Public

This Month in the Markets

January 2024

Equity Commentary

Forecasting Follies

"Humans don't want accuracy; they want reassurance." The Nobel laureate and retired Stanford University economist Kenneth Arrow did a tour of duty as a weather forecaster for the U.S. Air Force during World War II. Ordered to evaluate mathematical models for predicting the weather one month ahead, he found that they were worthless. Informed of that, his superiors sent back another order: "The Commanding General is well aware that the forecasts are no good. However, he needs them for planning purposes."

-Jason Zweig "Lessons from a Year of Market Surprises," Wall Street Journal Dec. 30, 2014

The equity markets started the year on a positive note, with the MSCI ACWI Index up 0.6% and the S&P 500 jumping 1.7%. The MSCI ACWI World Value Index slid slightly by 0.1%, while the MSCI All Country World Growth Index rallied 1.3%. MSCI EAFE rose 0.6%, but the MSCI Emerging Markets continued to slide by 4.6% on the negative news coming out of China, particularly regarding its real estate bust and deflationary conditions. The MSCI ACWI Information Technology Sector index was the top performer, posting a gain of 3.2%, as investors continued to buy large tech secular winners. The MSCI ACWI Real Estate Sector was the under-performer, with a loss of 4.7% as concerns over commercial real estate continue to mount.

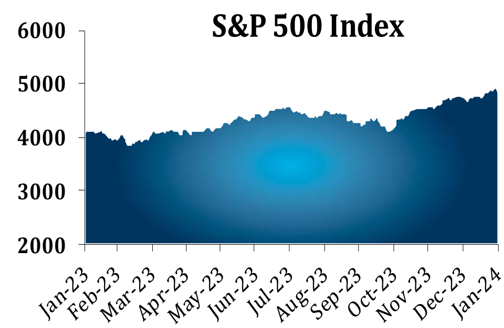
We are skeptical about the predictive power of most things, especially regarding any aspects involving human emotion or a collective social consciousness. We prefer to study businesses and companies and assess their value and likelihood of various scenarios rather than spend hours pondering the direction of markets. Finding great investments is often independent of guesses about the economy, interest rates, etc. January is the month when almost everyone in our industry has an opinion. To be right in predicting, the saying goes, is to predict often. It's hard to know how well many prognosticators do because their "predictions" are constantly changing. For the most part, however, it's your job as an investor to ignore pundits and their forecasts. Many famous forecasters are simply people who have gotten one prediction right in a row.

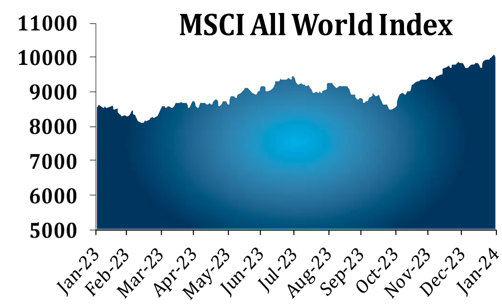
We've said this in prior newsletters, and we will say it again: forecasting is pretty much junk. Situations in financial markets are fluid; thus, all prognostications are almost instantly stale. Trying to guess what the market will do next is like trying to nail Jell-O to a tree. No one can truly claim with certainty that they know what tomorrow will bring, and if you meet someone who does, you should put your hands in your pockets to check for your wallet and slowly back away. Voltaire sums it up best: "Doubt is not a pleasant condition, but certainty is absurd." Besides, successful investing involves following the right principles, NOT the right predictions.

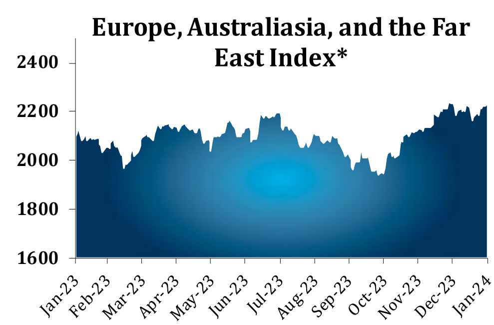
Anchor focuses our efforts on using qualitative and quantitative disciplines to identify under-valued securities that provide attractive returns on investment. So, we are not offering any grand predictions or forecasts here. We will point out, however, that Bloomberg economists said that in 2023, there was a 100% chance of recession, and there were many polls at the end of 2022 that had over 70% chance of a recession in 2023. There wasn't one…

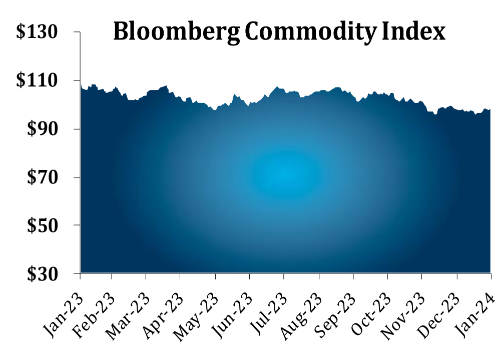
GXO Logistics Inc. was the month's largest underperformer, falling 11.1% on no noteworthy news. Palo Alto Networks Inc. was the top performer, rising 14.8% on continued broker upgrades on target prices and commentary surrounding the secular growth opportunity in cyber security.

We purchased Mitsubishi Heavy Industries during the month. Their business mix revolves around some very favorable secular themes. Its aircraft, defense, and space segment should benefit from the enormous ramp-up in Japanese defense spending and defense spending generally in a more conflict filled world. Its energy segment will benefit from the global and local energy transition surrounding the nuclear power renaissance and natural gas used as a bridge fuel. The purchase was funded by trimming a few of our more profitable positions.









*MSCI EAFE Index

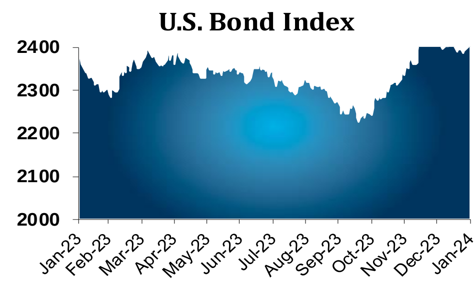
Fixed Income Commentary

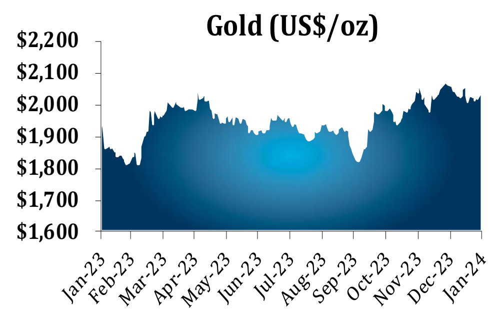
Bond Bonanza!

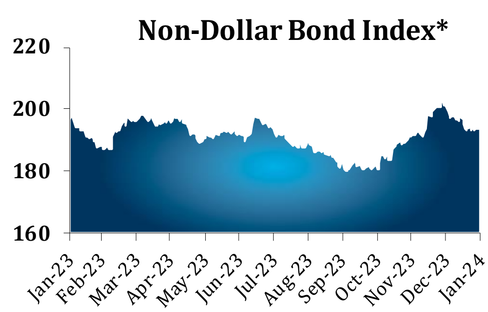
In late January, the Federal Open Market Committee (FOMC) held the fed funds rate at 5.50% (upper bound). In the press conference, Chair Powell pushed back on the possibility of a rate cut in March, saying, “I don’t think it’s likely that the committee will reach a level of confidence by the time of the March meeting.” Before the meeting, the market had priced in a 44% chance of a rate cut in the March meeting, per overnight index swaps. That probability fell to 35% after the press conference. May is widely seen as the most likely meeting for a rate cut (97% probability at January-end). The economic data has been largely supportive of a soft landing for the US economy – reported inflation figures are falling, consumer spending has been resilient, and the labor market is weakening on the margin but remains strong per the data.

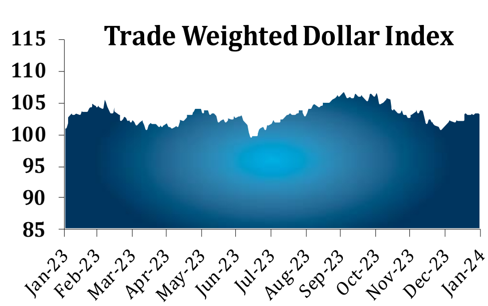
January was a blockbuster month for corporate bond issuance. January 2024 was the highest January on record for investment grade issuance, with over $188.8 billion, surpassing the previous peak of $175 billion in January 2017. Clearly, there is strong investor demand for corporate debt, as the average orderbook was oversubscribed by 3.6x! This ravenous demand reflects the consensus for a soft landing this year. Companies typically front-load funding towards the first half of the year, favoring raising funds and liquidity for the year ahead. There was likely also a sense of favorable timing involved. After all, treasury rates declined in November and December. For example, the 10-year treasury peaked at 5% in mid-October before declining in November and December (January-end = 3.91%). Additionally, credit spreads have tightened (from already skimpy levels), which, on top of the decline in treasury rates, makes the cost of issuing debt more attractive for companies. Banks issued $83.1 million, dominating investment grade new issuance, including JP Morgan ($8.5 billion), Wells Fargo ($8 billion), Morgan Stanley ($6.8 billion), Société Générale ($5 billion), and Bank of America ($5 billion). We expect U.S. regional banks to tap the primary market in greater size as the year progresses in anticipation of stricter capital rules to come.

On the topic of banks, after notable bouts of volatility in 2023 bank credit spreads ended the year strongly. Despite this strong performance, lingering fears of commercial real estate (CRE) exposures remain. We got a stark reminder of this with New York Community Bank’s (NYCB) Q4 earnings, where the bank missed analyst estimates by a huge margin driven by a large rise in write-offs, a material increase in provisions for future credit losses, and a 71% dividend cut in order to build capital. We note there are idiosyncratic elements to NYCB’s results. NYCB bought Signature Bank’s deposits when the bank failed, which in turn grew the balance sheet materially and pushed it over the $100 billion asset threshold, which brought stricter capital requirements by regulators. The increase in write-offs was driven by two large credits – an office building and an apartment building. Meanwhile the increase in provisions for credit losses brings it more in line with peers. So, taking it all in, Q4 could be a “kitchen sink quarter” whereby management takes multiple negative actions at once in order to clear the table for the future. This is the glass-half-full view. The pessimistic take is that this is a precursor for banks at large and CRE loan losses will start to ramp as the impact of higher interest rates over the last 2 years kick in; around $650 billion of CRE loans mature in 2024 per Mortgage Bankers Association and Newmark Research. We lean to the former but will nonetheless continue to monitor these developments. As with anything there is a considerable nuance – location of CRE exposures, loan-to-value ratios, etc – not all banks will be affected equally. For example, NYCB had $18 billion exposure (21% of total loans) to rent-regulated apartments. Another point of note is that the Bank Term Funding Program (BFTP) will end on March 11th. The BFTP is a liquidity facility enacted in March 2023 that allows banks to pledge agency MBS as collateral and receive cheap funding up to the par value of the security (this is notable because par value > market value). We expect banks and CRE to remain in the news for the foreseeable future.









*Merrill Lynch Global Broad Market, Ex US Dollar Index

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