This Month in the Markets

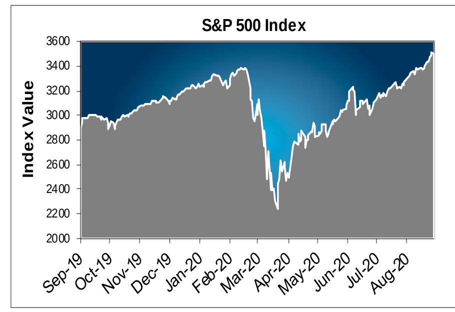
August 2020

ANCHOR
Investment Management

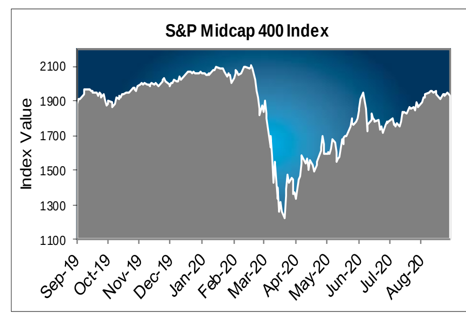
EQUITY COMMENTARY

Tech Powers the Market

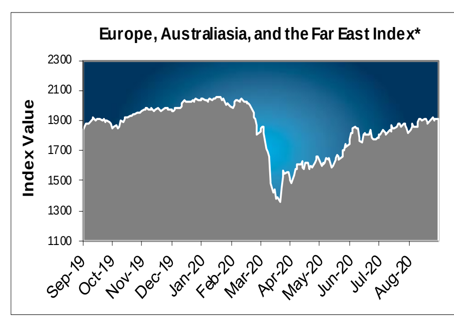
Despite the unrelenting spread of Covid-19, the equity markets continued their march higher in August. High-frequency data on travel, mobility, and employment continue to paint an upward but moderating recovery in the economy. Furthermore, the second-quarter earnings season was promising, with several high-profile companies posting positive earnings and revenue surprises with increasing forward guidance.



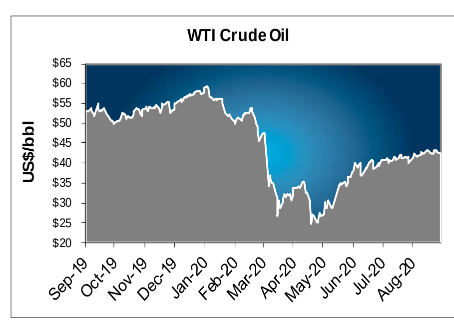
Within this context, equity markets posted one of the best August gains in decades, with the S&P 500 climbing over 7% and the MSCI All-World Index ending 6.2% higher. Both recorded new all-time highs. The MSCI ACWI Consumer Discretionary Index sector was the top sector, rising over 12% as investors embraced the economic recovery and bid up shares of some retailers and home builders. The MSCI ACWI Utilities Index was the underperformer – falling nearly 1.7% due, in part, to the rise in bond yields for the month. Our largest detractor for the month was KDDI Corp, which fell 10% on the threat of increasing mobile competition and pricing pressure. Our best performer for in August was salesforce.com, which soared 40% in August after reporting a blow-out quarter- posting subscription and support revenue growth of 29% year-over-year and signaling continued demand for its business system software in our age of digitization.



One of the most challenging aspects of this recent rally for active managers has been the lack of breadth and the narrowness of leadership within the market. Market capitalization index used for benchmarks have been disproportionately affected by larger company performance – especially within the tech sector. Apple, Microsoft, Amazon, Facebook and Google now comprise 24% of the market capitalization of the S&P 500 Index. Nearly 60% of the gain in the S&P 500 has come from two stocks: Apple and Amazon. Apple is the poster child for this and a stock we do not own. We are not suggesting it is a bad company, but we feel its valuation is excessive based on its business (note: we love the services side of its business, but it is still mostly a smartphone hardware company). Apple in now bigger than more than the 200 smallest stocks in the S&P 500 index combined and about 8% of the entire index. It is bigger than both Facebook and Alphabet put together. It trades at over 40 times earnings with an estimated long-term growth rate of about 8%. Regardless of if your opinion of whether it is expensive or not, its price action will have a major effect on the index. Maybe a better way to illustrate this is to look at what an equal weighting of stocks has done vs. a market cap weighting to get a better sense of how the "average" stock has performed. Over the past 5 years, the S&P 500 Equal Weight Index has returned around 65% while the S&P 500 (market cap weighted) has returned over 100% - a massive difference! This is essentially saying that the biggest stocks have done better than the smaller/average size ones.



Maybe the more difficult issue to grapple with at this point, however, is dealing with the fear of missing out. When it seems like high multiple large stocks trading at insane valuations appear to go up every single day it is more difficult to simply ignore them. Many will question whether they are missing something if they are not in "sync" with a new reality. We would suggest that this often happens. Investment strategies come in and out of favor – value vs. growth, at this point, has underperformed for decades. But rather than getting concerned about this current situation we are getting more excited. When performance gets polarized to a large degree in one sector or one style it creates an environment for outperformance. Our latest add is one such example.



After a challenging first half to 2020, we find Honda to be a compelling economic recovery story, selling at less than eight times next year's earnings and paying an indicated dividend yield of 3.5%. The company has several catalysts, including launching three new models using an efficient common module platform (Civic, Accord, and CR-V). After factory closures due to COVID lockdowns, we see the negative COVID impact dissipating and dealer restocking taking place. Low-interest rates should also help demand and support the profitability of Honda's financial service division. We also anticipate a recovery in the motorcycle division as manufacturing comes back online, and demand remains robust.

*MSCI EAFE Index

Opinions and recommendations in this piece are subject to change without notice. For more information about Anchor Investment Management Ltd. and our services please visit our website at www.anchor.bm or contact us directly at info@anchor.bm or (441) 296-3515.

Licensed to conduct Investment Business by the Bermuda Monetary Authority.

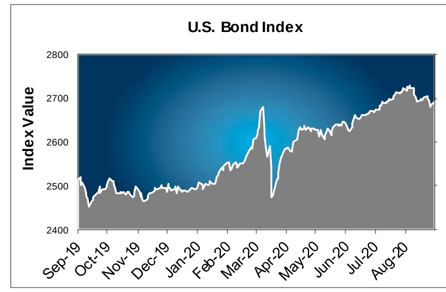
FIXED INCOME COMMENTARY

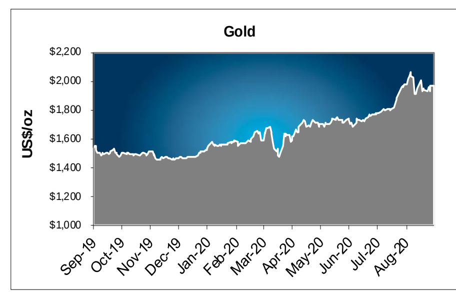
Reeeeeeach for Yield

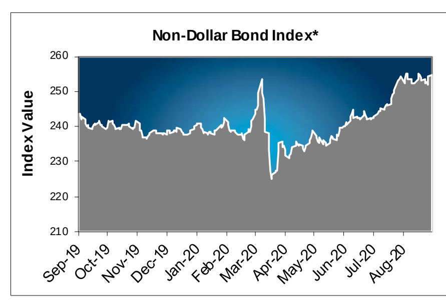
The risk-on environment that characterized Q2 and July continued through August. The USD continue to weaken in during the month, as per the DXY index, though not to the extent we saw in July. August is typically a quiet month in financial markets with many large money fund managers on vacation. However, August 2020 bucked the trend as high yield issuance breached the $50 billion mark, the second-highest ever monthly total. August also ushered in the lowest ever coupon on a high yield bond greater than 5 years to maturity, as Ball Corp issued a ten-year bond with a coupon of only 2.875%. High yield debt is on the riskier end of the corporate credit spectrum, encompassing companies rated BB and below. Demand for corporate credit has been insatiable. The investment-grade corporate bond market has grown by approximately +8% this year to $7.2 trillion, while the high yield market has grown +18% to over $1.4 trillion. Historically low government bond yields and the Fed's backing of (a portion of) the corporate bond market has produced a strong 'reach for yield' environment. Indeed, this can be seen through the lens of corporate credit spreads, where spreads of CCC-rated debt (the riskiest high yield companies) handily outperformed BB's (the highest quality high yield companies) in August. Despite the rally in corporate credit, we continue to view an overweight in this area as a suitable allocation within fixed income portfolios but we are focused on higher quality issues.

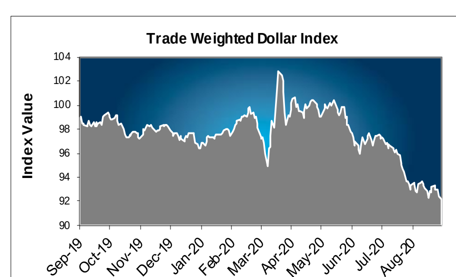
In Fed Chairman Powell's Jackson Hole speech in late August, he gave a general outline of the results of the Fed's inflation and employment framework review, which they had conducted over the last twelve months. He commented that the Federal Open Market Committee (FOMC) would put less emphasis on formulaic approaches (such as the Fisher model) and would target an average inflation rate. This is a shift from a purely forward-looking outlook on inflation, to an approach that takes into consideration past inflation. For example, if inflation is running below the 2% target (as is the case now), they would let it run above 2% for a period before lifting the fed funds rate. The fed fund rate range is currently 0-0.25%. It is our view that the Fed is terrified of deflation and being stuck at the zero bound indefinitely, like the Bank of Japan and possibly the European Central Bank. They are effectively saying that they want inflation to rise meaningfully, so they have an excuse to lift the fed funds rate and give themselves more maneuverability in the next downturn. Given the current economic slack, it points to rates at the front end of the Treasury curve to be well anchored for the foreseeable future. In contrast, long term Treasury rates could rise if the market believes sustained inflation is likely and/or if the economy recovers quicker than currently anticipated. Since plunging in March, gauges of market inflation expectations have risen back to pre-COVID-19 levels; however, a further meaningful rise is unlikely in the near term given the ravaged labor market.

Looking forward, the investment environment is very challenging. In many developed countries, bond yields are negative (Germany, France, Japan, Sweden, and Great Britain to name a few) or even lower than in the U.S. Meanwhile, Treasury rates have stabilized at historically low levels. In addition, central banks across the globe are openly signaling their desire for inflation and, by extension, higher interest rates. While low bond yields alone are no guarantee for generating inflation, governments across the globe have embarked on heavy fiscal spending to offset the devastating consequences of COVID-19 related shutdowns. This combination of extremely low rates and profligate fiscal spending has never been seen before in the 20th century. Will this combination eventually lead to inflation that has eluded central banks since the global financial crisis? This is a difficult prediction to make. There are many moving parts, including demographic shifts, supply chain disruption stemming from the Sino-U.S. trade war, and other unknown factors that will ultimately affect how this plays out. Putting it all together, we are in a "reach for yield" environment that is pushing investors into riskier corporate credit allocations to pick up extra yield, and central banks that are openly saying they want inflation (and higher interest rates). In navigating this environment, it is essential to keep in mind the risk-reward trade-off. Going further out the curve or dipping into the riskiest parts of the credit market to pick up measly extra yield could well prove to be simply "picking up pennies in front of a steamroller."









*Merrill Lynch Global Broad Market, Ex US Dollar Index

Opinions and recommendations in this piece are subject to change without notice. For more information about Anchor Investment Management Ltd. and our services please visit our website at www.anchor.bm or contact us directly at info@anchor.bm or (441) 296-3515.

Licensed to conduct Investment Business by the Bermuda Monetary Authority.

Disclaimer

Disclaimer: This material is not intended to be relied upon as a forecast, research or investment advice, and is not a recommendation, offer or solicitation to buy or sell any securities or to adopt any investment strategy. Past performance is no guarantee of future results. The opinions expressed may change as subsequent conditions vary. The information and opinions contained in this material are derived from proprietary and nonproprietary sources deemed by the authors to be reliable, are not necessarily all-inclusive and are not guaranteed as to accuracy. There is no guarantee that any forecasts made will be correct. Reliance upon information in this material is at the sole discretion of the reader. Investment involves risks. Readers should consult their financial advisors prior to any investment decision. Index performance is shown for illustrative purposes only. You cannot invest directly in an index. Sources may include MSCI, Bloomberg, and S&P Global. Information contain within is private and confidential and for the sole use of clients of Anchor Investment Management Ltd. ("AIM"). AIM respects the intellectual property rights of others. If you see a copyright or trade mark of yours which is being infringed, you may notify AIM at info@anchor.bm. We will contact you to obtain details of your claim.