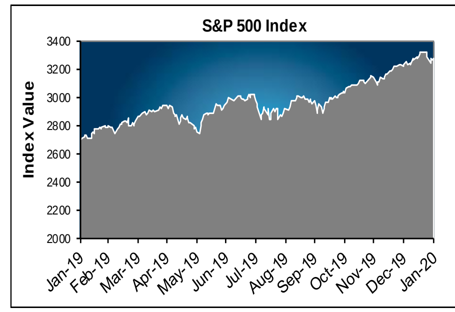
This Month in the Markets

January 2020

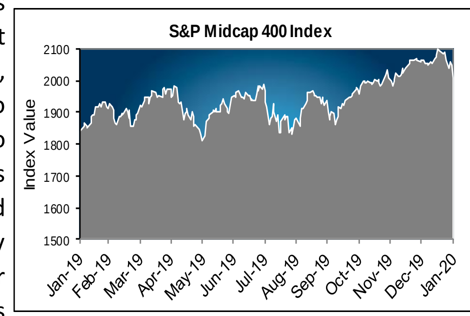
EQUITY COMMENTARY

Coronavirus Infects Markets

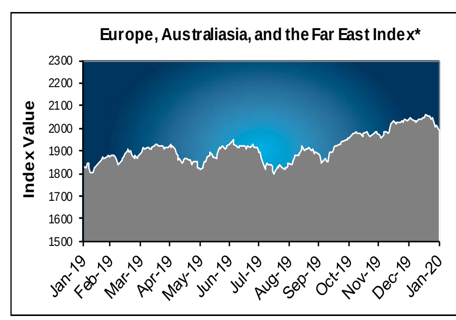
Pandemic concerns caused the equity markets to give back initial gains in January. The MSCI ACWI Index fell 1.1% in the month with the U.S. S&P 500 Index ending flat in the month. International markets, as measured by the MSCI EAFE Net Total Return Index fell by 2.1%, and the MSCI Emerging Markets Net Total Return Index sank 4.7%.



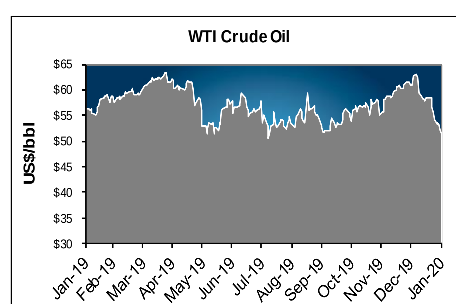
The MSCI ACWI Utility sector was the top sector, rising 4.9% as yields turned lower on global growth concerns. The MSCI ACWI Energy Index was the underperformer – falling nearly 9% with the collapse of commodities, which, as per the Bloomberg Commodity Index, fell 7.5%.



The main culprit for the shift in global growth concerns is the novel Coronavirus that has now become an epidemic with its epicenter in China. While we are not epidemiologists and would never profess to know exactly how this will play out, we do have some opinions on the effect of this outbreak. Although it appears to many that China is aggressively tackling the spread and doing a great deal to contain the virus, it may be too late to avert any dramatic effect on its economy. We believe that measures enacted by the Chinese government and companies within China will have a significant adverse impact on the economy for at least two quarters. As a result, economists are scrambling to lower their GDP estimates for the country and regions most affected. China represents 19.7%* of global GDP based on purchasing power parity and several economists now expect the Coronavirus to reduce Chinese growth by at least 2% this year. The result is likely to be prolonged easy monetary policy from the Chinese central bank, a downshift in earnings for companies levered to global GDP, and pressure on emerging markets in general.



Given this view, we did shift our equity portfolio slightly in January. We sold China Construction Bank Corp. as we feel the downshift in Chinese GDP would directly and adversely affect them. We replaced this with Fifth Third Bancorp, a U.S. regional bank tied to the strength we see in the U.S. economy and not exposed to global growth or regional emerging market weaknesses. We also sold Albermarle Corp after it had rallied 30% since the beginning of December. Lithium and metals demand could weaken with less overall demand from China.



The largest detractor in the Anchor Equity Portfolio this month was TechnipFMC PLC, which slid 23% in the month due to the collapse in crude prices and anticipated lower demand. Salesforce.com was the big winner in January as it climbed 12.1% on street comments suggesting a robust growth in revenue of 20% per year through 2024 and the potential for margin expansion.

- https://www.imf.org/external/datamapper/PPPSH@WEO/OEMDC/ADVEC/WEOWORLD

*MSCI EAFE Index

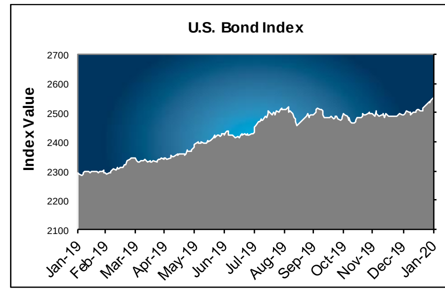
FIXED INCOME COMMENTARY

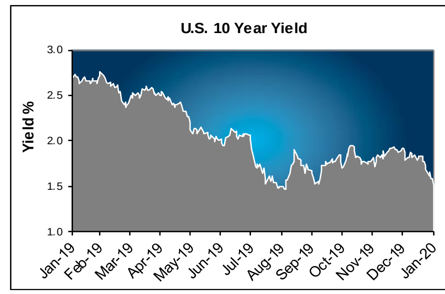
A Tale of Two Halves

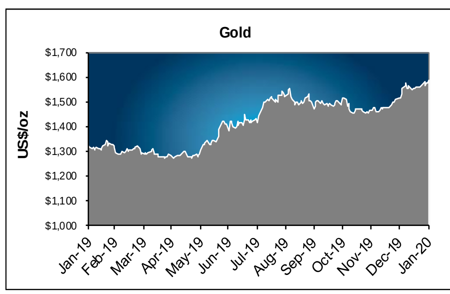
Credit markets started 2020 in the upbeat fashion of which it ended 2019 driven by an optimistic view on global growth given the easing of tensions between the U.S. and China after the signing of the Phase 1 trade deal in December. As such, new issuance was rampant, which was matched by investor demand, and credit spreads tightened from already skimpy levels. The rally in credit spreads was most evident in the lowest rated cohort of the high yield market (CCC-rated). The differential between BB-rated and CCC-rated credit is a barometer we monitor as it gives a sense of investor's appetite for risk. The spread between the two remained elevated in Q4 despite the rally in credit spreads. Notably, this spread ground tighter in early January indicating investors were taking a more sanguine view of the riskiest cohort (in terms of credit and liquidity) of the credit market.

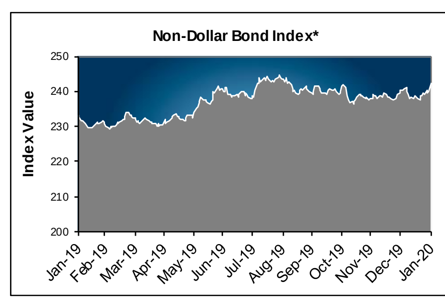
The risk-on sentiment changed quite quickly in mid-January when fears of the Coronavirus escalated. High yield spreads widened in line with the equity market's negative reaction. However, it should be noted investment grade credit spreads were only marginally wider in January. This was reflected in ETF flows in the month, where investment grade ETF's experienced inflows of $23 billion. Meanwhile, the largest high yield ETF had its biggest ever single day outflow in late January. Given BB-rated names are typically more liquid and had rallied in Q4, the sell-off in high yield was led by the higher rated cohort, while the tightening CCC's experienced relative to BB-rated credits in early January remained intact through month end. Given the rally in risk assets in Q4 the market was probably due for a pull-back, though the coronavirus was certainly the catalyst. Despite the pull back, credit spreads generally remain at historically tight levels.

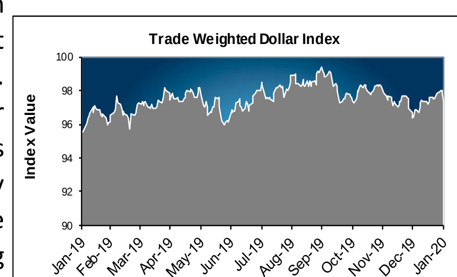
While credit spreads widened marginally, interest rates declined across the globe on coronavirus fears and the potential impact on global growth. The amount of negative yielding debt globally increased by USD-equivalent $2.6 trillion to $13.9 trillion. In the U.S., rates on the long-end and belly of the curve fell approximately 0.40%, outpacing the decline in short-term rates. As such, the yield curve flattened and inverted in places, most notably the 3M–10Y slope - historically a leading indicator of recessions. This is the second time in six months this has occurred. There is a clear dichotomy between the signals being given by the credit market and rates market. Tight credit spreads suggest a sanguine view on credit/liquidity risk, while the collapse in interest rates and shape of the yield curve indicate a far less optimistic view and low growth expectations going forward. We don't point this out to set off alarm bells, but it's worth noting. This dichotomy could remain in place for a sustained period due to the reach for yield prevalent in developed markets around the globe.











*Merrill Lynch Global Broad Market, Ex US Dollar Index

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