

# This Month in the Markets

May 2018



## EQUITY COMMENTARY

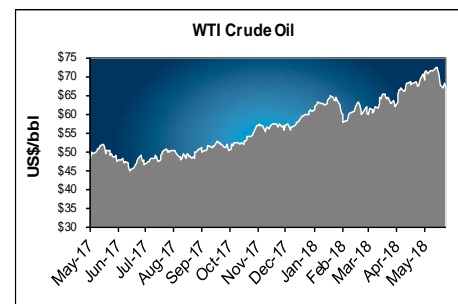
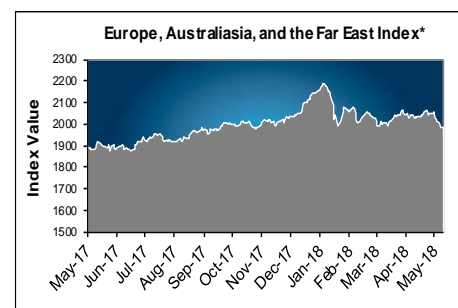
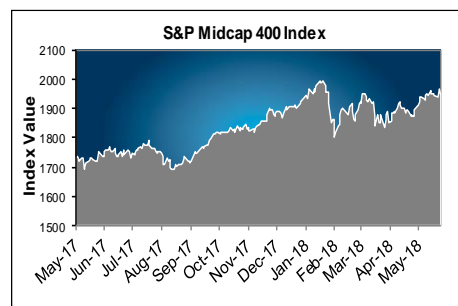
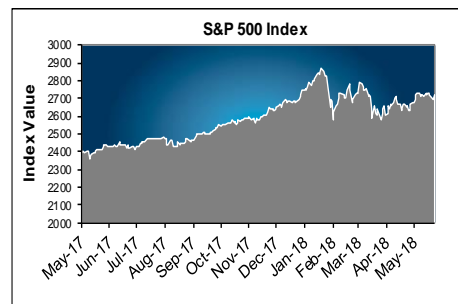
### Geopolitical Volatility Doesn't Halt Market Advance

Geopolitical events in May persisted. This time Europe took center stage with drama revolving around the Italian elections. Despite these factors, the MSCI Developed World Index eked out a 0.6% gain in May. This continues to highlight the complexity of the market and the general good sense to fade most news as inconsequential for longer term investors. The U.S. market posted strong gains jumping 2.4% in the month, EAFE was down 2.2%, while emerging markets declined 3.5%. Much of this had to do with the strength in the U.S. dollar.

The telecommunication industry was the worst performer declining 5.4%, pressured by rising yields and weak earnings reports from various telecom companies. World growth markets beat value, the former rising 2.5% while value fell 1.4%. (Note: we find the nomenclature used and categorization as silly as growing companies can be very valuable...but we digress).

Q1 looks to have been a very strong earnings season. Sales growth for S&P 500 companies that have reported has clocked in at about 8.5%, while earnings growth (helped immensely by tax reform) has surged over 23%. Anchor's standard equity portfolio has registered aggregate sales growth this quarter of over 18% and earnings growth of about 25%. Omega Healthcare was the biggest gainer in the month overall, rallying more than 18% as fears of client defections subsided. Campbell Soup slid 17.5% in the month on concerns about the tariff wars.

We made no changes to the equity holdings in May. It may be a good time to discuss holding periods and the "the long term". Jesse Livermore, famed trader and writer, once quipped: "It was never my thinking that made me my money. It was always my sitting". Compounding is a powerful force and its main driving constituent is time. Many of our holdings have large total addressable markets that allow long runways of growth where they can compound value over time. These holdings are compounders. Their inherent value, for example, may not be that difficult to assess if estimates are near what is expected. Bad quarters will come and go but if our qualitative assessment of the business is correct, the company will persevere and continue to generate long-term value and gains for investors. What is the edge here? What do we know that the market does not? In many cases it is nothing exceptionally different but rather our desire to "sit" and let great management teams in excellent industries execute on plans that offer potential. There are huge swaths of our industry that "needs to make the month" or "has to game the quarter". This market of shorter term catalysts is hugely competitive and intense. Thankfully we do not need to play here. Gains are lumpy and so is alpha. We are happy to capture this over the long term.



\*MSCI EAFE Index

## FIXED INCOME COMMENTARY

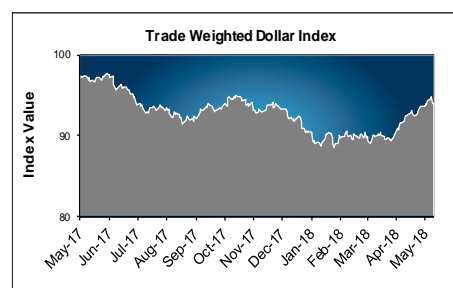
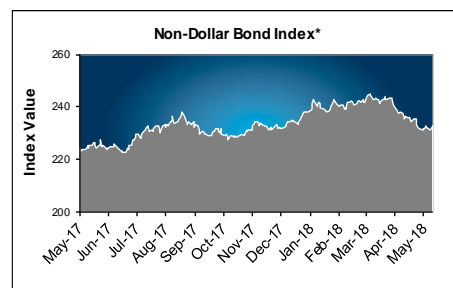
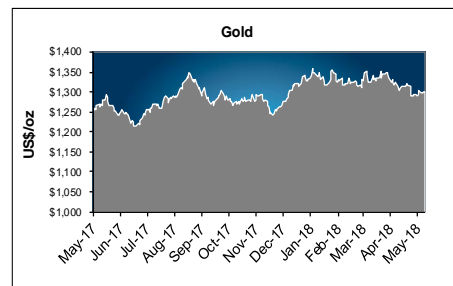
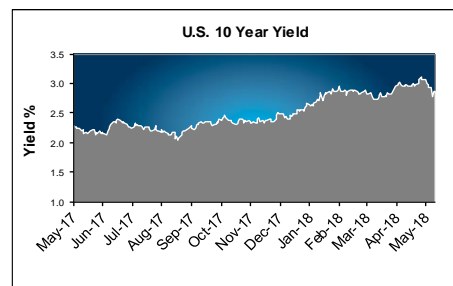
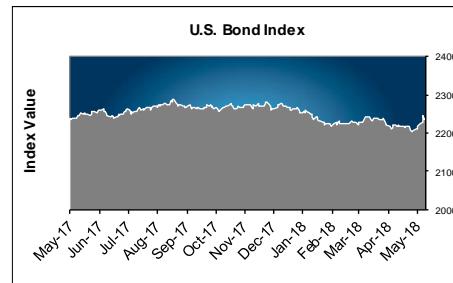
### May 2018 Fixed Income review: Geopolitics to the Fore

Low volatility, higher Treasury rates, and marginally tighter credit spreads aided by continued strong U.S. economic data was the lay of the land for most of May. The fallout from Argentina's currency devaluation in early May and the Turkish President's rhetoric of threatening the Turkish Central Bank's independence in mid-May were largely restricted to the Emerging Markets financial and currency markets. Then on May 29<sup>th</sup> political turmoil engulfed Italy which reverberated across global markets. In addition on the final day of the month, Spain's prime minister was set to face a looming vote of no-confidence stemming from corruption charges of his party (he stepped down as prime minister on June 1). Also, on May 31<sup>st</sup> President Trump announced that the reprieve the US gave the EU, Canada, and Mexico on steel and aluminum tariffs would not be extended (after expiring on June 1). We therefore exited May with geopolitics at the forefront of the headlines and investor's minds...

Of the geopolitical events that occurred in May, the Italian saga impacted global markets the most because it once again called into question Italy's future participation in the Eurozone and by extension the Eurozone's longevity. After the Italian President rejected the proposed coalition government (specifically the Euro-sceptic Paolo Savona as Finance Minister) the populist parties (Five Star Movement and Lega) were outraged and claimed new elections were needed, while at the same time poured cold water on the likelihood of any other proposed government winning a vote of confidence in parliament. Rhetoric from the parties then turned towards the European parliament in Brussels and, for investors, the situation quickly morphed into fears that the next Italian election would essentially become a referendum on whether to stay in the Eurozone rather than national leadership.

This came to a head on May 29<sup>th</sup>. The 2Y Italian government bond yield rose +1.84% in a single day; the interest rate differential between Italian 2Y debt and German bunds rose from +0.52% to +2.45%. Stress reminiscent of the European Sovereign Debt Crisis of 2011. Given the Eurozone is the world's 3<sup>rd</sup> biggest economy in the EU) the possibility of Italy leaving the Eurozone reverberated across markets including a sell-off in emerging markets, wider credit spreads, lower stock prices worldwide, and strong demand for U.S. Treasuries. The upward shift in U.S. interest rates that occurred earlier in the month, on the back of dovish-tilted Fed minutes, was quickly reversed. For example, the 10Y Treasury reached a year-to-date peak of 3.11% on the 17<sup>th</sup> of May before plummeting to 2.78% on May 29<sup>th</sup> (-0.15% on that day alone). Over the following three days the 5 Star Movement and Lega would eventually propose a new cabinet, ironically with Paolo Savona as minister for European Affairs. Italian government bond yields fell and stock markets recovered a portion of the May 29<sup>th</sup> impact. The saga was a stark reminder that geopolitical risks (trade war threats, European politics, North Korea/US meeting) are still very much alive and should be priced as such.

The USD continued to appreciate versus its largest trading partners in May. This was due to a variety of factors including better economic data, wider interest rate differentials in favor of the U.S., and a reversal of USD short positioning (exacerbated by the Italian saga) led the USD to rise +2.3% in May as per the DXY index. Populists are in power in Spain and Italy, Trump's allies are not backing down from his tariff imposition on steel and aluminum, but rather announcing tariffs of their own on U.S. goods. As such, we still believe there is more upside to the USD.



\*Merrill Lynch Global Broad Market, Ex US Dollar Index

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