



GUIDE TO THE GAUGES

Quarterly Economic and
Capital Market Review

Second Quarter 2023



Guide to the Gauges

Our Latest Assessment of Key Economic Indicators



Economy



Monetary Policy



Valuations



Investor Sentiment



Interest Rates

We believe that over the long term, stock prices are driven by two things: earnings, and what people are willing to pay for those earnings. These five gauges reflect our outlook for the factors that we believe drive stock prices.

Each gauge is comprised of a number of individual indicators, which the Investment Team evaluates on an ongoing basis to determine if the gauge is neutral, positive, or negative.

Second Quarter Summary

The first half of 2023 ended on a positive note as markets remained resilient despite continued Fed tightening, calls for an imminent recession, a regional banking crisis, the debt ceiling debate, and more.

GDP growth remains near trend; however, we believe there are some storm clouds on the horizon. While the likelihood of a mild recession has increased, the current strength of the job market leads us to believe that any potential recession would be short and shallow.

As inflation continues to trend downward, we believe that the Federal Reserve is at or near the end of the current rate hike cycle. After a "skip" in June, the market is anticipating the Fed will resume rate hikes at the July FOMC meeting. The June 2023 meeting was the first FOMC meeting since this rate-hike cycle began in March 2022 without an increase in policy rates.

P/E multiples have moved higher from the end of Q3 2022, and we continue to view stocks as "fairly valued" at the index level. Investor sentiment, which is a contrarian indicator, flipped from bearish to bullish in June. We also observed that stock volatility, as measured by the VIX Index, became more subdued as the quarter ended. This shift caused us to move the Investor Sentiment gauge backwards by two notches.



No Change in Position

Economy

This quarter, we held the Economy gauge in Neutral to reflect that GDP growth remains near trend but there are some storm clouds on the horizon. June marked the eighth consecutive month of declining manufacturing activity in the US. Given the likelihood of tighter lending standards from banks, the odds of a mild recession have increased. However, given the strength of the jobs market any potential recession, in our opinion, would be short and shallow.

Key Takeaways

GDP

The final read of Q1 GDP came in at 2%, revised higher from 1.3%. The Atlanta Fed's GDPNow is currently forecasting growth of 1.9% for Q2.

Labor Market

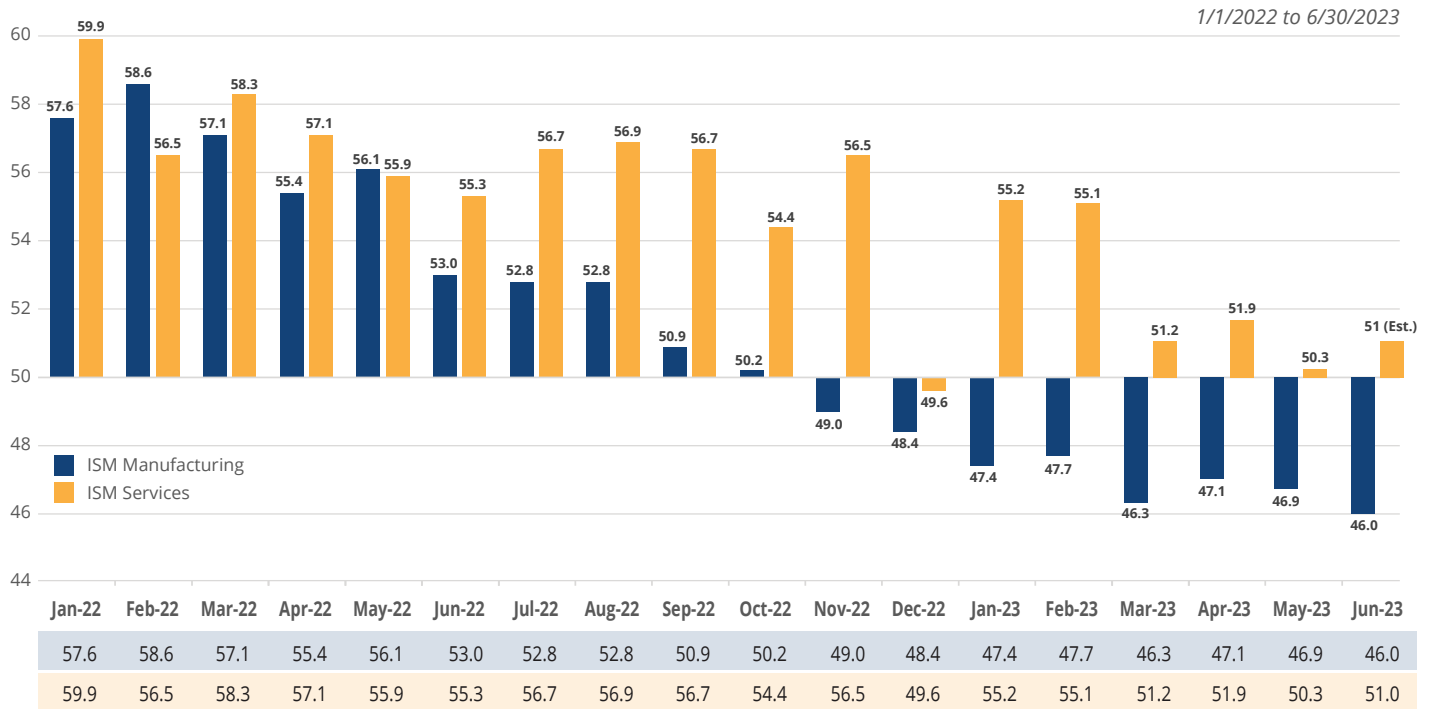
The unemployment rate of 3.7% is near the lowest level in decades and job openings are plentiful, although they are off their peak of March of 2022.

Inflation

Headline CPI and PPI for May came in at 4.0% and 1.1% respectively. The Fed's preferred measure of inflation, Core PCE, remains above the target of 2%.

ISM Manufacturing and Services PMI

The ISM Manufacturing PMI came in at 46 for June, marking the eighth straight month below 50. The ISM Services PMI came in at 50.3 for May, it's lowest reading of the year.



Source: Investing.com

Source: fred.stlouis.org

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



Monetary Policy

This quarter, we held the Monetary Policy gauge in Slow Reverse to reflect that the Federal Reserve “skipped” raising rates at the June FOMC meeting. While Fed policy is still a headwind for risk assets, we believe that the Federal Reserve is nearing the end of the current rate hike cycle.

No Change in Position

Key Takeaways

Rate Hikes

The Fed “skipped” a rate hike at the June FOMC meeting and signaled that additional rate hikes may be appropriate.

Fed Fund Futures

Fed Fund Futures currently imply a final rate hike in July and rate cuts beginning in May of next year.

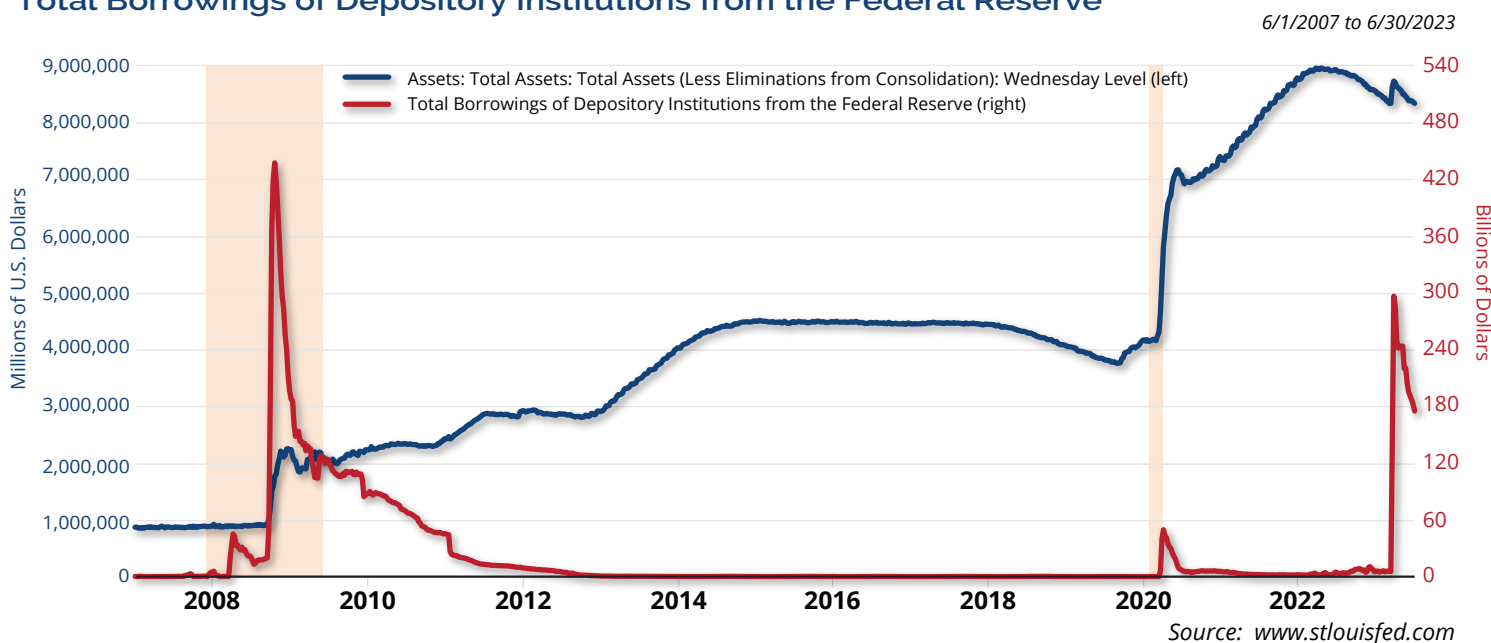
Balance Sheet

The Fed’s Balance Sheet has returned to levels observed prior to the regional bank issues experienced in March. Borrowing by banks through the Fed’s Discount Window has declined after spiking in March.

The Fed’s Balance Sheet

After some regional banks scrambled for liquidity in March, the Fed’s Balance Sheet has begun to shrink again.

Total Borrowings of Depository Institutions from the Federal Reserve



Source: Board of Governors of the Federal Reserve System. For illustrative purposes only. Past performance is not indicative of future results.



Valuations

This quarter, we held the Valuations gauge in Neutral to reflect that P/E multiples remain in “fair value” range.

No Change in Position

Key Takeaways

P/E Multiples

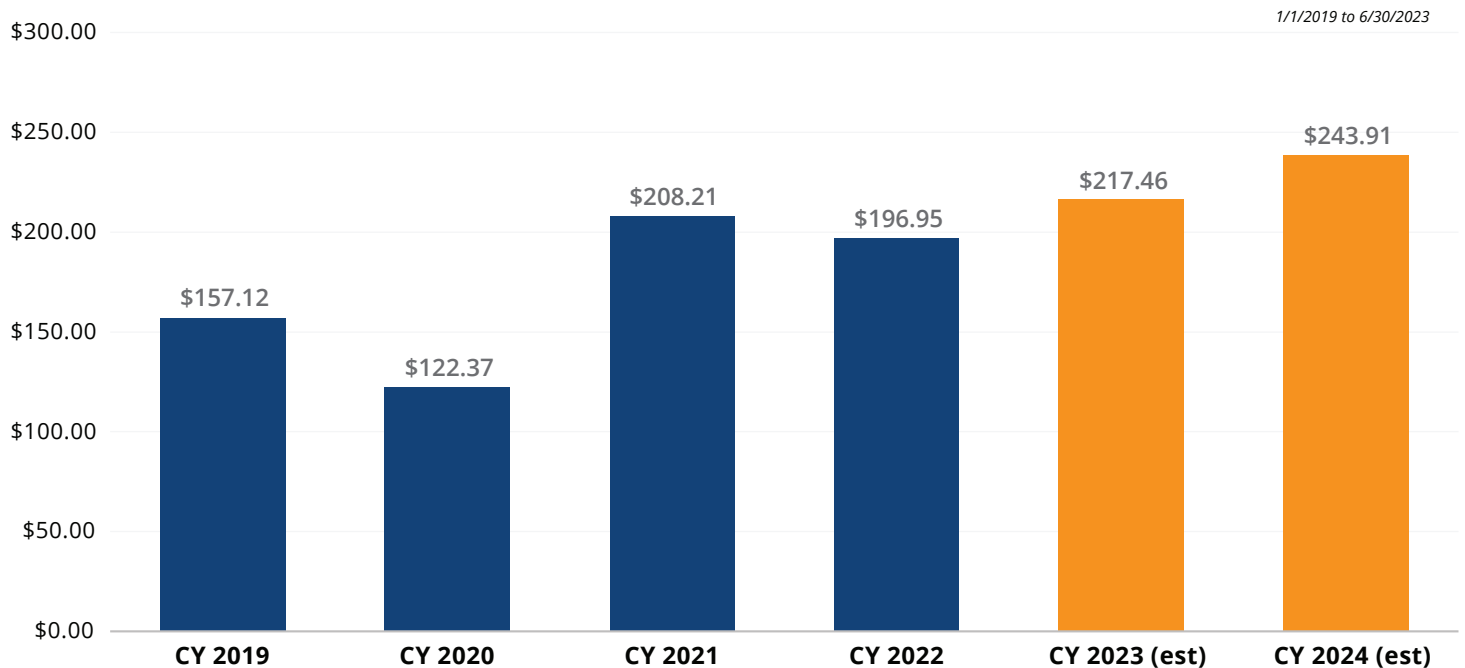
After reaching undervalued levels at the end of Q3 2022, stocks have staged a rally and remain in “fair value” range.

Earnings

In Q1 S&P 500 companies posted a 6.4% increase in operating earnings compared to a year ago. Analysts are forecasting better earnings growth in the second half of this year.

S&P 500 Calendar Year Operating EPS Actuals & Estimates

In 2022 S&P 500 operating EPS declined by 5%, albeit from a record level in 2021. For 2023 and 2024 the consensus of Wall Street analysts are for earnings growth of 10%-12% each year, although we acknowledge the possibility of revisions to those estimates.



Source: S&P Global 1/1/1996 to 6/30/2023. For illustrative purposes only. Past performance is not indicative of future results. Neither past actual, projections, nor other forward looking statements regarding future financial performance of markets are only predictions and actual events or results may differ materially



Moved Two Notches to the Left

Investor Sentiment

This quarter, we moved the Investor Sentiment gauge from Slow Forward to Slow Reverse to reflect that investor sentiment flipped from bearish to bullish in June. We also observed that stock volatility, as measured by the VIX Index, became more subdued as the quarter ended.

Key Takeaways

AAll Survey

After a resolution to the Debt Ceiling debate, stability in the regional bank sector, and further stock market gains; investor sentiment became Bullish in June.

VIX Index

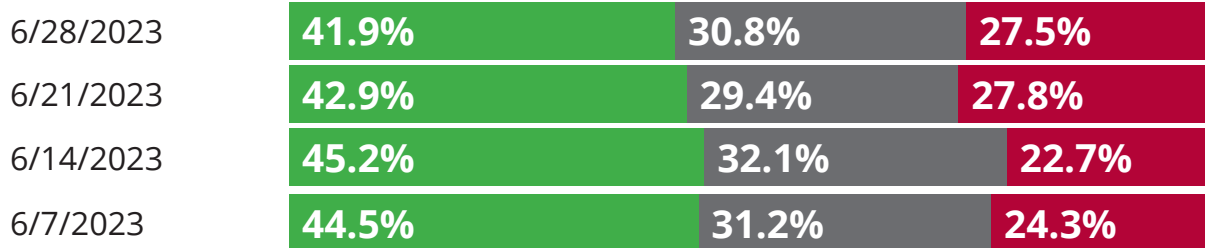
After briefly reaching 30 in mid March the VIX Index retreated to a new 52 wk low of 12.73 in June, signaling complacency amongst investors.

Sentiment Votes

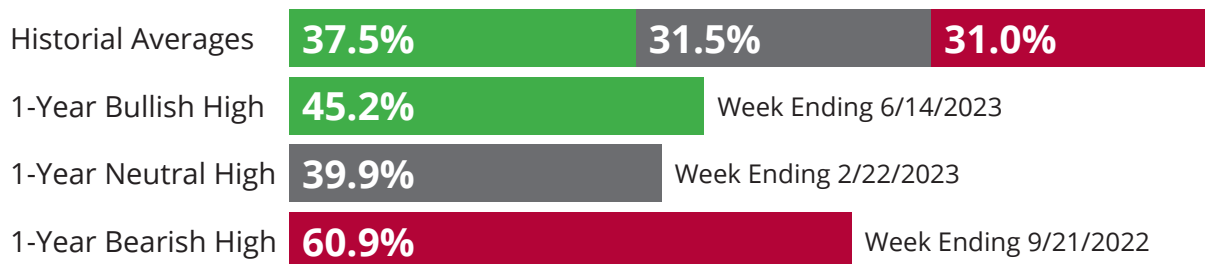
Since its inception in 1987 the AAll Survey has been a useful contrarian indicator. In the past when the survey reaches extreme levels of bullishness or bearishness a change in direction for the market often follows.

Week Ending

■ Bullish ■ Neutral ■ Bearish



Historial View



Source: American Association of Individual Investors

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Interest Rates

This quarter, we held the Interest Rates gauge in the Slow Reverse position to reflect that both the level of interest rates and shape of the yield curve remain a slight headwind for risk assets.

No Change in Position

Key Takeaways

Change in Yields

Short term interest rates have moved higher since March. At the same time, long-term interest rates have returned to the levels they were at during the beginning of the year.

Yield Curve

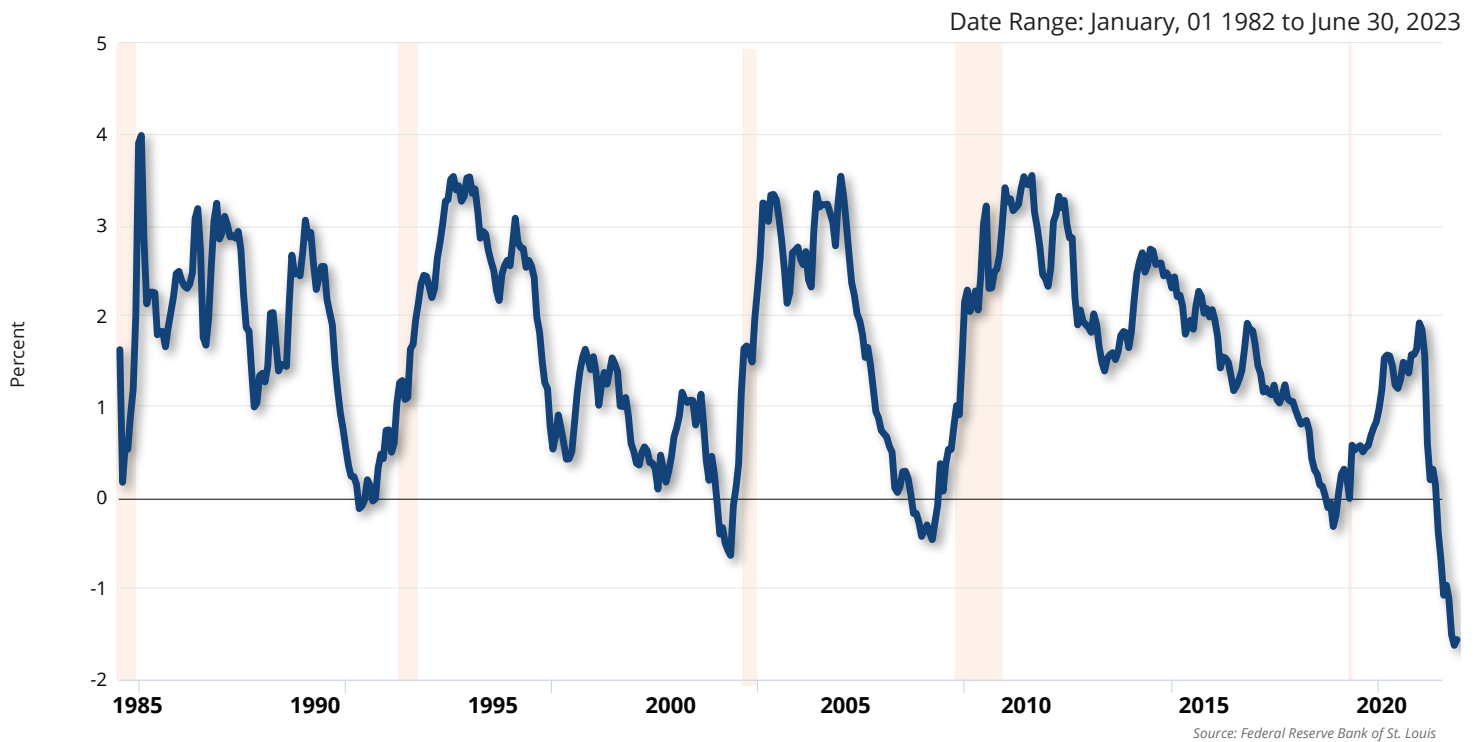
The spread between the 3m and 10yr Treasuries remains inverted. This signal has preceded prior recessions, although it does not indicate the depth or duration of a potential recession.

Interest Rate Volatility

Interest rate volatility, as measured by the MOVE Index, reached levels not seen since October of 2008 in March but retreated in June.

10-Year Treasury Constant Maturity Minus 3-Month Treasury Constant Maturity

The spread between the 3-month and 10-year treasuries has become deeply inverted. This pattern has preceded prior recessions.



Source: Federal Reserve Bank of St. Louis

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The "Economic Gauges" represent the firm's expectations for the market, and how changes in the market will affect the strategy, but are only projections which assume certain economic conditions and industry developments and are subject to change without notice.

The core PCE price index measures the prices paid by consumers for goods and services without the volatility caused by movements in food and energy prices to reveal underlying inflation trends.

The Standard and Poor's 500, or simply the S&P 500, is a stock market index tracking the stock performance of 500 large companies listed on stock exchanges in the United States.

The 3 Month Treasury Bill Rate is the yield received for investing in a government issued treasury security that has a maturity of 3 months.

The 10 Month Treasury Bill Rate is the yield received for investing in a government issued treasury security that has a maturity of 10 months.

The ISM manufacturing index, also known as the purchasing managers' index (PMI), is a monthly indicator of U.S. economic activity based on a survey of purchasing managers at more than 300 manufacturing firms.

The ISM Services PMI provides significant information about factors affecting total output, growth, and inflation.

Earnings per share (EPS) is calculated as a company's profit divided by the outstanding shares of its common stock. The resulting number serves as an indicator of a company's profitability.

The price-to-earnings (P/E) ratio relates a company's share price to its earnings per share.

The GDPNow model forecasts GDP growth by aggregating 13 subcomponents that make up GDP with the chain-weighting methodology used by the U.S. Bureau of Economic Analysis.

The Consumer Price Index (CPI) is a measure of the average change over time in the prices paid by urban consumers for a market basket of consumer goods and services. Indexes are available for the U.S. and various geographic areas.

The Producer Price Index (PPI) program measures the average change over time in the selling prices received by domestic producers for their output.

The MOVE Index measures U.S. interest rate volatility. The index tracks the movement in U.S. Treasury yield volatility implied by current prices of 1-month OTC options. The S&P U.S. Treasury Bond Current 10-Year Index is a one-security index comprising the most recently issued 10-year U.S. Treasury note or bond.

VIX of VIX (or VVIX) is a measure of the volatility of the Chicago Board Options Exchange (CBOE) Volatility Index (VIX). The CBOE's VIX measures the short-term volatility of the S&P 500 indexes, and the VVIX measures the volatility of the price of the VIX. In other words, VVIX is a measure of the volatility of the S&P 500 index and alludes to how quickly market sentiment changes.

Gross domestic product (GDP) is a monetary measure of the market value of all the final goods and services produced and sold in a specific time period by countries.

References to market or composite indices, benchmarks or other measures of relative market performance over a specified period of time (each, an "index") are provided for your information only. Reference to an index does not imply that the portfolio will achieve returns, volatility or other results similar to that index. The composition of the index may not reflect the manner in which a portfolio is constructed in relation to expected or achieved returns, portfolio guidelines, restrictions, sectors, correlations, concentrations, volatility or tracking error targets, all of which are subject to change. Investors cannot invest directly in an index.

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