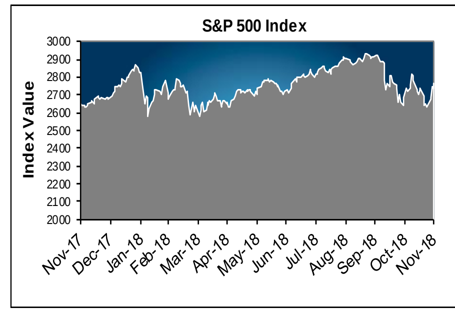
This Month in the Markets

November 2018

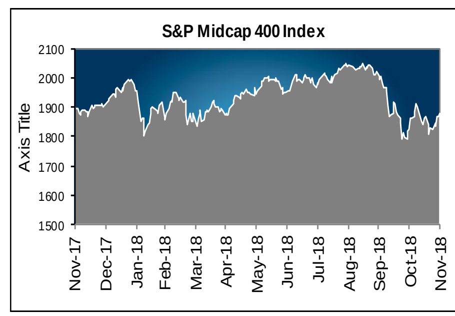
EQUITY COMMENTARY

Trade War & Peace

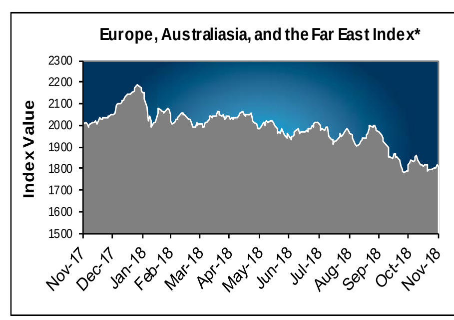
November was another month of heightened volatility. Despite intra-month swings of nearly 5% following the 7.4% decline in October, the MSCI World Net Total Return Index rose 1.1% for the month. The hope for resolution of trade wars and a budding peace sent MSCI Emerging Markets Net Total Return Index up 4.1% during the month. The Bloomberg Commodity Index fell slightly by 0.8% but crude collapsed 22% on a mix of demand and supply imbalance fears. Crude's collapse is likely due to supply side issues, including the surge in US production led by shale, Saudi Arabia's rising production and the Iran sanction exemptions. We would expect the supply side to normalize and the market to return to a supply deficit over the next 6 months. The energy sector was the worst performer with the MSCI World Energy Net Total Return Index dropping over 3% on crude's plunge. The MSCI World Health Care Net Total Return Index rose 5.4%. Value outperformed growth in the month by 90 basis points.



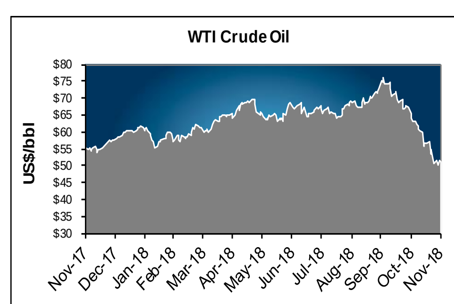
The U.S. elections turned out to be a non-event for the markets with the Republicans retaining the Senate but losing the House of Representatives to the Democrats. Grid-lock is almost assured at this stage with both parties positioning for the 2020 presidential election. The market continues to wrestle with a trifecta of fears: 1) escalation and extension of trade wars and the lack of any definitive resolution, 2) an aggressive Federal Reserve hiking cycle, and 3) slowing growth. The trade tensions were somewhat de-escalated this past weekend at the G20 with the meeting between President Trump and President Xi leading to a possible short-term truce. The U.S. Fed Chairman, Jerome Powell, also gave some less hawkish commentary, but growth fears remain. Across the pond while tensions between the EU and Italy have lessened, Brexit negotiations appear to be heating up with Prime Minister May's withdrawal agreement under fire domestically. Deutsche Bank recently reported that by the end of October, 89% of asset classes have had negative returns in U.S. dollars for 2018.* Macro and geopolitical uncertainty has pressured many asset classes and there has been little benefit to diversification so far this year.



Crown Holdings was the biggest gainer in the portfolio during the month overall, rallying more than 21% on the back of the markets shift to more defensive names and a rebound from what we believe to be oversold conditions. TechnipFMC slid about 11% mainly due to the collapse of energy prices as noted above.



To make room in the portfolio for Dollar Tree (DLTR) we sold shares of Campbell Soup (CPB) whose shares have rallied 7.0% in the third quarter compared to a decline in the market of ~7%. Going forward we believe that DLTR has a more constructive risk/reward outlook. Recent share weakness was primarily due to Family Dollar integration concerns and margin pressures from the trade wars and rising wages. Dollar Tree's management has acted to offset these pressures and we expect profit growth to re-accelerate in 2019. The company has used its scale, global sourcing and buying power to offset most of the tariff issues. Recent store improvements at Family Dollar is turning the store comps positive and lagging stores are being converted to the more profitable Dollar Tree format. The company generates significant free cash flow which it is currently using to transform the FDO stores and grow the Dollar Tree franchise. We believe that this retail category is "Amazon Proof" and we have a forward 12-month fair value for the shares to be $114. *https://www.theglobeandmail.com/investing/markets/inside-the-market/article-looking-back-on-the-year-of-declines/



*MSCI EAFE Index

FIXED INCOME COMMENTARY

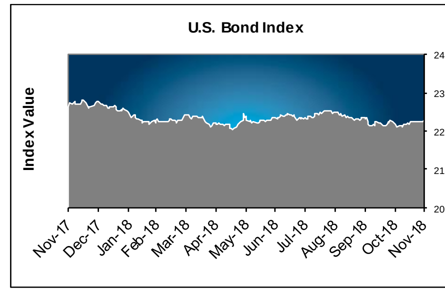
Credit Spreads Like Wildfire

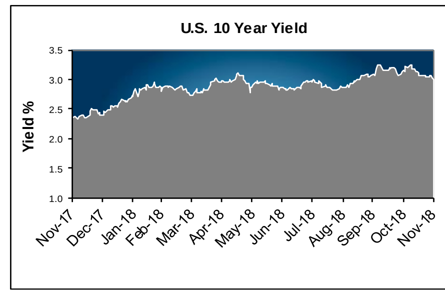
The same factors that negatively impacted equity markets in November filtered through to credit spreads. This was most notable in the CCC-rated index which widened by over 120 basis points compared to 26 basis points of widening in the BB-rated index. Thus, there was marked outperformance of the higher echelon of the high yield market relative to the lowest rated. On a sectoral basis, energy handily underperformed (especially within the high yield market) in November given the steep oil price declines. Note, the Anchor Fixed Income portfolio doesn't own any high yield energy names or CCC-rated securities. As we continue into the latter innings of the economic cycle (almost 10 years old) we expect credit spreads to receive more and more media coverage going forward given the increase in corporate credit outstanding since the global financial crisis (especially in the BBB-rated tier).

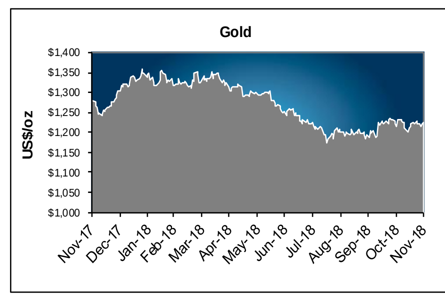
Treasury yields declined in November (2Y: -8 bps, 10Y: -15 bps) and the yield curve flattened, most notably in the short-end of the yield curve. The rates move was partially driven by Fed Chairman Powell's comments in a speech where he indicated the Fed is "just below" neutral in regard to where he saw monetary policy. He had previously suggested that currency policy was a "long way from neutral" in early October 2018, which the market interpreted as fewer rate hikes going forward. Chairman Powell has consistently preached a data dependent approach with regards to rate hikes. With U.S. growth expected to slow from current levels as fiscal stimulus fades in 2019, the market is pricing in one rate hike in 2019 (and no more thereafter) compared to the median Federal Open Market Committee (FOMC) expectation of 3 hikes in 2019 and one in 2020. It should be noted that market expectations for fed rate hikes have been below Fed expectations for numerous years.

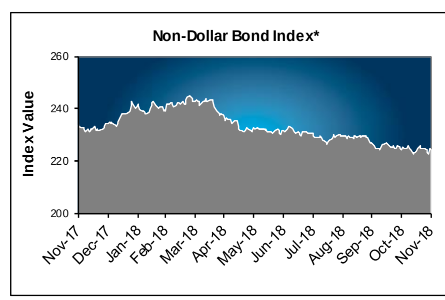
There has been a growing view in the market that inflation will, at the very least, remain well contained in 2019 owing to the fall in oil prices and base effects. Should this come to fruition it could give the Fed the flexibility to pause and/or raise rates by less than their current expectations. The argument for a rate path consistent with the median FOMC member estimates is that the U.S. labor market is very strong with limited slack, which in past instances has led to higher wages and ultimately higher inflation. We're seeing wage growth (with no shortage of empirical evidence from company earning calls), however we have yet to see wage inflation rise meaningfully to the upside.

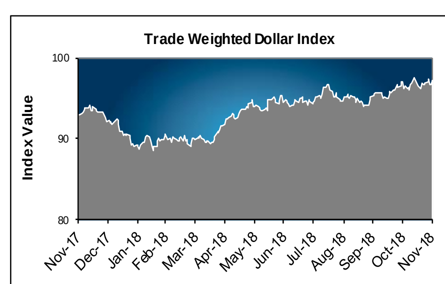
The USD was slightly stronger in November. Given the favorable interest rate and growth rate differentials relative to most of the developed world we continue to favor the USD in the near-term. Lastly a quick word on the U.S.-China tariff reprieve. While at the time of writing the agreement has led to bullish sentiment on risk assets, there remains considerable hurdles to clear (IP property theft for example) to cement a meaningful solution between the world's largest economic powers. While the democrats and republicans don't agree on much, taking a hardline on China's trade practices has the support of both parties… In a world focused on nationalism where trade has become a political hot button, there are no simple solutions in trade talks and we expect that the elevated volatility will continue.











*Merrill Lynch Global Broad Market, Ex US Dollar Index

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