This Month in the Markets

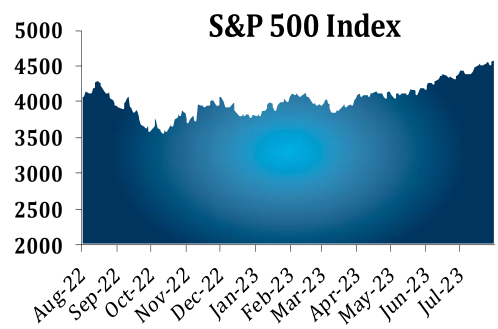
July 2023

ANCHOR Investment Management

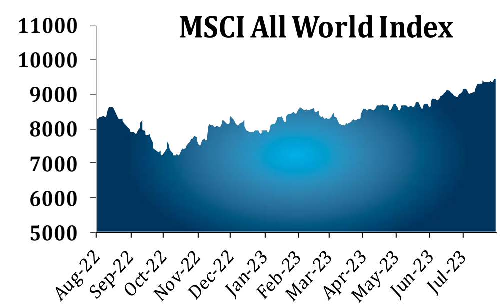
Equity Commentary

Stronger Economic Data and Lower Inflation Drove Stocks Higher

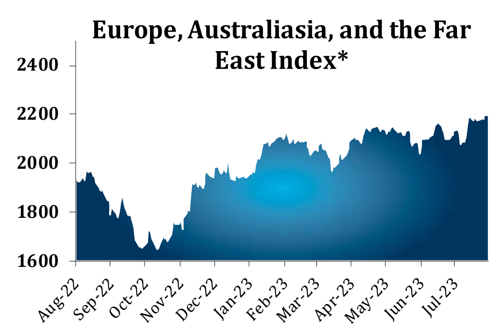
Improving economic and inflation data helped drive the rally in global equity markets in July. The U.S. market has led the gains this year, as many economists now believe the largest global economy will avoid a recession. In its initial estimate, the Commerce Department reported that US economic growth accelerated in the second quarter driven by resilient consumer and business spending, despite higher interest rates. US GDP rose at a 2.4% annualized rate compared to 2.0% in the previous three months, and higher than the 1.8% consensus estimate. On the inflation front, the Federal Reserve's preferred underlying inflation metric advanced at a slower-than-expected pace of 3.8% YoY. Excluding food and energy, the personal consumption expenditures price index rose at the lowest pace in more than two years.



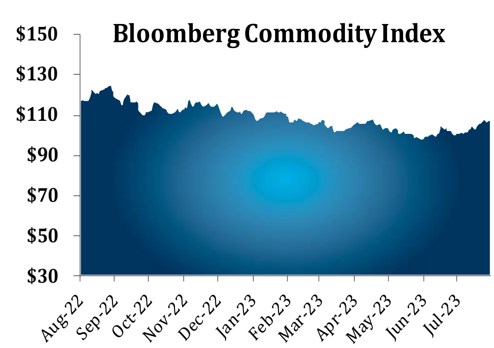
The MSCI All Country World Index gained 3.7% in July led by the Communication sector which jumped 6.2%. Alphabet and Meta Platforms produced double digit gains, while Comcast rose 9.1% leading the sector's advance. The Finance sector also outperformed (5.1%). Investors were relieved as banks reported second-quarter results that were mostly better than expected. The pain in US regional banks appears to have receded. The third troubled California bank (PacWest Bancorp) agreed to merge with Banc of California. All 10 sectors in the MSCI benchmark produced positive returns during the month. MSCI ACWI Index returned 18.1% in the first seven months of the year, led by the 20.3% gain in the S&P 500.



Looking forward, we continue to believe central banks aggressive tightening over the last 15 months will ring out the damaging impact of higher prices. As we have discussed in previous reports, our research indicates that Innovation will drive economic growth, as artificial intelligence ("AI") improves productivity in many industries. AI should transform the way individuals and businesses use the internet. The full impact is still not understood, but numerous implementations of AI are already underway. That said, it is important for investment managers to distinguish between AI hype and true incremental value. Anchor remains disciplined in our valuation approach and will continue to rotate out of companies where we determine a stock price achieves our intrinsic valuation for the company, and into under-valued companies.



This strategy was on full display in July as we sold our positions in Broadcom Inc (AVGO) and Comcast Corp. (CMCSA). Broadcom benefited significantly from the "AI Trade" to the point where we found the shares fully valued after gaining 190% since our purchase in June, 2020. While we like the company's exposure to AI, we felt that at current prices a great deal of good news was already priced in. Comcast also had a nice jump in the month which pushed its valuation to our target. When we purchased CMCSA a year and a half ago, the company had added 1 million broadband subscribers per year for two decades. Since that time broadband growth has slowed materially to the point where sub growth has turned negative in two of the last three quarters. As a result, we took the opportunity to exit the position after a nice rally. We used the proceeds of these two sales to add to our position in Citizens Financial Group (CFG) and to purchase shares in Elevance Heath Inc. (ELV). Elevance Health is a U.S. health benefits company that has a leading market share in most of the states where it operates. Historically the company has consistently produced double digit return on investment and EPS growth, and we expect this growth to continue. Trading at just 15 times trailing 12-month earnings and under 9 times EBITDA, we found the risk/rewards in the shares to be quite attractive. Valuation of Citizen Financial Group shares reached historic lows during the U.S. regional bank crisis. We felt comfortable adding to the position after management reiterated their long-term return goals during their second quarter conference call and presented a compelling five-point plan to accelerate shareholder returns.

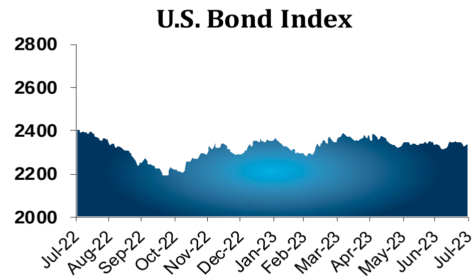


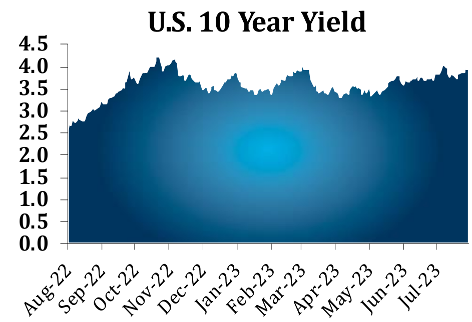
*MSCI EAFE Index

Fixed Income Commentary

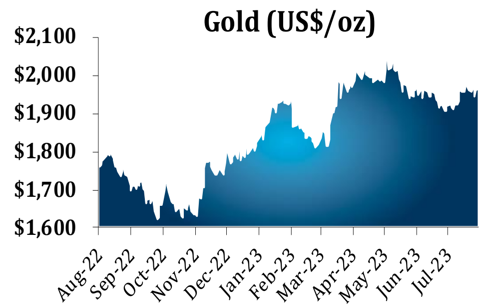
Most Central Banks Are Nearing the End of Their Historic Tightening Cycle

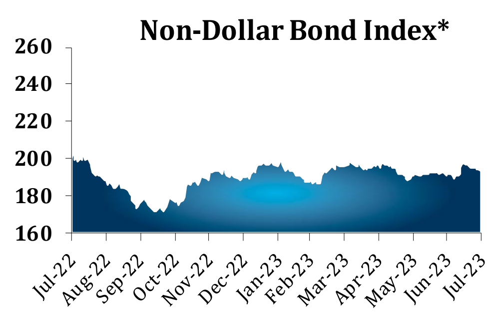
In the Federal Open Market Committee (FOMC) meeting in July, the Fed lifted the fed funds range another 0.25% to 5.25%-5.50%, as widely expected. In the press conference Chair Powell stressed the Fed would remain data dependent. Overall, it was an uneventful meeting as reflected by the muted equity and fixed income market reaction. The ECB also hiked its deposit rate by 0.25%, for a ninth straight increase to 3.75%. ECB Chair, Christine Lagarde, stressed that further rate hikes would be data dependent. Core inflation remains well above the ECB's 2% target in most EU countries while the bite of monetary tightening is showing up in weak demand for credit and slowing growth. Germany in particular is struggling. Second quarter real GDP growth was 0% following two negative quarters. The manufacturing sector is especially weak as per the S&P Global/BME Germany Manufacturing PMI which has plunged to 38.8 (lowest since March 2020) – a reading of below 50 is considered contractionary territory. At the time of writing forward rates suggest a below 50% chance of the Fed and ECB raising rates in their (next) September meetings. We may have seen the last policy rate hikes from the Fed and ECB.



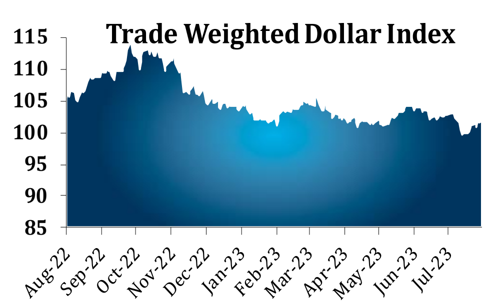


The Bank of Japan (BOJ) began yield curve control (YCC) in September 2016 with the aim of pegging the 10-year Japanese government bond (JGB) to 0%, with an allowable deviation from target of +/-0.10%. In time this allowable deviation was increased to +/-0.20%, then +/-0.25%, and then +/-0.50% in December 2022. On July 27th the BOJ left unchanged the -0.10% policy rate, 0% 10-year JGB yield target, and kept the allowable deviation from target at +/-0.50%. However, it surprised markets by saying it would conduct open market operations between the +/-0.50% to +/-1% yield range on the 10-year JGB. This allows the 10-year JGB yield to rise to up to 1%, however it also allows the BOJ to step in if yields rise too fast for their comfort. Indeed, we saw this on July 31st when the BOJ announced it would purchase up to $2 billion equivalent of 10-year JGBs when the yield rose to 0.60%. Widening the allowable 10-year yield trading band allows the BOJ the flexibility to slowly unwind YCC in a measured manner. As a reminder, while major central banks around the world have been raising interest rates since 2022 (and are now likely near the end of this process), the BOJ is only now slowly tightening policy. Japan CPI (+3.3% YoY) and Core CPI (4.2% YoY) are well above BOJ's 2% target and have been all year. On the other hand, Japan import prices have turned sharply negative YoY which in the past has been a leading indicator for lower consumer prices. With decades of deflation behind it the BOJ is loath to tighten policy too quickly, which is another reason they are giving themselves ample flexibility to manage the pace of rising bond yields. The wavering policy showed up in yen volatility, with the currency rallying almost 5 percent versus the dollar in the beginning of July and then reversing most of these gains in three days of trading.





The BOJ's actions are relevant because Japanese investors are the largest foreign holders of U.S. treasuries. Also, institutional fixed income money is one big fungible, global pool of money (pension funds, mutual funds, company treasuries, central bank holdings, etc), where money can quickly move from one market to another. As such if rates continue to rise in Japan it could lead to higher rates in other markets. We saw this on July27th on the back of the BOJ announcement where the 10-year treasury rate rose 0.15% on the day. While these forces could put upward pressure on treasury yields in the near-term, ultimately, we think there is limited scope for long-term rates to move higher. Inflation is falling on both a YoY and 3-month annualized basis, the yield curve is deeply inverted, and the conference board leading economic indicator index continues to deteriorate. Even if the Fed does not hike further, Chair Powell has been very clear on his intentions to keep rates in restrictive territory. The economic data has held up in 2023, however the rally in credit spreads on the back of this resilience leaves the risk-reward of high yield credit, specifically, unattractive. Lower rated credits are priced for perfection against a backdrop that is anything but certain. It's for this reason we favor a higher credit quality tilt, preferring to pick up yield in select investment grade U.S. banks whose credit spreads had widened earlier in 2023.



*Merrill Lynch Global Broad Market, Ex US Dollar Index

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