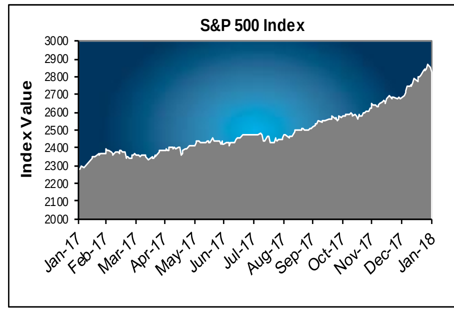
This Month in the Markets

January 2018

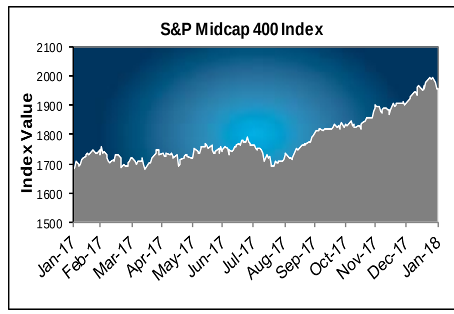
EQUITY COMMENTARY

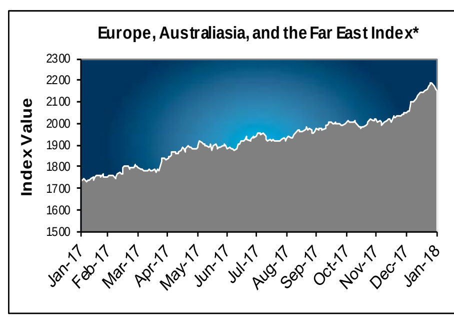
Surge To Start the Year

The equity horse was quick out of the gate this year. It sprinted forward to produce a 3.8% return for developed markets and a 6.8% return for emerging markets. In the developed markets, Europe leads with gains of 6.3%, while Latin America led emerging markets– gaining 13.2%. Inflation pressures coincided with higher yields which hurt the interest rate sensitive Utility sector as a result this was the only sector to decline. Consumer Discretionary was the leading sector, jumping 7.9%, as a solid Christmas season buoyed beaten down mall based retailers. Technology companies also continued to perform well with gains of 7.5% on the back of software and service companies.

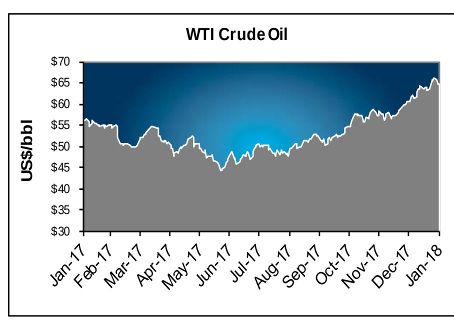


With the large surge in the market we trimmed some positions that have done very well: taking some profits on Alphabet, AbbVie and Facebook. We also booked profits and sold out of our entire positions in Target and Dollar Tree Stores as they hit price targets and our assessment of full intrinsic value – capturing gains of 36% and 60% respectively.[1] Two new positions were added to the portfolio in January: Ahold Delhaize ("AD"), and Dave & Buster's Entertainment ("PLAY"). Food retailer Ahold Delhaize, with about 60% of its business in the U.S., saw its share price beaten down after Amazon announced its purchase of Whole Foods. While we are cognizant of the potential for margin pressure that the entrance of Amazon's into the food space could bring, we deemed the pullback in shares of most food retailers to be an overreaction. At just 12.5 times Enterprise Value to Free Cash flow with double digit earnings growth over the next 5 years, we found shares of Ahold Delhaize too tempting to pass up. PLAY is a leader in the high-margin amusement and sports viewing industry. It boasts a unique dining experience all within a single entertainment destination. The company has 106 locations with the expectation to double this number in the U.S. PLAY shares have pulled back over the past six months on concerns that weaker than expected comps represents a long-term trend. Weather and tough entertainment comparison, due to game launch timing, is muting positive long-term trends. Management has addressed some operational issues and has outlined some exciting initiatives looking forward. Its EV/EBITDA multiple of only ~8 times suggests a great deal of negative news is already priced in.





Weakness in the US dollar and rising inflation pressures have begun to resurface to some degree. This has pushed risk free rates, as measured by U.S treasuries, higher during the month. We believe unanticipated inflation would be a major risk for both the bond market and the equity market. Risk free rates are used in discounting cash flows. All else being equal, rising rates reduce the value of discounted cash flows used in valuing risk assets like equities. We remain mindful of this dynamic and its ultimate effect on implied valuations. Our focus continues to be on finding companies with secular growth drivers and solid balance sheets that are somewhat agnostic to global growth dynamics and as result are less affected by any slowdown that could materialize as a result of higher interest rates.



[1] Gains and losses refer to initial purchase prices and may not correspond to clients that started with Anchor after the position was originally initiated.

*MSCI EAFE Index

FIXED INCOME COMMENTARY

Fixed Income Market Review

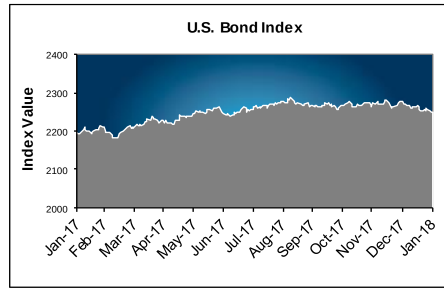
An increase in government bond yields was most noticeable in the U.S. where inflation expectations rose materially and subsequently pushed up Treasury yields. In the Eurozone, strong growth led to a shift in expectations of when the ECB would withdraw monetary stimulus and begin raising rates, which in turn drove the Euro's appreciation versus the U.S. dollar. Indeed, the dollar weakened relative to its main trading partners in January.

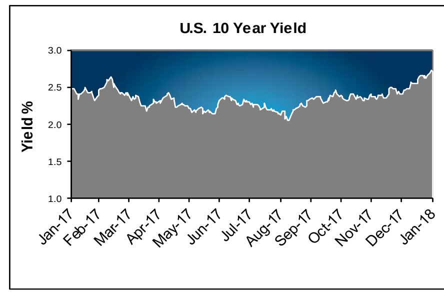
The most noteworthy occurrence in January from the bondholder's point of view was the upwards shift in the Treasury yield curve. The slope of the curve, as measured by the difference between the 2 year and 10 year yields, remains quite flat, however steepened 5 basis points to 0.56% at the end of January. An inverted yield curve is widely considered a precursor to a recession, so we will continue to keep an eye on this dynamic. The Treasury rate increases were slightly larger in the 3 to 10 year part of the curve, where yields rose over +30 basis points for each tenor therein. The strong move was driven by a shift in growth expectations (Trump's tax plan and strong holiday retail sales) and market inflation expectations as indicated by the month-on-month increase in breakeven inflation rates (nominal Treasury yield minus Treasury Inflation Protected Security yield) and forward breakeven rates.

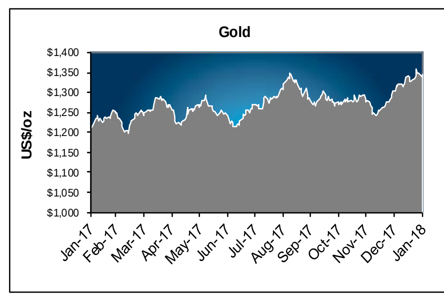
The Phillips Curve posits that there is an inverse relationship between the unemployment rate and the inflation rate, and that at a certain unemployment rate there is an inflection point where inflation rises. If one still believes the Phillips Curve relationship remains intact, then the tighter the labor market gets, the more likely we are to see an increase in inflation. The unemployment rate currently stands at 4.1%, while inflation as per the core personal consumption expenditure (PCE), the Fed's preferred measure of inflation, is currently 1.5%. In December the Fed adjusted its 2018 forecasts made just 3 months prior for the unemployment rate (4.1% to 3.9%) while holding its forecast for core PCE at 1.9%. If we reach an inflection point and inflation rises faster than the Fed expects, then we could see more than the 3 rate hikes suggested by the Fed dot plot median forecast for 2018. This is relevant as markets are essentially pricing in 3 hikes for 2018 (March, June, and September). Thus, any material change in inflation data and/or inflation expectations could potentially move rates.

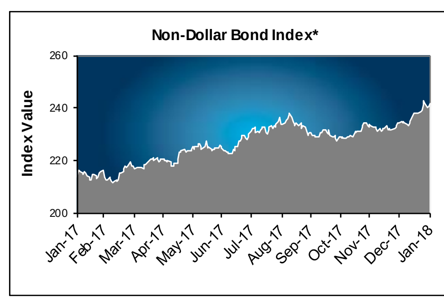
In Janet Yellen's final FOMC meeting as Chair, the Fed Funds rate (range) was left unchanged, while the four regional bank presidents (excluding NY Fed President), who were non-voting members in 2017 rotated to voting members in the January meeting. The dove/hawk dynamic within the FOMC, and most importantly the voting member's composition, is still very much undecided since Trump has not nominated two potential Governors. Given it is an election year, President Trump will want a strong U.S. economy, so we think it is unlikely he nominate hawkish members to the FOMC.

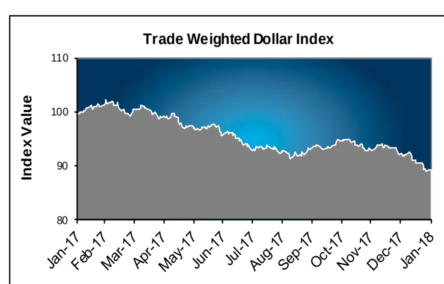
Finally, the bearish USD trend that prevailed in 2017 continued in January as the USD weakened versus its largest trading partner's month-on-month. At the beginning of 2017, investor USD sentiment was bullish which clearly did not materialize as the dollar declined -9.8% per the DXY index. In contrast, there is a USD bearish sentiment at present driven by synchronized growth across the globe, which has outweighed the Fed's tightening monetary stance (interest rates to) relative to other major central banks, most notably the ECB and BOJ. The Anchor team recognizes that currency cycles average seven years and believe that the eight-year bull market in the U.S. dollar that began during the financial crisis has reversed and investors can expect a period of dollar weakening. While U.S. yields remain higher than most developed countries, we have added both Norwegian and Singapore government bonds to the portfolio. We believe that they provide both attractive yields and currency appreciation potential.











*Merrill Lynch Global Broad Market, Ex US Dollar Index

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