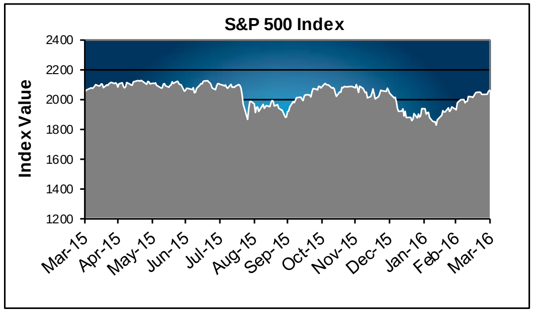
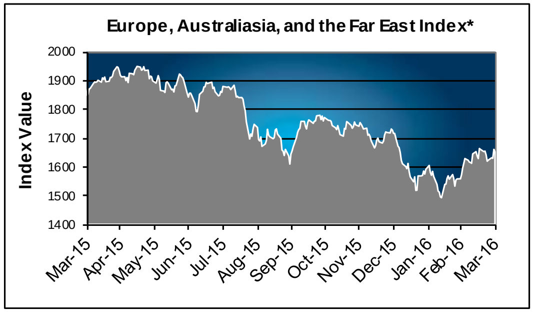
Stock Market Analysis





ANCHOR
Investment Management

Economic Sentiment Improves

The market is built on expectations and investors constantly gauge the risk of meeting those expectations. Uncertainty makes the market risk premium rise and share multiples contract. 2016 began with a flood of negative sentiment driven by plunging energy prices, rising political uncertainty and weakening leading economic indicators. Investors' fears of contagion grew as crude oil prices continued to plunge, falling an additional 23% in the first 12 trading sessions of 2015 after collapsing 35% in 2015. The correlation between the S&P 500 and crude prices has recently hit a multi-year peak, rising to 0.6 (1.0 is perfect correlation). At the same time, U.S. economic data started seeing the impact of the slowdown in the energy sector and the drag from the stronger U.S. dollar. The Citi U.S. Economic Surprise Index fell 12% during the first six weeks of the year. As a result, most major stock indices declined more than 10% over this period.

So what helped the stock market recover most of its losses in the second half of the quarter? Interest rates around the world remain near historical lows and we have consistently stated that the earnings yield adjusted for interest rates remains attractive. Investors will continue to seek higher returns in the equity markets as interest rates remain depressed by sluggish global growth. Secondly, lower energy prices are positive for the global economy as long it does not lead to significant defaults in the energy sector. There had been a growing concern about rising non-performing loans and widening credit spreads in the oil patch. While we are unlikely to see a strong recovery in energy prices, it appears that the supply and demand dynamics in the industry are improving and prices are stabilizing. There will likely be some losses taken in lower grade credit investments and we anticipate further consolidation in the industry but losses for most banks and financial institutions are manageable. Anchor took the opportunity to add to positions in several financial shares in February during the selloff.

The U.S. political "silly season" is also impacting share prices. We are witnessing the usual attacks on "Big Banks" leading to some of the industry's volatility but we believe that the political sentiment against banks cannot get much worse than what investors witnessed following the financial crisis. U.S. banks now have the strongest balance sheets in the world with solid capital ratios. Calls for breaking up large financial institutions will linger and higher capital requirements will cause institutions to shed businesses that produce inadequate returns for their shareholders. Many financial institutions now sell well below tangible book value and we believe they will produce reasonable returns for shareholders.

Hillary Clinton's attacks on the U.S. healthcare industry led to market weakness in the sector. The markets went through a similar impact during Bill Clinton's presidential campaign when Hillary led a similar attack on the sector. The S&P 500 Healthcare Sector Index under-performed the S&P 500 by 27% during the year leading up to Clinton's presidency when he appointed his wife to chair the President's Task Force on National Health Care Reform. The threats against the industry were mute during Clinton's eight year term as the healthcare index rose 312%, more than 100% higher than the S&P 500 Index. The reality is that the U.S. has many of the leading pharmaceutical and biotech companies in the world. While healthcare price inflation remains a concern, demographics favor the healthcare industry as aging baby boomers join the retirement ranks and live longer. Anchor continues to have significant exposure to this sector which we believe has some of the best global growth prospects.

At year-end we discussed how the growth disequilibrium has caused significant market divergence with the S&P 500 Index out-performing other major international indices over the past five years. We believe that many regions of the world are having a difficult time adapting to the "New Economy". While the U.S. economy sputtered at the beginning of 2016, it appears that U.S. economic growth will remain more resilient than traditional industrial models despite slowing global growth. The S&P 500 Index out-performed the MSCI EAFE Index by 3% in the quarter, with European, Japanese and Hong Kong shares lagging. While stock investors face challenges in 2016, low inflation, energy prices and interest rates, along with a more stable dollar, should help corporate profitability. We believe the free cash flow and earnings yields of the shares in the Anchor portfolio should continue to provide our investors with attractive returns in this low yield environment.

MSCIEAFE Index   All stock index returns are adjusted for 30 percent foreign withholding tax.

Fixed Income Analysis

Merrill Lynch Fixed Income Indices Name	Code	Yield to Worst	Yield to Maturity	Modified Duration To Worst	Macaulay Duration (Years)	Maturity WAL (Years)	Period Total Return* Quarter	1 Year	3 Years	5 Years
Global Bond	GBMI	1.3%	1.4%	6.9	6.9	8.5	5.7%	4.6%	1.1%	2.0%
Non-USD Bond	GBXD	0.6%	0.6%	7.9	8.0	9.5	8.4%	7.2%	-0.2%	0.5%
US Corporate/Govt	B0A0	2.1%	2.1%	6.4	6.5	8.7	3.5%	1.9%	2.5%	4.1%
US Government	G0Q0	1.3%	1.3%	6.3	6.3	8.0	3.3%	2.4%	2.3%	3.7%
US Corporate	C0A0	3.2%	3.2%	6.9	7.0	10.3	3.9%	1.0%	3.0%	5.2%
US High Yield	H0A0	8.4%	8.6%	4.1	4.8	6.3	3.2%	-4.0%	1.8%	4.7%
US Hybrid Preferred	P0H0	5.2%	6.2%	8.0	14.1	102.3	2.1%	7.1%	6.5%	6.4%

*3 and 5 year returns are compounded annualized returns

More Negative Rates

Bond indices enjoyed a robust rally in the first quarter of 2016, with government bonds returning 3.3%, preferred securities advancing 2.1% and investment-grade and high-yield bonds appreciating by 3.9% and 3.2%, respectively. At the beginning of the year, the broad based sell-off in the commodity space led to increased deflation and recession fears which resulted in a strong bid for fixed income securities. Government bonds also benefited from concerns around capital adequacy of European banks and the tragic bombings in Brussels. Corporate bonds were the outperformers during the quarter after commodity prices bounced back, the European Central Bank (ECB) and the Bank of Japan (BOJ) loosened their monetary policies further, and the Federal Reserve (Fed) took a surprisingly dovish stance. The consequent improvement in investor sentiment, lower recession concerns and interest rate expectations weighed on the U.S. dollar. The greenback lost 4.1% during the quarter. The worst performing G10 currency was the British pound with a quarterly drop of 2.6% versus the U.S. dollar due to the upcoming vote on Great Britain's membership in the European Union.

A study by Bank of America calculated that since the financial crisis in 2008, central banks had cut rates 637 times and purchased $12.3 trillion of assets. It also estimated that nearly half a billion people now live in countries where short-term interest rates are negative. While rates in developed economies can hardly be cut much further, negative interest rates are a sign of the current economic times and likely to remain for years to come – especially in the Eurozone and Japan. The U.S. economy has remained the outstanding performer despite moderate growth and a sideways trending debt-to-GDP ratio. Consumer spending has been robust and should stay supported from lower energy prices and an improving employment market. The service industry is enjoying an upswing while manufacturing is more or less in a recession. The strong dollar and the weak global economic environment are weighing on the U.S. export sector. After the rate hike in December of last year, the Fed has acknowledged the negative effects of subpar global growth, currency devaluations and disinflation on the U.S. economy and issued a fairly dovish statement. The prospects for interest rate hikes were cut from four to two this year and its forecast for inflation was reduced materially as well. Even two rate hikes may be difficult to achieve in 2016 since much will depend on the direction of commodities prices, the stabilization in emerging markets and the growth prospects of other developed economies. Every time the Fed takes on a more hawkish stance with the intention to hike its target rate, the U.S. dollar's appreciation results in monetary tightening. At a time where interest rates are negative in the Eurozone and Japan, each small rate hike in the U.S. will increase the value of the greenback and require less monetary tightening from higher interest rates. The Anchor managers continue to expect somewhat higher long-term interest rates in the U.S. over a cyclical horizon but any rise can be used to add to duration. Since it is expected that interest rates in other developed economies will remain extremely low until the end of the decade, this will also anchor the yields of U.S. Treasury securities which are in any case already attractive on a relative value basis.

Based on our calculations, the U.S. dollar has become one of the most expensive currencies. Nevertheless, the outlook for growth, inflation and interest rate differentials still favors the U.S. currency. The BOJ surprised the market with its first ever cut of its target rate into negative territory and the ECB reduced its deposit rate further to -0.4%. The latter is essentially subsidizing European banks which are getting paid to borrow funds from the central bank at a level as low as the deposit rate. While this setup should slightly improve European banks' earnings potential and provide more stability in the financial sector, it may weigh on the euro as long as rates remain negative. In regards to other currency pairs, emerging market exchange rates bounced off their lows due to the rebound in the commodities space. However, the necessary adjustments from overspending and misallocation of resources from past years in those economies have not been completed. Consequently, emerging market currencies will remain volatile with a depreciation bias. Anchor's strategy continues to overweight the U.S. dollar in the fixed income portfolios.