This Month in the Markets

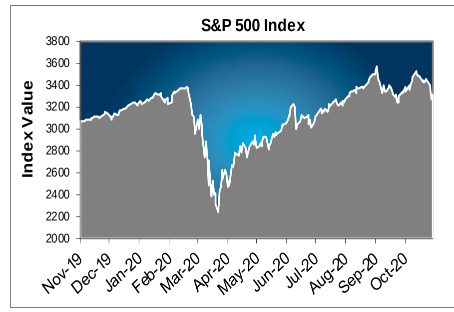
October 2020

ANCHOR Investment Management

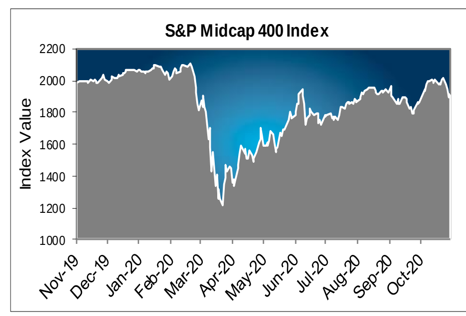
EQUITY COMMENTARY

Focus on Profits Not Politics

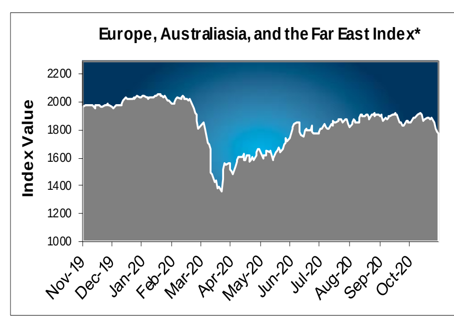
Market volatility remained elevated in October as equities needed to digest rising COVID-19 cases and associated lockdowns, vaccine trial tribulations, and the upcoming U.S. election. Europe COVID-19 cases are now spiking to new highs in various countries, albeit with much lower hospitalization rates and deaths compared to the first wave.



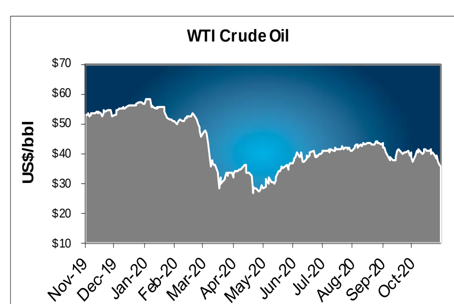
Within this context, equity markets were weaker, with the MSCI All-World Index ending the month 2.4% lower. The MSCI ACWI Communications Services Index sector was the top sector, rising 2% as investors gravitated to more stable names. The MSCI ACWI Energy Index was the underperformer – falling nearly 6% due, in part, to concerns over the economic recovery. Our largest detractor for the month was BAE Systems CPLC, which fell 14.9% - dragged down by volatility in the U.K. market over BREXIT and COVID fears. Our best performer was Tencent Holdings, which climbed 13% after receiving a favorable ruling from the 9th U.S. Circuit Court of Appeals protecting it from its popular WeChat app from an immediate ban on downloads.



A lot of discussions recently have revolved around the U.S. election. We are publishing this on election day and if the recent polls/guesses are to be believed, it looks like we may have a Democratic President. Senate and House. What this exactly entails for future equity returns is not, and never has been, clear. We believe you should not put politics in your portfolio. It is the profits that you should consider. Even if you know what political outcome will transpire, it is still nearly impossible to predict investing effects. For example, most experts are predicting a major infrastructure program with a Democratic sweep, but this was the same call when Trump won the last election, and the program never occurred. Geopolitical shocks, innovation, disruption, and even pandemics can easily overwhelm political policy. Making investing decisions, like adding or subtracting your level of investment base on political parties, seems ineffective. The S&P has risen regardless of who is in the White House. The presidential winner is only one variable amongst a myriad that affects returns. Long-term investing goals and your risk tolerance are more important investment considerations.



During the month of September, we decided to sell two names: Danaher and Raytheon Technologies. Danaher is a leader in the life sciences space that boasts high recurring revenue bolstered by its incredible ability to make and integrate accretive and moat-widening acquisitions. We think this is a great business and believe they will continue to do well, but as we have mentioned in our write-ups in the past, trees do not grow to the sky. Trading at 40x P/E and 30x EV/EBITDA versus when we bought it at 30x P/E and 22x EV/EBITDA, we believed it was a good time to rotate into another incredible business but at a significant discount. Our Raytheon sell was largely driven by missed signposts and our dwindling lack of conviction. When we first purchased the name, it was a pure-play defense business with exposure to the fastest growing areas in aerospace and defense. However, our investment thesis was altered when they merged its defense business with United Technologies aerospace business. Note that this merger was announced back in June 2019 and completed in April 2020 - amid the COVID shelter-in-place rules. The result? Few passengers are flying, which meant no planes in the air, which meant no aerospace sales. RTX, in our opinion, now appears to be stuck in purgatory due to Aero headwinds that continue to be a moving target with the pace of recovery being flatter and slower than initially anticipated, especially with the second COVID wave hitting Europe and the U.S.



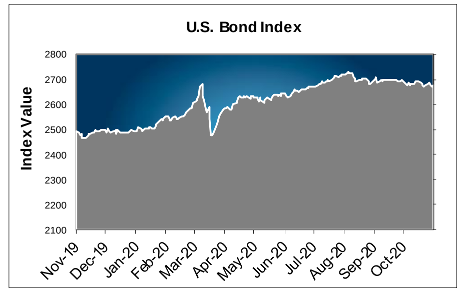
We had one new buy in the month. Keysight Technologies is the leading provider of electronic tests and measurement equipment and software, with a dominant 25% market share. It is deeply embedded in the electronic design and testing process of over 32,000 customers. We believe it is well-positioned to benefit across several secular growth markets with significant opportunities in 5G, semiconductors, Aerospace & Defense, quantum computing, and autonomous driving. The company boasts 18% recurring revenues and has continued to expand its margins since its spinout from Agilent by growing its subscription software business, which tends to be stickier with higher margins. Almost everything that is manufactured today must be electronically designed and tested before it is physically made. Keysight is there to take a slice of the pie and to ensure high-quality products are produced faster and at a lower cost with its full suite of solutions.

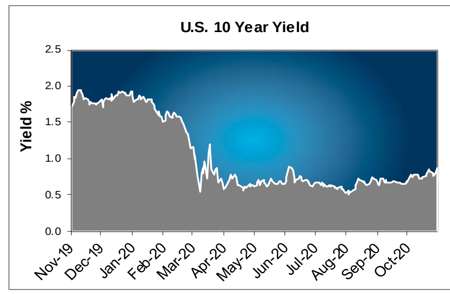
*MSCI EAFE Index

FIXED INCOME COMMENTARY

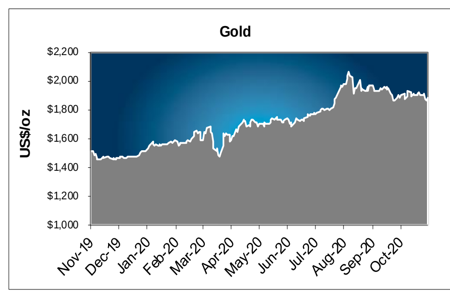
Short-Term Risks Still Linger

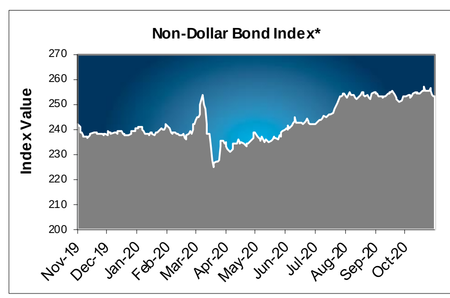
Despite a month of busy headlines including President Trump contracting COVID-19, corporate credit spreads continued to grind tighter in October. This is in despite of large outflows from the biggest high yield ETF in the final week of October. For the most part, the short-term threats to risk assets we mentioned in last month's piece have yet to really impact credit spreads (only equities), despite having bubbled to the surface in October. To recap, firstly, we cited the risk of COVID-19 cases rising. In October, France and Germany entered nationwide lockdowns, with the UK to follow suit on November 5th The second risk highlighted was no pre-election fiscal deal. Despite a flurry of headlines throughout the month, no agreement was struck on fiscal spending. Lastly, we cited the potential for a contested election. As the election has yet to take place at the time of this writing, this remains a possibility. Despite these short-term risks, we expect the considerable demand for corporate credit, aided by historically low treasury yields and Fed-related support programs, to continue going forward. Over the medium term we expect corporate credit spreads to continue to grind tighter, although we acknowledge there could be some short-term weakness.



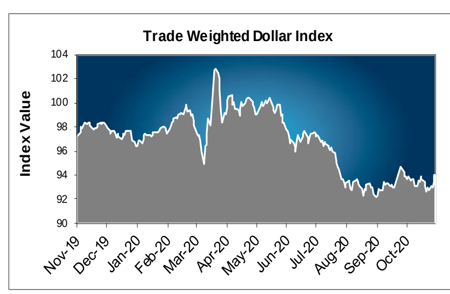


With regards to the USD, which party ultimately controls the House of Representatives, and the Senate is of huge importance. A democratic sweep would likely lead to a huge fiscal spending package, and higher benefits (healthcare, etc). We would expect the USD to fall in this scenario, all else equal. Meanwhile, split control of the House and senate would likely lead to a smaller fiscal stimulus deal. This would also be bearish for the USD, but not to the extent of a 'blue wave' win in the election. The worst short-term outcome would be a contested election. This would produce considerable uncertainty and markets do not like uncertainty. In this scenario we would expect the USD to rally. The longer the issue remains unresolved, the greater the scope for a rally. Over the medium and long-term we expect the USD to depreciate, though accept there are both political and health outcome risks to this view in the short-term.





Despite the risks highlighted above, Treasury rates rose in October. Rates in the long end of the yield curve outpaced the belly and short end. As such the yield curve steepened. This was likely due to the bond market's expectation that higher fiscal spending (trillions of dollars) is on the way regardless of which party controls the White House, Senate, and the House. As such, trillions of treasuries will need to be issued and absorbed by the market (and the Fed, of course). Indeed, super charging the economy with fiscal stimulus on the backdrop of a dovish fed could prove to be a fertile breeding ground for inflation; the bane of bond holders. While inflation is not imminent, the long end of the curve will move in anticipation of inflation and growth prospects well before they come to fruition. On this note, there is a very large (crowded) short CFTC treasury futures position which would benefit from rising rates. Should this positioning unwind, it would likely lead to lower treasury rates. Nonetheless, our expectation over the medium term is for treasury rates to drift higher.



*Merrill Lynch Global Broad Market, Ex US Dollar Index

Disclaimer