Public

This Month in the Markets

October 2023

Equity Commentary

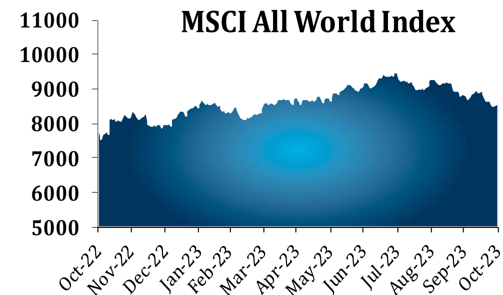
War and Weight

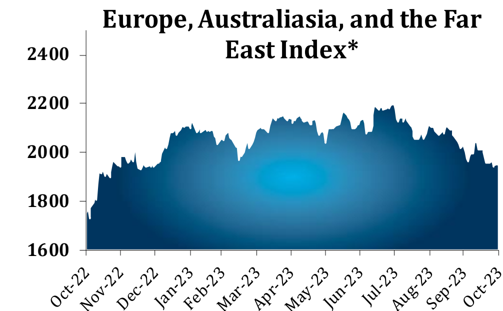
The equity market fell in October after Middle East tensions and rising bond yields increased volatility. The MSCI ACWI Index fell 3.0%. The MSCI ACWI World Value Index declined 3.4% compared to the drop of 2.6% in the MSCI All Country World Growth Index. International markets underperformed the U.S. as the S&P 500 fell 2.1%, and the MSCI EAFE and Emerging Market Indices slid 4% and 3.9%, respectively. The MSCI ACWI Utility Sector index was the top performer, posting a gain of 0.2%, as investors returned to the sector which has historically been considered to be low risk. The MSCI ACWI Consumer Discretionary Sector was the under-performer, with a loss of 4.8% as the jump in global yields pressured cyclical shares.

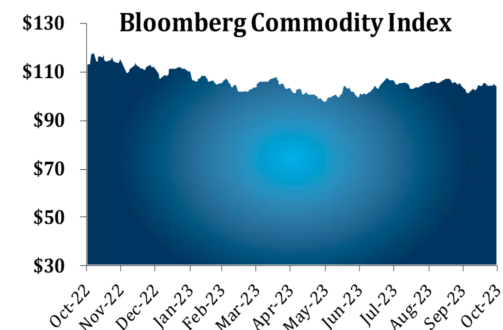
Geopolitics continues to evolve, and it is probable that the world will move further along the scale of increasing conflict globally as deglobalization continues to manifest itself. The Ukraine war continues, but now another front of tension has opened in the Middle East with the Israel/Hamas war. It would be insensitive to suggest these conflicts are inconsequential as the human suffering is shocking and despairing, but the future consequences are still unknowable from a market perspective. The second or even third-order effects from conflicts are nearly impossible to prophesize as the outcomes are multi-dimensional and complex. It is, therefore, of little value to change investing strategies dramatically once events surrounding war begin. Instead, we believe it is best to focus on what stays the same in the medium to longer term: to continue to buy and hold companies with sustainable advantages at reasonable prices.

The other development that may have more consequential and/or lasting effects on markets is being waged in the war on weight. Momentum has been growing in popularity regarding a host of GLP-1 weight loss drugs from Novo Nordisk and Elly Lilly – specifically Ozempic and Mounjaro. The results from these formulations have been impressive, to say the least, and the potential effect they could have in terms of elevating the burden on the healthcare system surrounding obesity and its associated complications and diseases may be dramatic. As a result, large swaths of the market were adversely affected in October as some investors, fearing potential dramatic effects, took the opportunity to sell select sectors and stocks. For example, food and beverage stocks slumped as consumption concerns escalated surrounding the effects these GLP-1 drugs seem to have. Walmart even mentioned that it had seen an impact on shopping demand from people taking Ozempic, Wegovy, and other appetite-suppressing medications. A whole host of med tech stocks also were severely punished after Novo Nordisk reported positive news that Ozempic showed effectiveness in a kidney-failure trial. The general concern is that if these drugs continue to show significant effectiveness and are more widely distributed and taken up by insurance programs, a whole host of companies, from sleep apnea to knee replacement, will suffer from much lower demand as obesity rates fall and the population overall gets healthier. The irony here is that this would be a phenomenal development for society but a devastating one for some companies that profit from the obesity epidemic. We continue to monitor this disruption and look for ways to avoid dislocations while participating at a reasonable price in its evolution.

GXO Logistics Inc. was the month's largest underperformer, falling 13.9% as it suffered from a series of price target downgrades from various brokerage houses on concerns about slower growth. The defense stock BAE Systems PLC was the top performer and rose 11.4% with the news on the Middle East conflict.







*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.

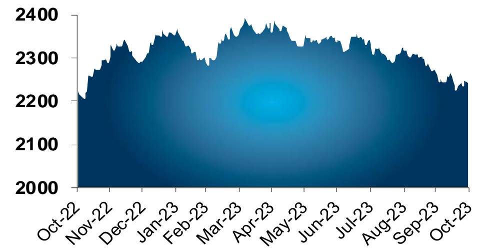
Public

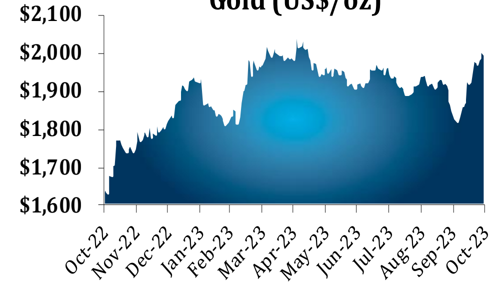
Fixed Income Commentary

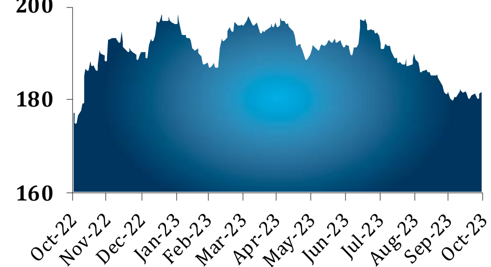
Value in Bonds

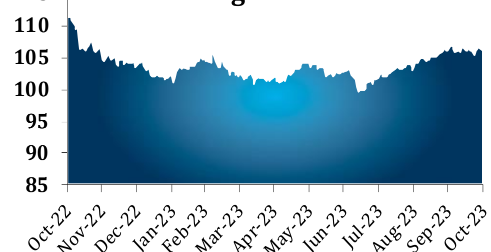
As was the case in September, interest rates continued to move higher in October led by the long end of the curve. The 10-year treasury yield rose 0.36% to 4.93%, while the 2-year treasury rose just 0.04% to 5.09%. The 2Y-10Y portion of the yield curve is still inverted, but it is far flatter than it was a couple of months ago. This flattening of the curve (from steep inversion) has been driven by a stronger-than-expected US economy, as evidenced by resilient retail sales and durable goods orders. Third quarter real GDP came in at a whopping 4.9% QoQ up from 2.1% in Q2! Very strong growth, especially given the rapid pace of monetary tightening since March 2022. One aspect that has been buffeting growth has been government spending. The federal budget deficit through September-end has been 6% of GDP (while the economy in aggregate has been very strong). This lack of regard for balancing the budget has supported growth, but also worried the bond market... If the government is willing to run a large deficit in good times, how large is the budget deficit going to get in a recession when the economy needs the stimulus? Not to mention what the clearing price will be for such spending, which will have to be funded with treasury issuance. Only time will tell on this front – this is a structural issue for the bond market that will play out over the medium to long-term. However, there is also a cyclical element to owning bonds. When the economy turns over or there is financial stress (from a credit crunch or rapid repricing of company earnings expectations), there is typically a flow of funds into treasuries. While the last two years have been painful for bondholders due to the seemingly unrelenting move higher in interest rates, the outlook for bonds moving forward over the next year looks compelling.

Our favorable view on bonds is centered around treasuries and specific investment grade credits, while we remain cautious on high yield. High-yield credit spreads have been very well behaved considering the considerable interest rate volatility over the last few months. One aspect that has been a positive for the high yield market has been the lack of issuance year-to-date – only $102 billion – the lowest since 2008. Additionally, there isn't a looming maturity wall – maturities don't begin to ramp until 2025. On top of this, the size of the high-yield market has shrunk over the last few years due to rating upgrades. We have experienced this in our own portfolios with HCA, Occidental Petroleum, T-Mobile, and Lennar having all been upgraded from high yield to investment grade. Thus, there appears to be a supply/demand imbalance that has propped up credit spreads. Nonetheless, with monetary tightening having yet to fully filter through the economy, high yield is particularly at risk. We have already seen both residential and commercial real estate come to a virtual standstill. As per BCA, over 40% of the smallest 1,000 companies in the Russell 3000 have higher interest expense than what they generate in cash from operations; this stands at almost 20% for the middle 1,000 companies. These are known as "zombie companies" – they are only still alive due to the availability of willing creditors and are at the greatest risk of economic hardship when refinancing is needed. We've seen defaults pick up notably this year. Through September-end, the number of bankruptcy filings has risen 96% YoY (from an admittedly low level), however is now running at the same year-to-date level as 2020 (COVID-19 year!). So, while we are bullish on the bond asset class, we prefer a cautious stance on the riskiest cohort of the market.









*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 trademark of yours which is being infringed, you may notify AIM at info@anchor.bm. We will contact you to obtain details of your claim.