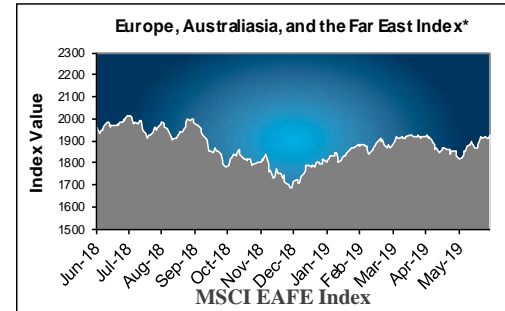
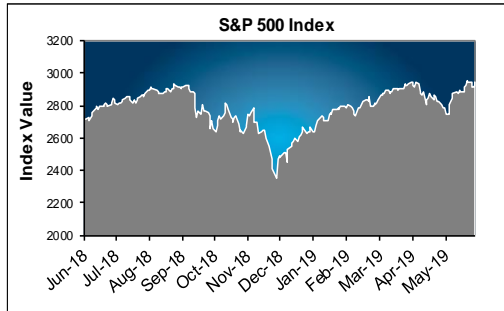


Stock Market Analysis

Stocks Move Higher Despite Political Crosscurrents



Global share prices continued to rally in the second quarter despite political crosscurrents. Stocks benefited from the U.S. Federal Reserve's more accommodative stance and the 1.2% decline in the 10-year Treasury yield since November. The sudden change in stance at the Fed reduced fears that higher interest rates would stall the 10-year economic expansion. **The MSCI Developed Market Index returned 3.9% in the second quarter and 16.5% in the first half of the year.** The gains were driven by strength in U.S. shares while Asian and emerging market stocks lagged due to trade concerns.

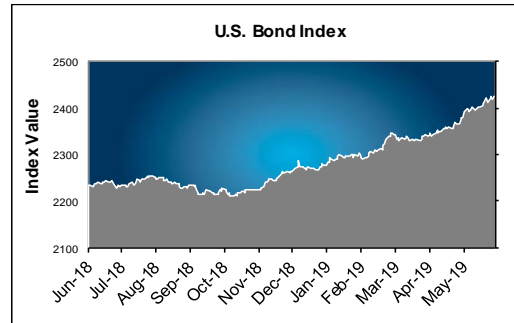
It is a challenging investment environment due to increasing geopolitical risks and the disruption to free markets and security markets. Trade wars, Brexit, Middle East tensions and increased populism are impacting risk premiums. It is becoming increasingly difficult to model companies' long-term expectations and projected cash flows which determine their share values, especially when one "Tweet" can impact these expectations. Due to this uncertainty investors sold economically sensitive stocks and focused on growth stocks. The trend to growth from value has caused significant divergence in share performance with the S&P Growth Index returning 32.8% over the past two years while the S&P Value Index has produced less than half this return. This difference will narrow when investors gain more clarity on long-term economic trends and the China/U.S. trade truce may spark the reversal.

The trade war rhetoric has caused many global investment managers to shift their focus away from China. While this may have been prudent in the short-term, we believe that there are investment opportunities in the second largest global economy. Chinese manufacturers will be challenged due to rising labor costs but domestic consumption growth is higher than other developed economies and we are focused on those companies benefiting from this growth (Alibaba, Naspers (Tencent), China Construction Bank and China Mobile). The valuation difference between these companies and their developed market peers are compelling.

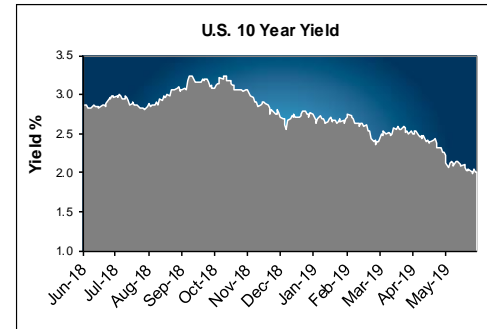
The U.S. Presidential election is heating up and the Democrats and the Republicans have very different visions for the largest global economy. The Democratic debates focused on universal healthcare, reversing the Trump tax cuts, higher wealth taxes, new regulations on the tech giants and immigration reform. While platforms can change, it appears that both parties are focused on reducing elevated healthcare costs in the U.S. This is a global theme with an aging population and a larger burden on workers to cover retirees. The power of scale became evident when AbbVie surprised the market by announcing the purchase of Botox maker, Allergan. The AbbVie shares initially sold off after the announcement and we elected to average down on the position. We believe the combined entity which will be the fifth largest global pharmaceutical company is significantly under-valued compared to its peers. While AbbVie's blockbuster drug, Humira, will lose exclusivity with biosimilars entering the U.S. market in 2023, the company is using the strong cash flow from Humira to fund its new drugs pipeline. This pipeline includes cancer and arthritis therapies. Allergan is well known for its anti-aging products, including Botox and Juvéderm, but has grown by acquiring developed products, including gastrointestinal drug Linzess and anti-psychotic treatment Vraylar. The drug maker's eye medication, Restasis, is seeing some new competition but continues to be a big money maker. We assume the new larger combined franchise will have the scale to acquire and develop new drugs offsetting patent expirations. The valuation difference compared to other large cap pharmaceutical stocks is also compelling – the stock offered a dividend yield of ~6% and traded at less than 8 times 2020 standalone earnings. We estimate that the merged company can earn approximately \$11 per share and in a worst-case scenario trade at 8 times earnings or \$88/share.

Fixed Income Analysis

How Low Can You Go?



Merrill Lynch US Corporate & Government Index



U.S. 10 Year Treasury Yield



The credit spread widening that occurred in May on the back of Trump tariff tweets was largely reversed in June. As it happens a U.S-China trade truce was announced on the final weekend in June so the market appears to have made the right call in this regard. Whether this truce will hold is anyone's guess. President Trump has shown his ability to flippantly change his mind at any moment. His motivations towards any lasting truce/deal will likely hinge on what he perceives as his best course of action with regards to the 2020 presidential election. Meanwhile, Premier Xi of China will be wary of appearing weak should he agree to any trade deal. On top of this, further complicating matters, remains the national security aspect (technology). Viewing the situation through a long-term lens, it remains a case of the dominant world power clashing with the rising challenger. Thus, underlying tensions are likely here to stay regardless of whether a trade deal is ultimately reached.

Interest rates fell in June, and in Q2, driven by lower rates in the short-end and belly of the curve which have reacted to dovish Fed rhetoric and slowing U.S. economic data. On this front market expectations for lower interest rates intensified in Q2. At the time of writing fed fund futures are pricing in three 0.25% rate cuts by year-end 2019, compared to just one cut priced in as of the end of Q1. Throughout 2019, treasury rates and futures pricing have noticeably diverged from the Fed's own rate path expectations. In the June Federal Open Market Committee (FOMC) meeting numerous FOMC members revised down their fed funds rate expectations for 2019. No members now expect a rate hike in 2019 compared to YE18 when 11 members expected at least one rate hike for 2019.

While the Fed's interest rate expectations remain far less dovish than the market's, the Fed has clearly turned dovish. While a rate cut is fully priced in by the market for the July FOMC meeting, it will be interesting to see what the Fed does after July if the recently announced trade truce holds or if an actual deal is reached. In the June FOMC meeting Chairman Powell cited the committee's focus on the trade war uncertainty saying, *"It's really trade developments and concerns about global growth that are on our minds."* If this uncertainty were to dissipate and inflation remain at or around current levels (Core CPI 2%), the Fed will have an interesting decision to make. Keep in mind, when the Fed disappointed bond markets in 4Q18 risk assets sold-off sharply (S&P -20%).

Given the decline in U.S. interest rates in 2019, the yield curve differential has fallen versus many developed market peers. Indeed, the real yield differential (adjusted for inflation) has also declined. This is the case with the two foreign currency bonds held in the Anchor Fixed Income portfolio. The Singapore 2Y real yield (adjusted for inflation) is now higher than the U.S. 2Y real yield, while the Norway 2Y real yield is almost flat to the U.S. 2Y real yield. The U.S. real yield differential has declined over 1% versus both countries since YE18. This bodes well for these currencies going forward all else equal. In addition, Norway's central bank is the only hawkish major central bank in the world at present. The Norges Bank raised its benchmark rate in June and is expected to raise it once again by year-end, further aiding the currency.