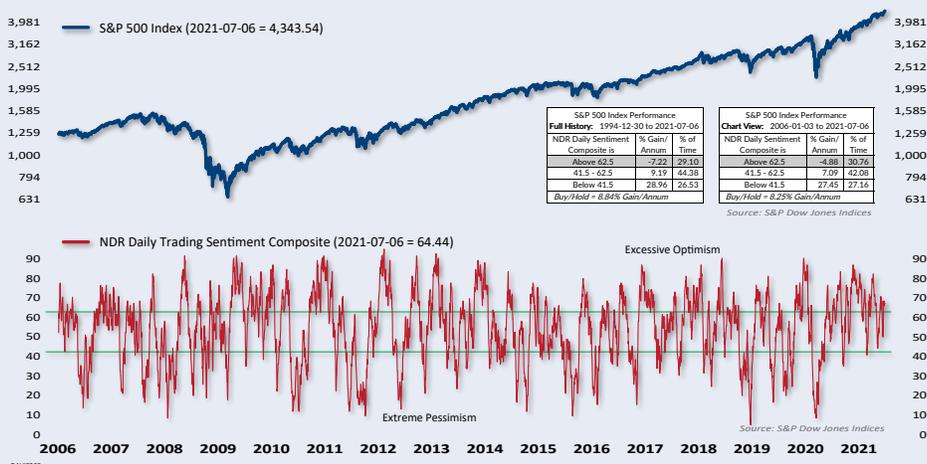
Investor Sentiment



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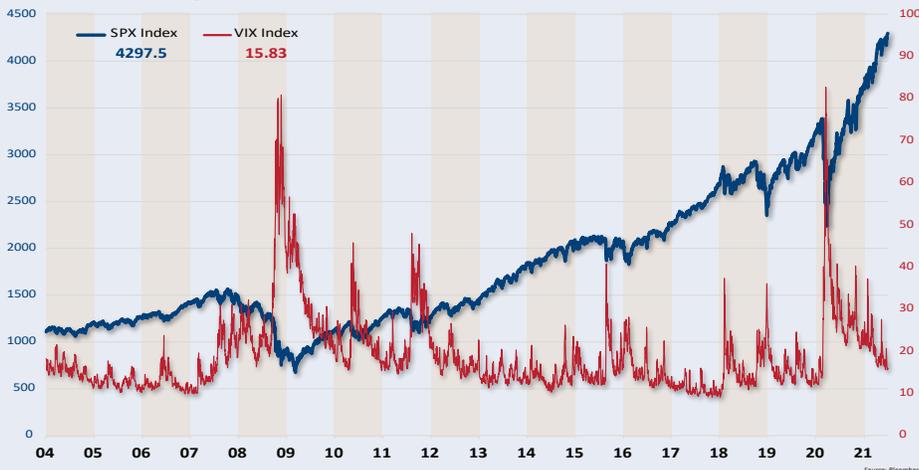
S&P 500 vs. NDR Daily Trading Sentiment Composite



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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 briefly above 25 in May and briefly above 20 in June, but it settled below 16 at the end of the second quarter. While not back to pre-pandemic levels, the VIX Index is near its lowest levels since the pandemic began and put in a 52-week low in late June. The low level of the VIX might be indicating some complacency in the market, which further compels us to keep the Investor Sentiment gauge back in the half backward position.

S&P 500 vs. Volatility



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Based on the cumulative data we analyze for investor sentiment; we believe this gauge is positioned correctly as we move into the second half of 2021 and believe it is important for investors to be prepared for some increased volatility moving through the summer and into the fall.



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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, but also reflecting the move higher in yields so far in 2021.

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. However, the market has more control on longer-term rates and has moved them higher in 2021. The move higher in yields was primarily a first quarter story as yields have slid lower from those recent highs during the second quarter.

Treasury Constant Maturity Rates
(Percent, Daily, Not Seasonally Adjusted)

4/1/2016 to 7/6/2021



Source: FRED, Board of Governors of the Federal Reserve System (US)

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With the Fed anchoring shorter-term yields at low levels, but yields rising further out on the curve, we call this a steepening of the yield curve. Although rates moving higher might hurt bond prices in the near term, the opportunity to buy bonds at higher yield levels as the yield curve steepens is a positive moving forward. As the yield curve is steepening and 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 also is supportive of tilting towards credit in the portfolio and away from pure interest rate risk. We believe we are positioned well at Clark Capital to navigate through this more dynamic time in the bond market.

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 they reduce 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.



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Conclusion

We know these remain challenging times, but the good news is that the U.S. economy has rebounded strongly, and the vaccine has begun to roll out more broadly across the United States. We continue to believe that the U.S. economy and corporate America will continue to fight through this crisis and corporate earnings so far in 2021 have rebounded strongly.

We also acknowledge there could still be some bumps in the road to recovery from both an economic and stock market perspective, but we believe we are heading in the right direction. We expect economic improvement to continue as the vaccine becomes more widely available and consumers unleash pent-up demand. 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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