This Month in the Markets

October 2019

EQUITY COMMENTARY

Equities Rise in the Fall

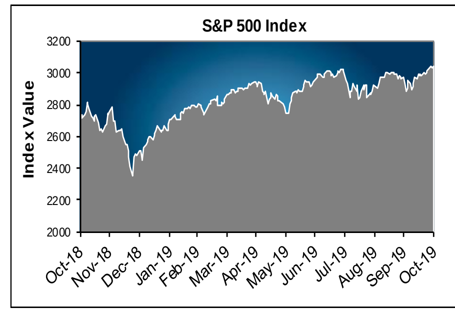
Equity markets posted solid gains in October. The MSCI World Net Total Return Index rose 2.5% in the month with the U.S. S&P 500 Index posting a positive 2.2% return after hitting new all-time highs at the end of the month. International markets, as measured by the MSCI EAFE Net Total Return index, jumped 3.6%. The MSCI Emerging Markets Net Total Return Index led gains with a surge of 4.2% as trade tensions eased on the "Phase One Trade Deal".

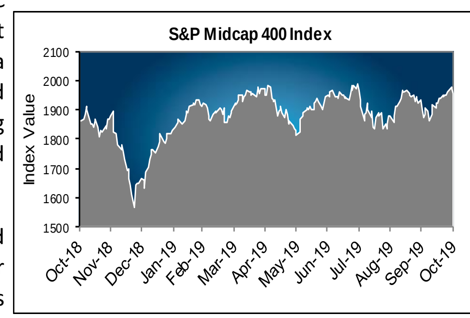
Healthcare was the top sector, rising 5.0% as compressed valuation due to political fears regarding healthcare and drug pricing reversed. The MSCI World Energy Net Total return index continued its weakness on macroeconomic growth concerns and demand fears, sliding 1.6%.

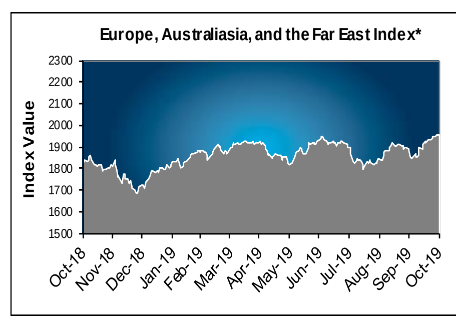
The largest detractor in the Anchor Equity Portfolio this month was TechnipFMC PLC ("FTI") which fell 18.3% as it signaled challenges for its surface and subsea equipment divisions amid slower drilling in North America and a decline in margins for subsea gears. Skyworks Solutions Inc. ("SWKS") was the big winner in October as it climbed 14.9% on analyst upgrades and notes suggesting it will stand to benefit from the rolling out of 5G-enabled handsets in 2020. The resolution of trade disputes with China would also offer significant upside to SWKS.

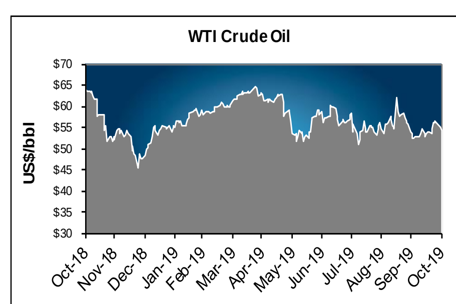
Many are skeptical of this rally given rather anemic economic growth factors, stretched valuations and geopolitical volatility. All this negativity has increased investor skepticism, which we see as healthy since any hint of exuberance or bullishness has been squeezed out of the market. Barron's Magazine published their "Big Money Poll" on October 21, 2019 and professional investors noted that they are the least optimistic since the poll began in 1999. To put that into perspective, investors are now more pessimistic than they were during the Global Financial Crisis in 2008-2009! This negative sentiment, a growing confidence that the U.S. will avoid a recession and abundant liquidity offered by a global coordinated central bank easing has created an environment conducive to further near-term gains.

There was one addition to the portfolio in October – Dell Technologies Inc ("DELL"). While most investors would associate DELL with desktop computer workstations it has evolved into a global conglomerate of various technology companies. At the time of purchase, we found the company to be significantly undervalued as its publicly listed companies (VMWare, Pivotal Software and SecureWorks) were worth ~$52.8bn. This significantly exceeded Dell Technologies' market cap of $35.75bn and implied a market value of negative $17bn for the "Dell Parent". Despite concerns associated with the company's complex structure and stewardship risk, we belief this negative sentiment will begin to reverse once the company pays down its large debt burden using its strong free cash flow and achieves an investment grade status. This should allow the company to simplify the structure further and/or commence a large share repurchase program to help close the valuation discount.









*MSCI EAFE Index

FIXED INCOME COMMENTARY

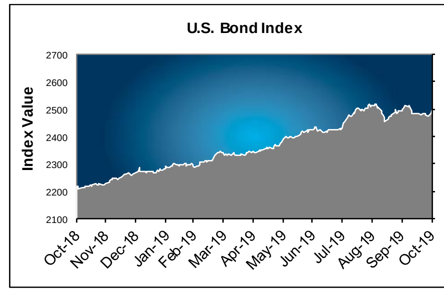
End of an Era

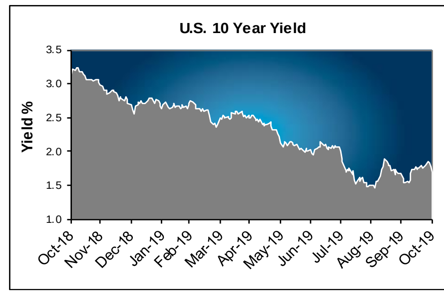
Mario Draghi chaired his final meeting as President of the European Central Bank (ECB) in October after eight eventful years at the helm. He became ECB President in November 2011, at the height of the European Debt Crisis, when European government bond yields were exploding higher. For context, the 10-year debt yield differential between Europe's riskiest country (Greece) and the safest country (Germany) reached a staggering 31 percentage points. However, it wasn't only the least credit worthy nations whose credit risk premiums sky rocketed. France, Spain and Italy each saw their funding costs rise dramatically. In his first meeting as ECB, President Draghi cut policy rates, followed by two more interest rate cuts in subsequent ECB meetings. However, these cuts had little effect. It was a crisis of confidence in the Eurozone's very future, as opposed to an economic slow-down that could be treated with looser monetary policy. In July 2012, in the now infamous "big bazooka" speech, he declared "the ECB is ready to do whatever it takes to preserve the euro. And believe me, it will be enough." This remark had the desired effect of reassuring markets of the Eurozone's future, as evidenced by the plunge in European government bond yields over the remainder of the year. This was undoubtedly Draghi's greatest achievement as President of the ECB.

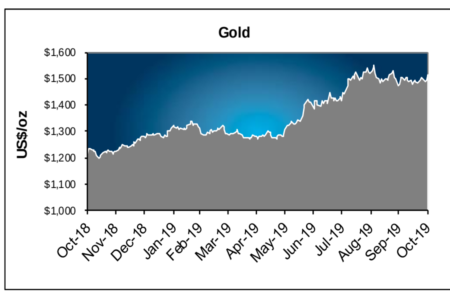
However, Draghi will also be remembered for taking ECB policy interest rates into negative territory (June 2014). This was, in theory, supposed to lead to more bank lending which would in turn drive growth and push up inflation. However, European bank share prices have cratered, and European core inflation is virtually unchanged. While there is no doubt negative interest rates and ECB quantitative easing (QE) led to lower borrowing costs, it came at a cost. The resultant investor 'reach for yield' has forced investors into riskier credits and pushed down credit risk premiums. Credit risk has been totally distorted by the ECB. For example, in October Greece issued 3-month government debt with a yield to maturity of -0.02% (yes, Greece!). As of the time of this writing there is USD-equivalent $12.8 trillion of negative yielding debt globally (this figure has been as high as $17 trillion). Before stepping down as ECB President Draghi cut ECB policy rates further into negative territory and re-established QE, with the ECB committing to purchase €20 billion of European bonds a month for "as long as necessary."

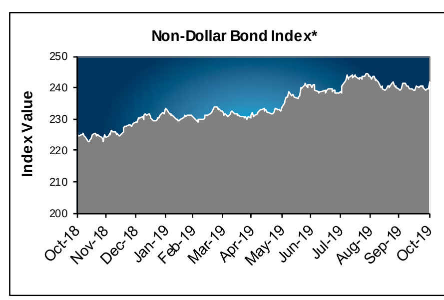
Moving on to the U.S., in late October the Federal Open Market Committee (FOMC) lowered the Fed Funds rate as widely expected, however Chairman Powell's commentary suggested the Fed is now on hold. Offsetting this less dovish shift, the Fed is again expanding its balance sheet. The Fed is buying $60 billion of T-bills a month in order to boost bank's excess reserves, offsetting part of the balance sheet run-off that occurred in 2018. While the ECB QE program is meant to keep borrowing costs low to spur investment, the Fed's program is aimed at smoothing the functioning of short-term money markets (which we wrote about last month). This increased demand in the short-end of the curve has led to the 3 month – 10-year portion of the Treasury yield curve to steepen + 0.31% to 0.15% (it was inverted last month).

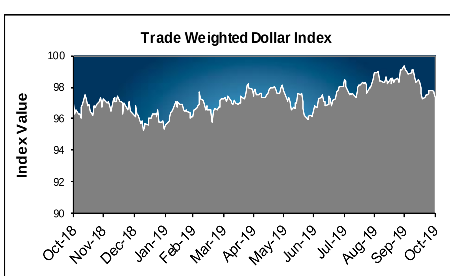
Overall credit spreads narrowed in October, continuing the course of much of 2019. This year credit spreads of the lowest rated cohort of the high yield market (CCC-rated) have not rallied nearly to the extent of the highest rated cohort (BB rated) of the high yield market, indicating investors are becoming more wary in the higher risk portions of the credit market. The Anchor Fixed Income portfolio continues to favor a more conservative stance on credit risk as the longest economic expansion in US history reaches the final innings.











*Merrill Lynch Global Broad Market, Ex US Dollar Index

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