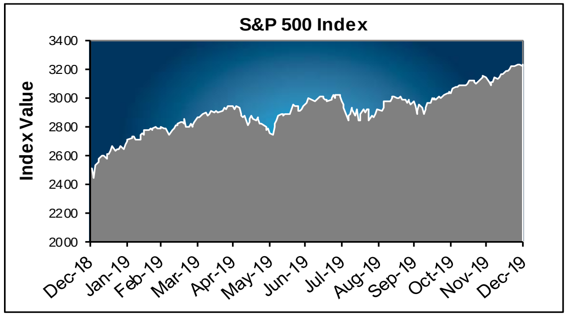
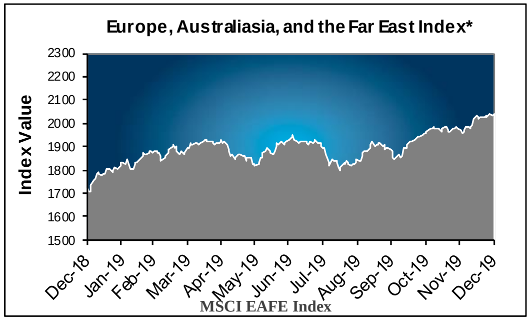
Stock Market Analysis

A Decade of Technological Innovation





MSCI EAFE Index

Stock investors finished a profitable year helped by accommodative central banks and strong growth in the technology sector. While the markets in 1990s were driven by the promise of technology innovation which eventually led to the "Tech Bubble", the 2010's saw a spike in profitability in the tech sector driven by the "FANGAM" shares. Facebook, Amazon, Google (Alphabet), Apple and Microsoft all ascended to join the top ten largest companies in America. While Netflix did not reach the top 10 list, it led the price gainers in the S&P 500 rising more than 4000% during the decade. **The MSCI Developed World Net Total Return Index gained 27.7% in 2019, driven by U.S. shares with a 30.7% net return in the S&P 500 Index**. It was the best annual return for the MSCI World Index since 2009. **The MSCI Technology Sector was the top-performing group with a 47.6% net return**. High-quality income strategies significantly out-performed bond indices but did not keep pace with growth stocks. **The SG Global Quality Income Index returned 17.9% after withholding tax.**

The U.S. benchmark led global returns for the decade with an average annualized net return of 12.9%, propelled by a record decade-long U.S. economic expansion. **This compares to an average annualized net return of 9.5% for the MSCI World benchmark.** While these are impressive returns, it followed heavy losses during the 2008 Financial Crisis. To put it in perspective, the MSCI World Index produced higher annualized returns during the decades of the 1980's (18.8%) and 1990's (11.4%) and the S&P 500 Index produced an average 19.3% annual return in the 1950's (the MSCI indices did not exist). Growth stocks significantly outperformed value stocks during the last decade with **the MSCI Technology Sector leading this performance with a 15.5% net average annualized return. The MSCI Energy Sector lagged with only a 1.4% net annualized return.**

Developing markets lagged the developed indices, as the MSCI Emerging Market Net Total Return Index produced a 3.6% net average annualized return during the decade and an 18.4% net return in 2019. The developing market's benchmark led all the other indices in the prior decade which included the "Great Financial Crisis" and "Tech Bubble". The emerging markets index has produced a net annualized return of 7.6% over the last 30 years compared to 6.8% for the MSCI Developed World Index. Non-US developed markets (MSCI EAFE Index) have dragged down this benchmark with only a 4.5% annualized return over this period. This long-term underperformance has led many value investors and strategists to shift their focus outside the United States. We recognize that price is not the only measure that investment managers should focus on. Profit growth, country regulations, sector leadership and capital markets efficiency impact regional performance and the U.S. has demonstrated an advantage in these factors. When one reviews the development of the new service-based economy and innovation, it is apparent that North America has shown leadership in these sectors.

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

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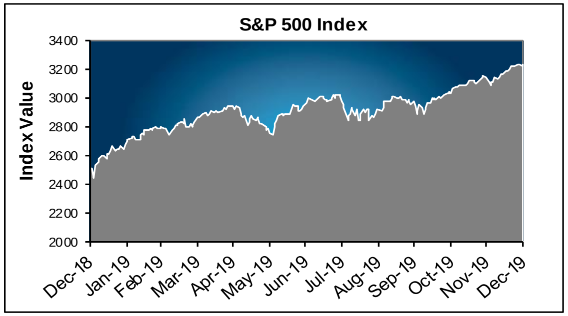

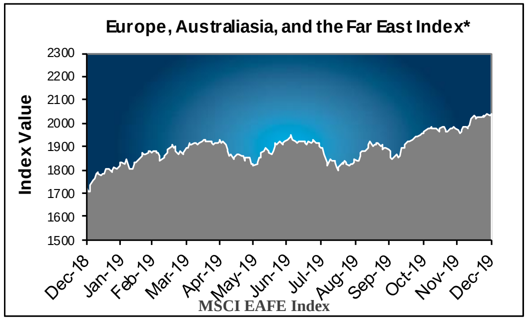

Looking forward to 2020, there is a lot of good news discounted in stock prices. At year-end, investors appeared comfortable that political and economic headwinds have subsided across the globe. There is also consensus that central banks will remain accommodative. After the substantial gains in 2019, the markets would be vulnerable to a change in the optimistic sentiment, as we witnessed at the end of 2018. The rising tensions between Iran and U.S. need to be monitored. The outcome of Brexit and the U.S. elections will impact performance in the short-term, but we believe trade disputes will be a long-term risk for the markets. Open markets have been a significant factor in strong global growth over the past decade and managing global competition is complex and challenging. Regulations and anti-competitive measures won't stimulate a domestic economy. Stagflation becomes a risk if the trade wars and regulatory burdens spread.

We believe that investors should be selective in 2020 and focus on stocks where future earnings and cash flows support their valuations. We also believe that interest rates will slowly normalize over the next five years, and therefore, highly leveraged companies may be vulnerable. Technology is disrupting many industries, including retail, media, communications and finance and therefore, investors need to identify the winners during this disruption. We have benefited from owning the disruptors, Amazon, Alibaba, Facebook and Alphabet. The growing call by politicians to limit their dominance needs to be monitored. The good news is that these companies would likely be worth more if their businesses were separated based on sum-of-the-parts valuation. We also believe there is some value in the laggard energy sector. Our recent purchase of Magellan Midstream Partners (MMP) was based on both strong fundamentals, a stable business model and an attractive yield.

We enter the new decade with some challenges and opportunities. It is impossible to predict when the historic bull market will end, but we need to remind investors how difficult market timing is. The stock market produces positive annual returns 3 out of every 4 years on average. According to a study conducted by Nordea, over the past 80 years, stocks rose 7% on average during the year that followed a 25% or higher return. While one could argue that we are overdue for a correction, returns over the past decade are not abnormally high and 20-year returns are below long-term historic norms. We continue to recommend that investors maintain their long-term asset allocation and understand that market timing can lead to lost opportunities.

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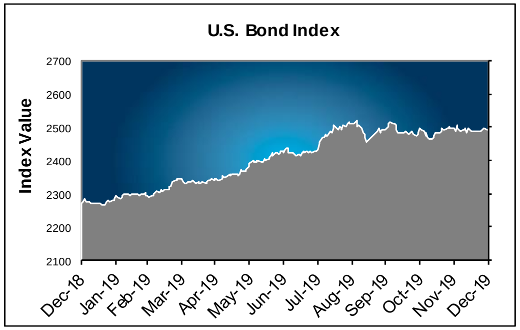
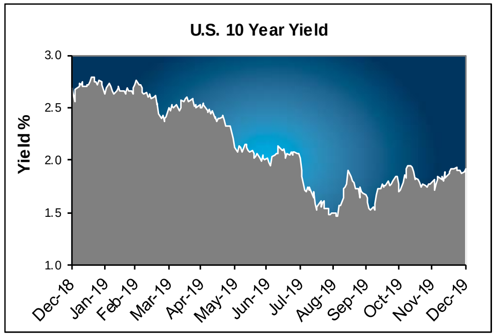
Fixed Income Analysis

Good Year for Bond Investors



Merrill Lynch US Corporate & Government Index



U.S. 10 Year Treasury Yield

The fixed income markets benefited from lower interest rates and tighter credit spreads in 2019, with the ICE BofA U.S. Corporate & Government Index returning 9.8%. Looking back, it is interesting to note just how different it was to the previous year. In 2018, the Fed raised interest rates on four occasions and reduced its support for the rates market by tapering the size of its balance sheet. Thus, the Fed was in a hawkish mode. However, in 2019 the Fed made a complete 180, thereby turning dovish as it cut rates on three occasions and reinstituted balance sheet growth. On top of this, to sooth short-term funding market stress that erupted in September, the Fed instituted a reverse repurchase operation. In December 2018, there wasn't a single high yield new issue – a complete closing of high yield funding markets, virtually unheard of unless in times of severe credit/funding stress. This compares to tens of billions of new issuance funding in December 2019. With regards to the USD, despite the greenback's yield differential advantage shrinking, the USD was largely range-bound in 2019 as measured by the Bloomberg U.S. Dollar Index.

In December, President Donald Trump was impeached. However, the Republicans control the Senate so President Trump is unlikely to lose the presidency and is likely to be acquitted once a trial is completed. Of greater importance to the markets was the reported agreement on a phase one trade deal with China. As such, the tariff escalation that was due to come into effect in mid-December was avoided. The financial markets took the easing of tensions in stride and credit spreads ground tighter. Nowhere was this more apparent than in CCC-rated credit spreads, the riskiest cohort of the high yield universe. As of the end of November CCC-rated credit had noticeably underperformed BB-rated credit (the highest quality cohort of the high yield universe) in 2019. The spread between the two had reached a three-year high, indicating a lack of demand for CCC-rated credits despite the greater relative reward on offer. These gulfs typically don't last for prolonged periods, so either the BB spread will widen or CCC's will tighten. Going forward, gauging this relationship will be instructive as to the risk appetite among credit investors.

Looking forward to 2020 and beyond, it will be difficult to replicate the fixed income returns of 2019. Corporate credit benefitted from a rally in credit spreads and the collapse in U.S. treasury yields. Credit spreads are now at historically tight levels, while Treasury yields are unlikely to fall materially lower unless reacting to economic deterioration (which would be detrimental for credit spreads). In summary, there is far less potential juice to squeeze from the orange. The U.S. is in the longest economic expansion of its history. While the U.S. economy is currently in good shape, buoyed by a strong consumer and job market, the tightness of credit spreads leads us to assume a conservative credit risk exposure position in the Anchor Fixed Income Portfolio.