This Month in the Markets

November 2019

EQUITY COMMENTARY

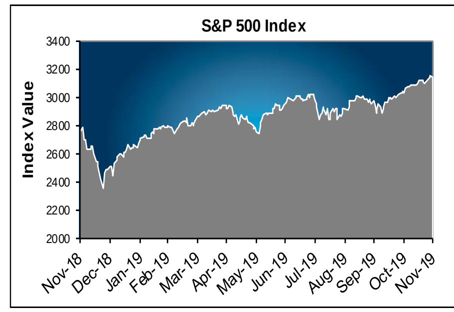
Equities Continue to Rise

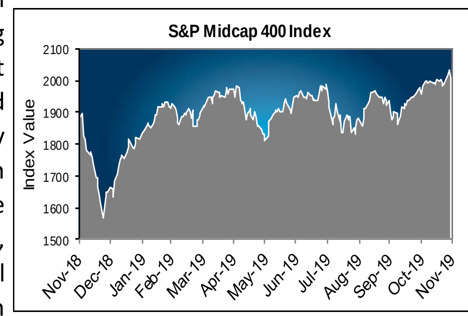
Equity markets marched higher in November. The MSCI World Net Total Return Index rose 2.8% in the month with the U.S. S&P 500 Index posting a positive 3.6% return and setting another all-time high. International markets, as measured by the MSCI EAFE Net Total Return Index advanced by 1.1%. The MSCI Emerging Markets Net Total Return Index ended essentially unchanged.

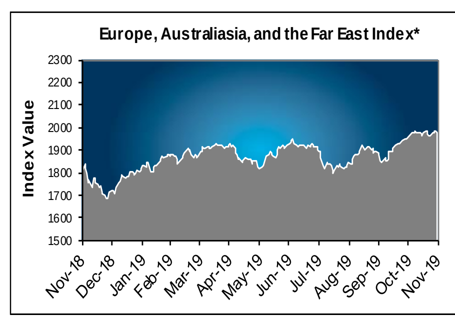
Technology was the top sector, rising 5.3% as trade war fears dissipated somewhat with positive rhetoric. The MSCI Utilities Net Total return index was the underperformer – falling nearly 2% as fixed-income yields rose.

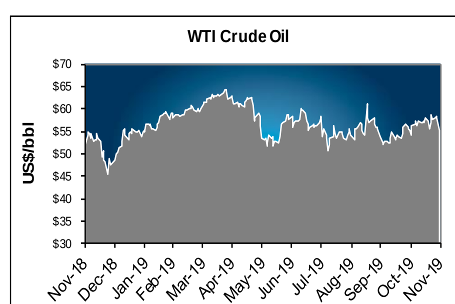
Markets in November, in general, have risen on the prospects of having a trade deal signed before the end of the year and in advance of the December 15th tariff hike. Unfortunately, as at the time of writing, this seems to be shifting toward a less reconciliatory tone. With current news flow suggesting this is not a "done deal" and potential trade spats breaking out with Europe, we would not be surprised to see further volatility over the next month. In prior monthly missives, we wrote: "It has become less clear to us why China would even consider making a deal. If they could create an economic dislocation in advance of Trump's run for reelection, and knowing they subscribe to a "100-year view", it is becoming less of a probability that they will cave to hammering out a deal in advance of November 2020… a recession or economic slow-down dramatically hurts Trump's bid for reelection and therefore increases the odds the Chinese can begin a discussion on the trade front with a less acrimonious adversary post-2020." It now appears this was somewhat prescient, and it looks like negotiations may be stumbling. The US House of Representatives passing the Hong Kong Human Rights and Democracy Act and China threatening retaliation does not bode well for a conclusive deal – even a cease-fire of sorts seems less likely. Our strategy remains unchanged in trying to allocate to higher-quality companies that offer attractive valuations.

The largest detractor in the Anchor Equity Portfolio this month was Dell Technologies Inc. ("DELL"), which fell 8.3% as it lowered its guidance due to an Intel-PC chip shortage. CVS Health Corp. ("CVS") was the big winner in November as it climbed 13.4% on analyst upgrades and a new activist stake from Starboard Value. There was only one change to the portfolio this month, and that was the sale of Skyworks Solutions Inc. ("SWKS"). After rallying over 50% for the year, we chose to take profits as the company reached our target price. We are still positive on 5G, but note that the potential benefit accruing to SWKS seems to be fully reflected in SWKS's stock price, and there was little risk discount given to its exposure to China or its heavy reliance on a new phone from Apple in 2020.





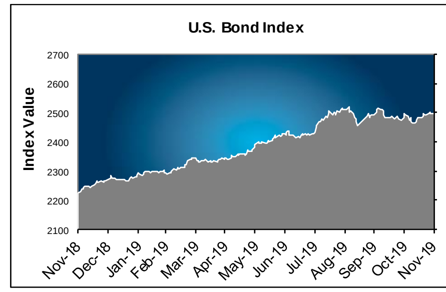


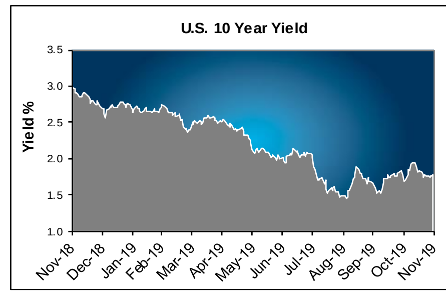


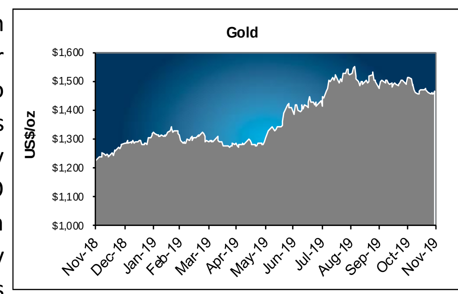
*MSCI EAFE Index

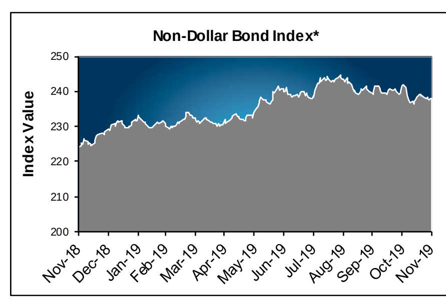
FIXED INCOME COMMENTARY

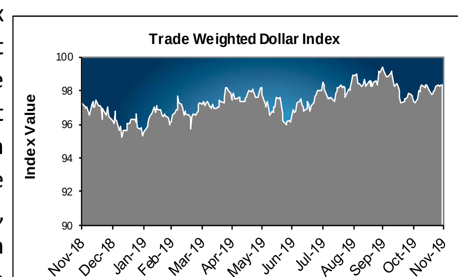
More of the Same in November











*Merrill Lynch Global Broad Market, Ex US Dollar Index

Economic data continues to be resilient in the U.S. The consumer has been supported by low unemployment and contained inflation, while recent housing data has reflected the benefit of the lower interest rates year-on-year (though interest rates were higher month-on-month). A quick word on the Fed - rhetoric has indicated they don't intend to increase/decrease the fed funds rate unless inflation ramps or economic data deteriorates. Year-end 2019 interest rate futures agree with the assessment as indicated by fed fund futures and Eurodollar futures. However, post-2019 there remains a distinct dispersion of short-term interest rate expectations between the market (as indicated by fed fund futures) and Fed expectations.

Credit spreads narrowed in November on investor risk-on sentiment. The high yield spread tightening outstripped the investment-grade market; however it was only the BB-rated and B-rated segments that saw spread tightening. The lowest rated cohort of the high yield market, the CCC-rated segment, underperformed as credit spreads widened. As the longest economic cycle in U.S. history continues, investors have shunned the riskiest cohort of the credit markets. This phenomenon is also playing out in the collateralized loan obligation (CLO) market – essentially a pool of loans that serve as collateral for different tranches of risk and return. CLO's are typically contractually limited to holding a maximum of 7.5% of their collateral in CCC-rated loans. If this limit is breached, the CLO manager must reduce the CCC-rated exposure (hopefully there is a willing buyer) or is forced to restrict payments to investors. The CLO market has doubled since 2010, in line with the growth of the leveraged loan market, which has served as a favored funding avenue for private equity buyouts. As such, the leveraged loan market and credit rating movements therein, have the potential to impact other asset classes and market participants meaningfully.

Lastly, as we enter the last month of 2019, it's interesting to observe how strikingly opposite Q4 2019 has been compared to Q4 2018. Perhaps the starkest difference can be seen from the Fed. In Q4 2018, the Fed was intent on hiking rates in December (which it did - 4th hike of 2018) and signaling further hikes in 2019. Also, the Fed was draining liquidity from the financial system by reducing the size of its balance sheet, known as quantitative tightening. Thus, the Fed was very hawkish. As a result, volatility, as measured by the VIX index rose. The U.S. equity markets were in a downward spiral, and high yield debt issuance fell dramatically (to a complete halt in December). Fast forward to the end of November 2019, and the Fed has cut the fed funds rate in each of the last 4 FOMC meetings. Also, the Fed is increasing the size of its balance sheet again via purchases of T-bills and is offering both over-night and term repurchase facilities. The most recent term repurchase operation, maturing on January 13, 2020, was oversubscribed 1.7x, indicating healthy demand for funding through year-end. Essentially, the Fed has completed a complete 180-degree turn! The effect can be seen in other asset classes. Volatility has been muted, the S&P 500 sits at a near all-time high, and high yield debt issuance has been strong.

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