This Month in the Markets

April 2018

ANCHOR
Investment Management

EQUITY COMMENTARY

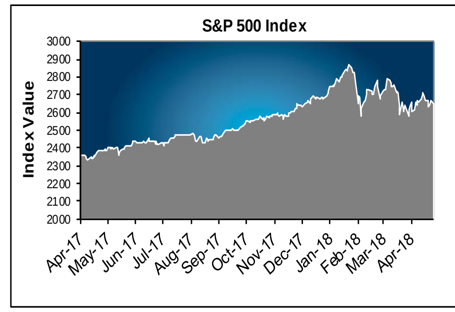
Strong Earnings Season

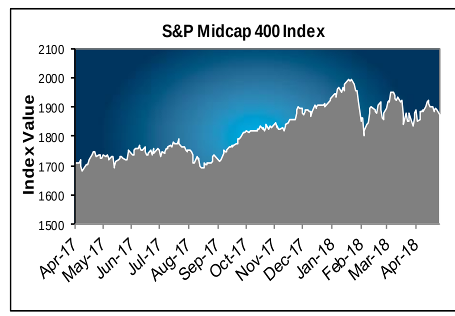
Geopolitical events in April did not help the level of volatility that persisted throughout the first quarter. There were escalating discussions on trade wars between China and the U.S. The Syrian conflict also was brought to a boil over chemical weapons attacks which severely soured U.S./Russian relations. Despite these factors, the MSCI Developed World Index eked out a 1.1% gain in April. The UK market was the strongest developed market, jumping 4.8% in the month, while emerging markets declined 0.4%.

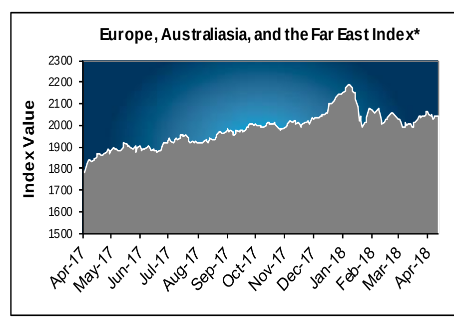
The unrest in the Middle East, including tensions with Iran, put a bid in the price of crude which helped to lift commodities to the best asset class with a gain of 2.4% in the Bloomberg Commodity Index. Crude oil prices continued to rise propelling the energy sector to post the best sector return of the month at +9.4%. Consumer Staples was the worst performing sector declining 2.0%, likely pressured by rising yields and concerns on the viability of some brands in a world of generic competition.

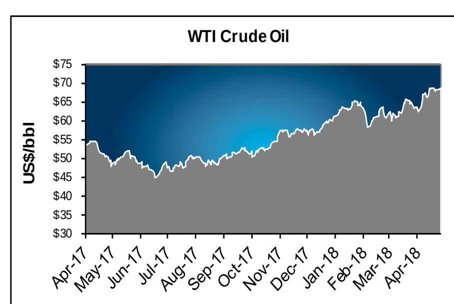
April ushered in the beginning of earnings season. So far earnings momentum has been strong. Sales growth for S&P 500 companies that have reported has clocked in at over 9%, while earnings growth (helped immensely by tax reform) has surged nearly 24%. The aggregate earnings surprise for all companies so far reported is over 6%. Anchor's standard equity portfolio has registered aggregate sales growth this quarter of over 14% and earnings growth more than 25%. It has been a mixed bag on share price reactions. Facebook soared over 9.0% the day after reporting better than expected results and alleviating concerns of mass defection caused by the latest privacy scandal. CVS was the biggest gainer in the month overall, rallying more than 13% as fears on Amazon's encroachment into its line of its business subsided. JM Smucker slid 8% in the month.

We made one change to the equity holdings in April. Anchor has benefited from our over-weight position in internet companies and specifically in Chinese internet companies. While we continue to believe that this industry has plenty of runway left to move higher we recognize that the larger dominant players continue to take market share from the smaller players. For competitive risk reasons we decided to sell our position in MOMO Inc. which modestly reduced our exposure-. We replaced the position with Campbell Soup (CPB). Over the past several years we have been underweight the packaged food and consumer product groups. Valuations for the group had become extended relative to projected growth rates and return on invested capital. Over the past 18 months however, this group has come under significant pressure. Shares of CPB for example dropped from a high of $68 to nearly $40 despite growing very stable earnings by a mid-single digit range. Around the middle of 2016 CPB traded at about 23 times earnings which equates to an earnings yield of just 4.35%. In April we added CPB with a trailing PE ratio of just 13.4 times, which equates to an earnings yield of 7.5%. The significant multiple compression over the past two years has given us an attractive entry point into a strong company with nearly recession proof earnings and a historical mid double-digit return on invested capital.









*MSCI EAFE Index

FIXED INCOME COMMENTARY

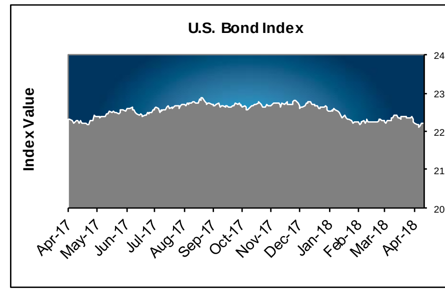
Fixed Income Market Review: Don't Panic

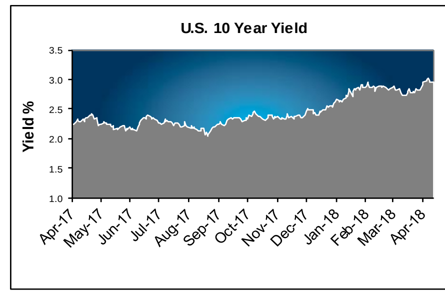
Market participants are always focused on specific index levels that raise concerns or indicate an imminent change in economic activity. Investors preoccupation with fears of rising inflation in the U.S. has made many traders focus on the 10-year Treasury yield breaking through the 3% level. While we are monitoring the impact of the tight U.S. labor market, there remains little evidence of rising inflation pressures. We have stated that U.S. interest rates would slowly normalize over the next two years with improved U.S. economic activity. The yield curve has moved higher in line with Fed Fund increases and recent statements from the Federal Open Market Committee (FOMC) is consistent with this view. To put into a triathlon context, where Flora Duffy is inflation and the rest of the field are the Fed… the rest of the field can't afford to let Flora get too far ahead on the bike leg or they won't be able to reel her in and ultimately lose the race (cause a recession by hiking too quickly). At this time, it appears there are no Flora Duffy's in this race but we will keep an eye for the break.

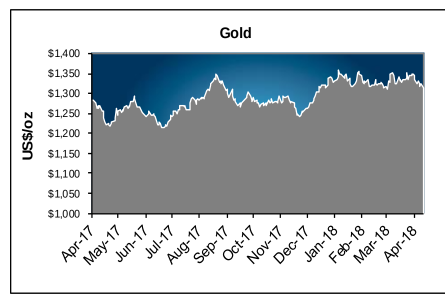
We also continue to believe yield differentials between Treasuries and other G10 sovereign debt will continue to widen, supporting the U.S. dollar. While rising rates are not ideal for bond investors in the short term due to mark to market losses, they should appreciate more normal interest rates after years of below average yields. After widening in February and March, credit spreads tightened in April, led by high yield, offsetting a portion of the negative impact of higher Treasury rates. Performance of the investment grade universe was more muted, driven by a combination of limited spread tightening and the longer duration profile relative to the high yield market. The upbeat U.S. economic environment (especially relative to Europe), strong corporate profit margins, and outlook for a low default rate still signal a supportive environment for corporate credit.

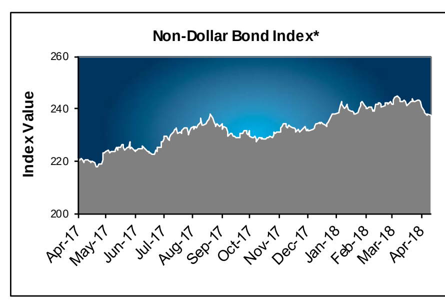
As was the case in February 2018, there was an upward shift in the yield curve in April with both 2 and 10 year Treasury yields rising 22 basis points. Despite the 2Y/10Y part of the Treasury curve steepening marginally mid-month, it ended the month largely unchanged from March-end. The rates move was driven by continued strong U.S. economic data (ISM Manufacturing PMI, durable goods orders), rising inflation expectations as evidenced by break-evens, minimal negative political headlines (muted trade war headlines, North/South Korea to enter peace talks), and sanguine Fed beige book commentary. It is important to note that the April shift in interest rates did not lead to a massive bout of volatility and/or credit spread widening like in February. The volatility in February was driven by market fears of a sudden, unexpected ramp in inflation which would in turn force the Fed to raise rates quicker than expected but cause a recession in the process.

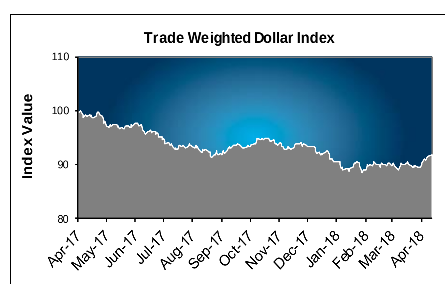
Lastly, on to the US dollar… After depreciating versus its largest trading partners in Q1, the USD strengthened in April against most G10 currencies with the DXY index appreciating 1.4%. Economic data outside of the U.S. has largely disappointed as evidenced by the steep drops in the Citi Economic Surprise indices for Emerging Markets, UK, Japan, and especially the Eurozone, while data in the U.S. has largely met if not exceeded expectations. This along with rising interest rate differentials between the U.S. and the rest of the developed world has led to a stronger demand for the USD. Over the medium to long-term we expect to add to the non-USD exposure, but as outlined in prior months, we will likely hold off in the near term in favor of USD exposure.











*Merrill Lynch Global Broad Market, Ex US Dollar Index

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