This Month in the Markets

February 2018

EQUITY COMMENTARY

Markets Stumble

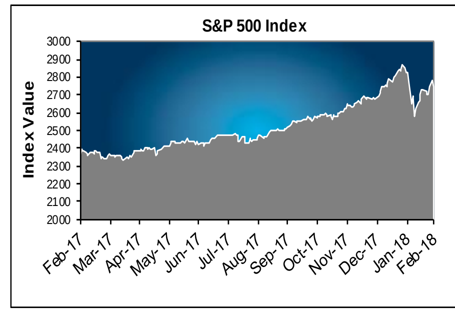
After fifteen consecutive months of equity market gains, volatility finally returned in February. The VIX Index – a measure of volatility often referred to as the "fear gauge" – jumped to levels not seen since 2015. Risk assets sold off sharply but recovered some of the losses by the end of the month. The S&P 500 ended the month down 3.7% and the MSCI World Index shed 4.1%. The United Kingdom was the big loser in the month, with the FTSE 100 losing 6.4% when measured in dollars, as the pound slid 3%. Hawkish commentary from the BOE and Brexit fears pressured the market.

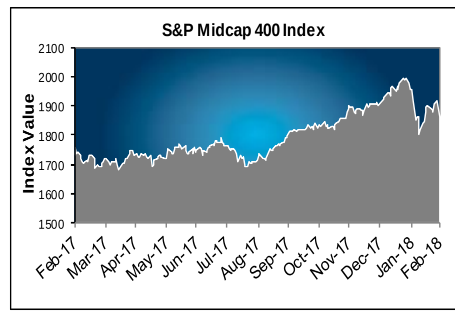
With the continued scarcity of opportunities for true secular trends, growth continued to outperform value in the month – MSCI World Growth Index slid 2.6% while MSCI World Value Index fell 4.4%. The rapid increase in interest rates had a detritus effect on REITS, they were the worst performing asset class or style – FTSE NAREIT All REITs index dropped 7%.

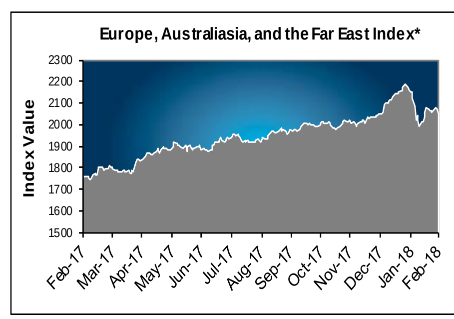
We reshuffled the portfolio slightly in February. We sold our position in Snap-On for a small gain of 1.3%. We were becoming increasingly concerned with the faltering tool division and the escalating receivables and financing balance. We also took advantage of the sell-off to initiate two positions that have been on our radar screen for some time. We replaced Snap-On with Roper technologies. This company, run by Brian Jellison, is likely to be featured in any new addition of the book the "Outsiders" by William Thorndike. "The Outsiders" features legendary CEO's who have an incredible track record of capital allocation, including the likes of John Malone, Henry Singleton and, of course, Warren Buffett. We find Ropers collection of high cash flow, high recurring revenue, and high return on capital businesses attractive and are glad to be joining the ride with Jellison at the helm as he continues to deploy over $7 billion dollars into new attractive and growing businesses. We also bought Naspers during the market selloff as based on our calculations, it was trading at a 40% discount to its net asset value. Naspers is a diversified media company with leading positions in every significant and attractive emerging market. Their investments tend to focus on platform businesses that have high frequency usage and a significant growth outlook. The crown jewel in the portfolio is Tencent. Tencent is a Chinese holding company that dominates many markets in China. It is the owner of WeChat which involves payments, social networking and messaging. WeChat has nearly 1 billion users and is growing at more than 20% per year. It is also the largest video gaming company in the world with revenues estimated to be greater than $12 billion per year. At our purchase price, we essentially paid a discount for Naspers 33% stake in Tencent alone and got the remaining businesses for free. We feel many of these business (including FlipKart which is India's version of Amazon and MakeMyTrip, India's version of Expedia) offer the potential for significant value accretion and very attractive optionality. Overall we are happy being owners of Tencent and a collection of incredible business at a substantial discount.

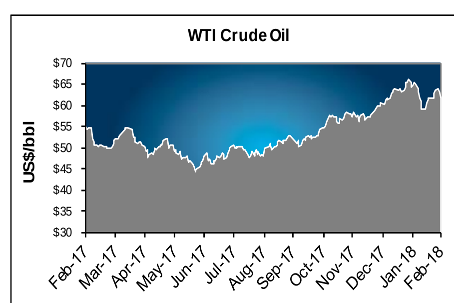
In the Berkshire Hathaway annual letter recently penned by Warren Buffett a few sentences resounded with our thinking and philosophy: "In our search for new stand-alone businesses, the key qualities we seek are durable competitive strengths; able and high-grade management; good returns on the net tangible assets required to operate the business; opportunities for internal growth at attractive returns; and, finally, a sensible purchase price." Sounds familiar and we wonder if Warren has bugged the office. The other quote: "Though markets are generally rational, they occasionally do crazy things. Seizing the opportunities then offered does not require great intelligence, a degree in economics or a familiarity with Wall Street jargon such as alpha and beta. What investors then need instead is an ability to both disregard mob fears or enthusiasms and to focus on a few simple fundamentals." We would like to think we are super smart but we would rather be known for being disciplined and rational.

[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

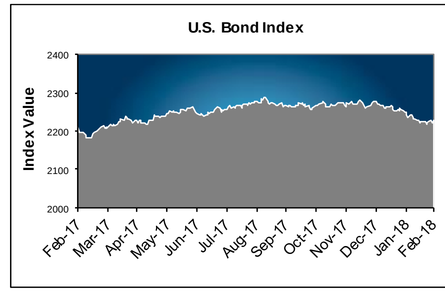
FIXED INCOME COMMENTARY

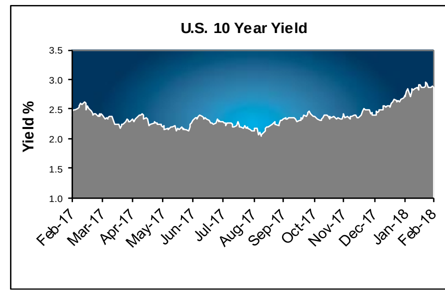
Fixed Income Market Review: The Return of Volatility

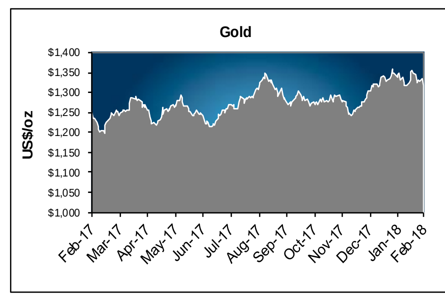
Like January, February was a difficult month for the bond market, characterized by both higher interest rates month-on-month (3Y +12bps, 5Y +12 bps, 7Y +15bps, 10Y +16bps, 30Y +19 bps) and higher interest rate volatility. On February 5th, market sentiment moved sharply into risk-off mode - the US stock markets sharply sold-off, the VIX index spiked, the 5Y Treasury yield fell 15 basis points, the 10Y declined 14 basis points and the Merrill Lynch Option Volatility Estimate (MOVE) index (volatility of 2Y and 5Y Treasury futures options) soared above 70. From February 5th-9th high yield credit spreads widened 50 basis points (not a large move by high yield market standards), driven by large ETF and mutual fund outflows, before tightening the latter half of the month. Meanwhile, investment grade credit spreads only widened ~10 basis points from the risk off episode. Given we are late in the credit cycle and credit spreads are at the tighter-end of the spectrum historically, it was reassuring to see the demand for corporate credit hold-up.

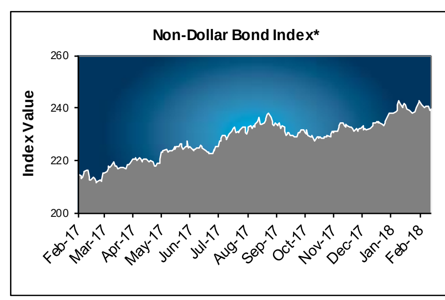
In late February, Fed Governor Powell made his first appearance in testimony to the House Financial Services Committee. The testimony was a focus for investors because in his 6 years as a Fed Governor he hadn't been overly outspoken about his views. As a result, the market hadn't been able to identify him as a dove (proponent of lower interest rates) or a hawk (for higher rates) or place him somewhere along the spectrum between. It was also an opportunity for the market to glean some insight from the Fed Chairman before the FOMC meets (Powell's first as Chairman) on March 21st. In the March meeting each FOMC member will update their December 2017 projections for the expected path of the Fed Funds rate over the next few years. In his testimony, he spoke of the strong economic data since December (and tail-wind of fiscal spending to come), a tight labor market, and encouraging inflation data, all of which will be considered in the soon to be updated FOMC projections. His testimony was viewed by the market as slightly hawkish which was reflected in slightly higher Treasury rates and a stronger USD on the day.

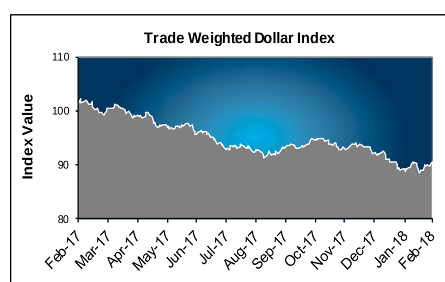
In February the USD clawed back some of its losses from January as the DXY index rose +1.7% month-on-month. The dollar fell -2.3% versus the Japanese yen, however appreciated versus its other major trading partners (EUR -1.8%, GBP -3%, CAD -4%, MXN -1.3%). In periods of heightened volatility and/or "risk-off" episodes the yen tends to appreciate versus the dollar . On the 1st of March President Trump announced tariffs on steel (25%) and aluminum (10%) imports (no other details were released). Whether an all-out trade war occurs remains to be seen (we think and hope not), but it looks to have set the scene for continued volatility at the very least. As such, while we expect the USD to depreciate over the long-run (assuming there isn't a trade war), we have decided to wait before adding to our existing non-USD positions. The greenback should benefit in this time of increased volatility and uncertainty.











*Merrill Lynch Global Broad Market, Ex US Dollar Index

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