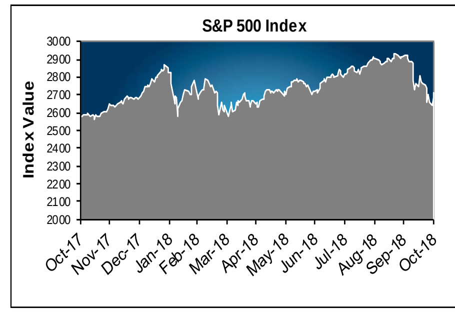
This Month in the Markets

October 2018

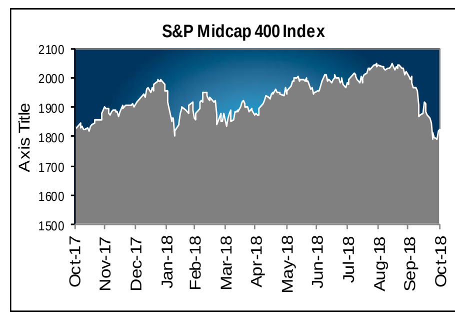
EQUITY COMMENTARY

Market Offers a Halloween Scare

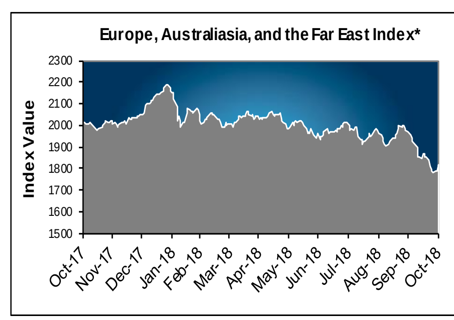
October was a volatile month to say the least. What is often referred to as the "Fear Gauge", the CBOE Volatility Index (VIX Index), spiked to over 25 at one point in the month as trade war fears, Federal reserve rate hike worries and dampening forward guidance led to a selloff in global equities. October was the worst month in seven years for the S&P 500 Index which fell almost 7%. The MSCI World Net Total Return Index slid 7.3% for the month. The fears of a Chinese slowdown on the back of tariffs and trade-war rhetoric pushed the MSCI Emerging Markets Net Total Return Index down by 8.7%. The emerging markets benchmark declined 15.7% in the first 10 months of 2018.



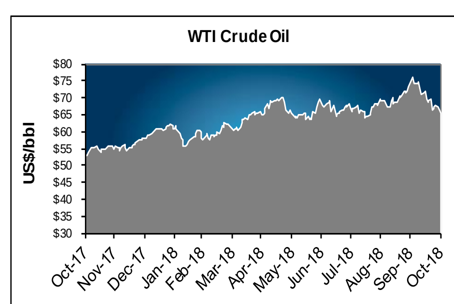
There were no areas to hide as all sectors fell for the month. The industrial sector was the worst performer with the MSCI World Industrial Net Total Return Index dropping over 10% on global trade concerns. It is not a surprise that a defensive group was the top performing sector– the MSCI Utilities Net Total Return Index fell only 0.7%. Value outperformed growth in the month by 400 basis points.



We do not think this is the start of something like a bear market. The economy in the U.S. is still powering forward even if some parts of the world are slowing somewhat. Markets do not tend to have large drawdowns outside of recessions, so we view this latest pullback as a correction and an opportunity to put additional capital to use and take advantage of discounted prices. As we pen this, the market has already bounced nearly 4% from its October lows. (See also the attached letter from the Managing Director).



JM Smucker was the biggest gainer in the portfolio during the month overall, rallying more than 5% on the back of the markets shift to more defensive names. Celgene slid 20% in the month on concerns over biosimilars, but we feel this is overdone and the stock remains compelling value.



During the month we bought a leader in the technology sector. We believe Cisco Systems ("CSCO") will benefit from the global roll out of cloud infrastructure. CSCO's enterprise momentum should be helped with its Catalyst 9K switching gear, increasing strength in security and its longer-term strategy to shift to more recurring revenue and software sales. The company has a solid balance sheet and a free-cash flow yield of over 8%.

*MSCI EAFE Index

FIXED INCOME COMMENTARY

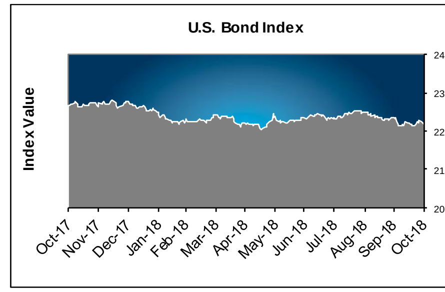
Risk Off

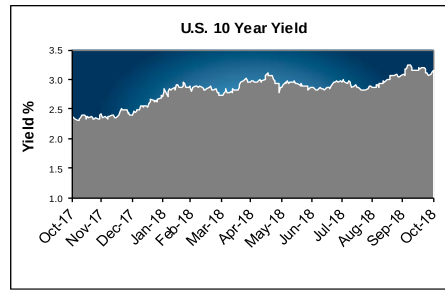
While October was not as lively a month for the fixed income market as it was for equities, it was a difficult period nonetheless. The risk re-rating that crumpled equities filtered into corporate credit via wider credit spreads. This spread widening was most evident in the lower rated tiers of the high yield credit market. Investment grade credit spreads overall experienced only limited widening as there remains significant demand for investment grade credit (BBB-AAA rated). The second largest bond issue of the year, Comcast's $25 billion new issue, was more than 3x oversubscribed. Meanwhile, high yield issuance plummeted in October.

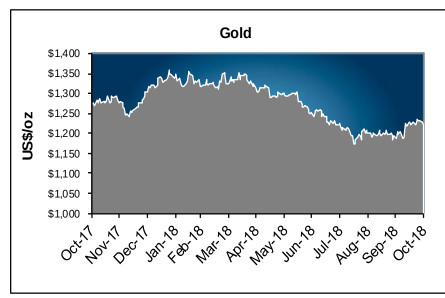
A major theme of the earnings season was the expectation or realization of higher costs and/or higher wages, which will pressure operating margins, and in turn credit metrics. Over the last 10 years there has been an explosion in corporate debt levels – the U.S. corporate credit market (investment grade and high yield bonds) is almost $8 trillion compared to just over $3 trillion in 2008. Most of this growth has come from the investment grade market, and the BBB-rated tier which now accounts for ~50% of investment grade debt compared to ~30% in 2008. Despite the widening in October, credit spreads remain at historically low levels. As we go forward through the latter innings of the current economic expansion (almost 10 years old), the risk of spread widening will likely rise. As such, the Anchor Fixed Income portfolio is holding less corporate credit than it would otherwise; we don't view the risk/reward trade-off as particularly enticing.

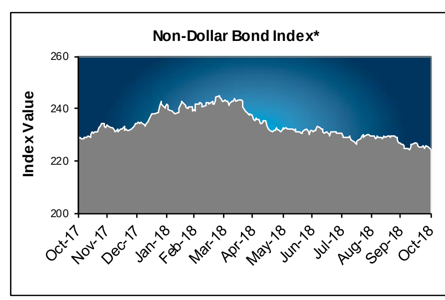
Corporate credit performance was also negatively impacted by higher Treasury rates in October. In early October we added exposure to the 10Y Treasury after the 10Y and 30Y Treasury yields broke out of the trading ranges we spoke of in the previous fixed income market review. Indeed, the 10Y Treasury yield reached a year-to-date high of 3.23%. However, this was before the equity market sell-off which led to a bid for safety and a rally in Treasuries. Nonetheless, relative to September the Treasury curve steepened led by higher rates in the long end of the curve (10Y +8 bps to 3.14%; 30Y +19bps to 3.39%).

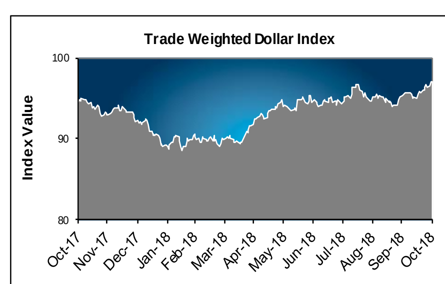
The USD benefitted from the risk-off sentiment that characterized the great majority of October. Going forward USD strength will be heavily influenced by the Fed (interest rate differentials) and the extent of China's stimulus. As evidenced by the weakness in China's recent PMI readings among other data, the economy is slowing and looks set to continue slowing. The combination of moving ahead with its stated goal of cracking down on shadow banking and the impact of the trade war with the U.S. is starting to bite. The Chinese authorities have implemented measures to stimulate the economy including another reserve requirement cut (4th this year) and measures to boost private businesses' access to credit. Just how stimulating these measures (and any future measures) will be remains to be seen, however at present they don't appear to be potent enough to have any meaningful impact for growth outside of China itself.











*Merrill Lynch Global Broad Market, Ex US Dollar Index

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