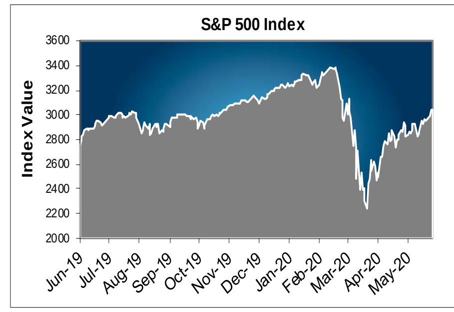
This Month in the Markets

May 2020

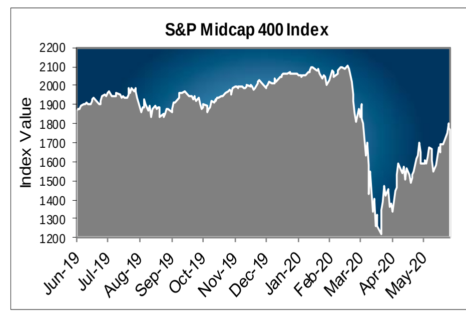
EQUITY COMMENTARY

Growth Has Value

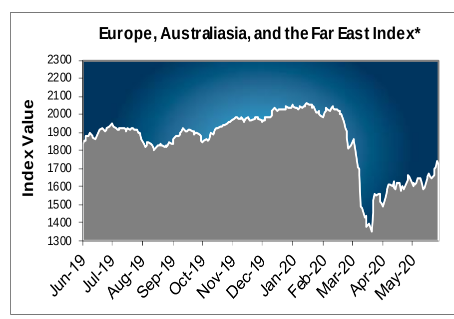
The market continued its recovery through May, albeit at a more moderate pace as investors continue to digest the uncertainty associated with the fallout from COVID-19 and the reawakening of economies. Containment measures do appear to be working and infection rates are trending down in many countries. The economy is likely to be far worse in the second quarter than the first, but investors do appear to be looking forward to a rebound in the third and fourth quarters. Caution is still warranted, however, and we continue to favor higher quality companies with less uncertainty embedded in their cashflows.



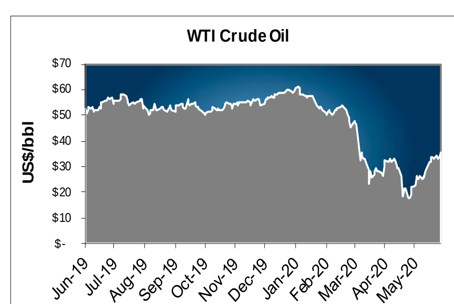
The MSCI ACWI Index rose 4.4% in the month with the U.S. S&P 500 Index climbing 4.8% which is now only about 10% below its February peak. International markets, as measured by the MSCI EAFE Net Total Return Index rose 4.4%, and the MSCI Emerging Markets Net Total Return Index remained largely unchanged with a 0.8% gain. The MSCI ACWI Information Technology sector was the top sector, climbing 6.8% as investors continued purchasing companies that benefit in the Work-From-Home environment and have been little affected by the recent restrictions. The MSCI ACWI Real Estate Index was the underperformer – gaining only 0.5% as investors soured on various commercial and retail REITS. ViacomCBS rebounded over 20% in May with an earnings beat and decent streaming numbers. TechnipFMC PLC, fell about 17% for the month, giving back some of the gains it mustered the month before.



We have taken advantage of the rally to reposition the portfolio slightly and take partial profits on positions that have done extremely well. During the month we trimmed our positions in Amazon, Danaher, Microsoft, Roche and Facebook, with many at prices near multi-year or all-time highs. We deployed some of this cash into positions that have not participated extensively in the rally, but we feel have substantial upside – adding to Manulife Financial and DBS Group.



Much has been written in the last few weeks about the "death of value investing". This is marked by the fact that value (as defined by the Russell 1000 Value Index) has now underperformed growth (as defined by the Russell 1000 Growth Index) since inception of these indices or 1979. This has always struck us as peculiar and only a theoretical discussion amongst practitioners of our craft. For example, does it not make sense to buy a company that is growing profits and cash flows versus one that is declining or stagnant? Isn't growth then a factor of value? In a world of low overall growth or maybe devoid of sustainable quality growth, it would seem reasonable that companies that offer brighter or persistent perceived growth are more valuable. The proposition, in general, for value investing rests along the premise that companies that are cheap are riskier and one needs to be compensated for this. It also postulates that value companies have been unfairly tarnished and once things get "less bad" they will rerate higher – mainly in the form of multiple expansion. Both aspects are not unappealing but lean significantly toward a more trading philosophy – you are buying something, not necessarily because it is a quality company with a strong moat that mitigates risk, but rather because it is temporarily out of favor or deemed less attractive than it once was. The thought being, you will sell once this aberration is rectified. This strategy, of course, can work, but we would prefer to compound capital in companies that have proven to do so and seem in all likelihood to continue to do so because their total addressable markets are large and competitive positions solid. Things for these quality compounders, of course, can change, but we feel more comfortable making selling decisions because a company's prospects are dimming or if valuation is downright egregious. With that being said, price does matter, and the Anchor team continues to search for quality companies that provide our investors with attractive long-term returns.



*MSCI EAFE Index

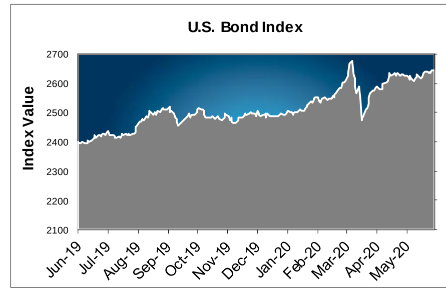
FIXED INCOME COMMENTARY

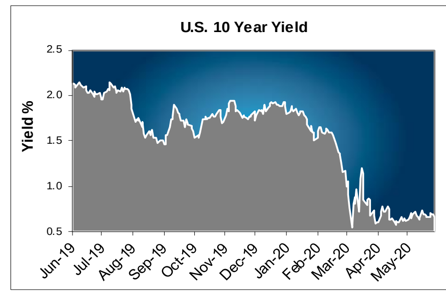
Momentum in May

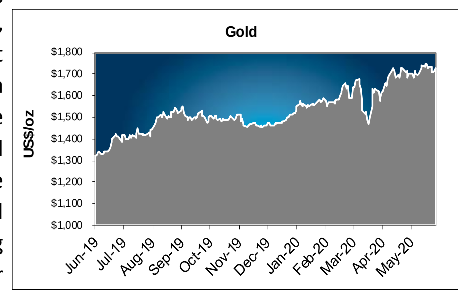
The strong performance of corporate credit that characterized April continued into May. While spread tightening was broad-based, it was led by the lowest rated, most risky cohort (CCC's and B's) and the most damaged sectors (energy & retail). According to Refinitiv Lipper, $25 billion flowed into investment grade funds and $16 billion into high yield bond funds during the month. Year-to-date there has been over $1 trillion of investment grade bond issuance, double last year's pace. New issuance in March and April was largely restricted to investment grade bonds sold at a discount to their existing bonds to entice investors. By the end of May this dynamic had totally switched with new issues pricing in-line or even through existing issues. Several high yield companies have also been able to tap the market. With the Fed supporting the corporate debt market and Treasury yields at historically low levels, we expect demand for corporate credit to remain very strong going forward. Our overweight corporate credit allocation reflects this view.

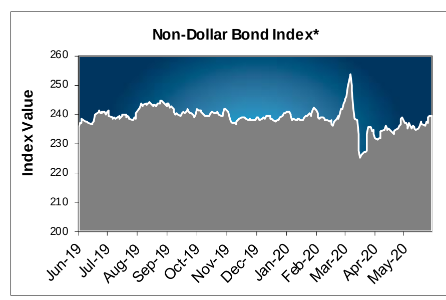
The Fed has increased its balance sheet by approximately $2.5 trillion (a stunning increase!) mainly due to purchases of agency mortgage-backed securities and Treasuries. With the Fed having successfully reduced bond market volatility, markets are trying to get a handle on how the Fed will act going forward. In mid-May Chairman Powell appeared on 60 minutes where he said the Fed is not considering negative interest rates and is confident in its current policy tools (forward guidance, security purchases). Chairman Powell also cited that in a Federal Open Market Committee (FOMC) meeting in late 2019, all of the FOMC members voted against a negative fed funds rate (range), and that evidence of the effectiveness of negative rate policies was at best mixed. Despite Chairman Powell's comments, fed fund futures continue to price in a negative fed funds rate in mid-2021. While negative rates will likely remain a tail risk, the Fed is more likely to employ yield curve control whereby it publicizes a target rate for a certain tenor of the yield curve (or along multiple parts the curve). This tactic has been employed by Japan since September 2016 and was recently adopted by the Reserve Bank of Australia. It appears that the Fed has essentially already employed yield curve control since late March considering rates out to the 10Y tenor of the U.S. treasury curve have traded in a 0.20% bandwidth or so since the Fed announced support measures in late March.

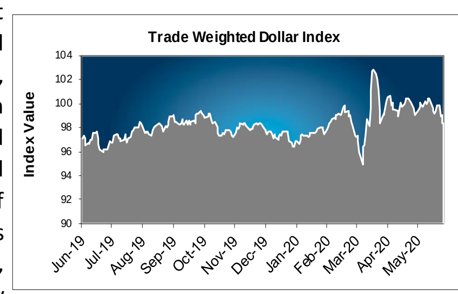
The USD weakened in May, using the U.S. Dollar Index ("DXY") as a proxy. Emerging market currencies, which really took it on the chin in March and April, rebounded. Whether this is a just a dead cat bounce or a move with legs remains to be seen. The NOK also had a very strong month aided by a rising oil price (and lower oil market volatility) and the raising of cash from its sovereign wealth fund acting as tailwinds. Lastly, a quick word on the European Union. In early May, the German High Court questioned the legality of the composition of the ECB's ~€2 trillion sovereign bond purchases. This issue has been bubbling for years, but the news is negative, nonetheless. Since the ruling France and Germany have proposed a €750 billion recovery fund which would be funded by common bonds issued by a newly created European entity. The funds would then be distributed as grants (€500 million) and loans (€250 million) to EU nations. This is significant because it is the first proposal of risk sharing in the EU. The proposal needs to be approved by all EU nations, which is unlikely in its current form due to opposition by the "frugal four" (Austria, Netherlands, Denmark, and Sweden). Thus, there is likely to be a compromise if any deal is to be struck. If it leads to closer EU integration it should be positive on the margin (especially for Italy!), however the devil will be in the details.











*Merrill Lynch Global Broad Market, Ex US Dollar Index

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