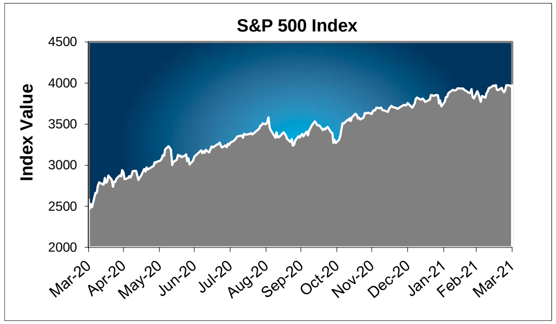
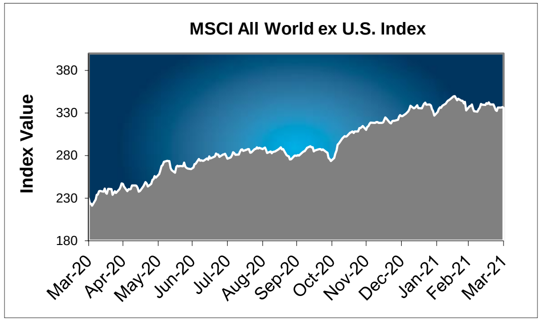
Stock Market Analysis

Risks and Rewards





It was an eventful first quarter of 2021. This included the largest all-time short squeeze brought about by the new breed of "Robin Hood" investors, driving significant volatility in several highly shorted stocks. This was followed by the largest all-time margin call caused by Archegos Capital Management's family office run by Bill Hwang. Risk managers in the security brokerage industry will learn to improve the management of their client's leverage after Nomura and Credit Suisse took multi-billion losses from Archegos swap positions. Periods of low interest rates have historically increased risk-taking. Outside of some volatile trading in a handful of names, these events had little impact on overall positive market sentiment.

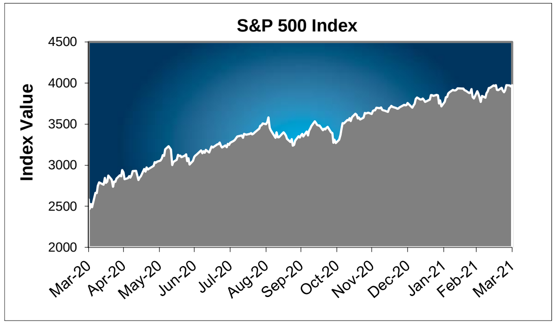
Anchor has always stressed that it is essential to know the value of what you own, and that investing requires discipline. Our year-end report warned that the growth in ETF investing had created a distortion in the equity market and a widening gap between value and growth stocks driven by narrow leadership in select large-cap growth stocks. We stated, "While many of these companies have strong fundamentals that justify market premiums, the good news is already discounted in their prices, and in many cases, the large premiums are not justified….valuation will matter in 2021." Last year the MSCI ACWI Growth Index net return was 33.7%, while the equivalent Value Index lost 0.7%.

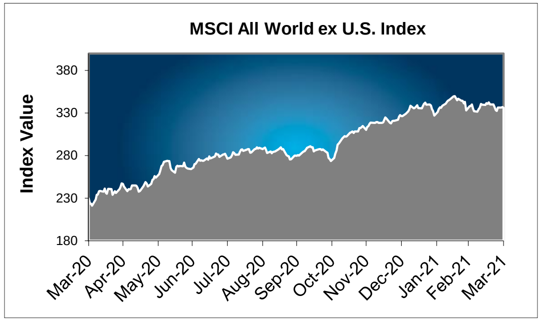
Our prediction has panned out so far in 2021, as the MSCI ACWI Value Index had a net total return of 8.9% in the first quarter while MSCI ACWI Growth Index was flat. The "cyclical/re-opening rotation" ended the narrow leadership in large-cap growth shares. Anchor's equity portfolio benefited from this rotation, producing a return of 8.3% and outperforming our MSCI ACWI benchmark by 3.9% in the quarter (excluding management fees). We believe that the value/growth rotation has further to go as the global economy rebounds from the impact of the Covid pandemic. Over the past decade, the MSCI ACWI Value Index had a net annualized total return of 6.4% versus the MSCI ACWI Growth Index, which has produced an 11.7% annual return over the same period.

Internal

Stock Market Analysis

Risks and Rewards





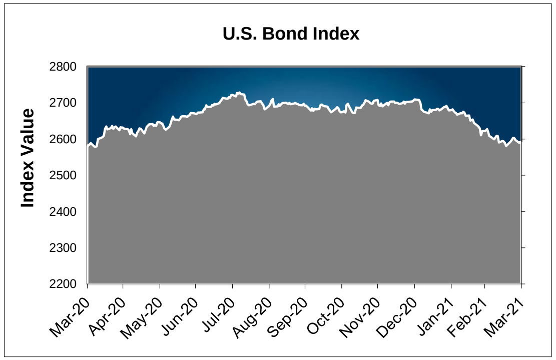
ANCHOR
Investment Management

It has been an extraordinary year for the stock market. After plunging 34% when Covid initially struck in the first quarter of 2019, the MSCI ACWI Index rapidly regained all the losses and more. Thanks to global monetary and fiscal stimulus, the benchmark produced an impressive 55% net total return over the past 12 months. The market is discounting a robust economic rebound as vaccinations are rolled out across the globe. There is some risk in this assumption, but governments and central bankers appear willing to provide an insurance policy if the recovery stumbles. Consumer sentiment measures have improved this year, leading to increased consumer spending. Market participants have become more concerned about the rise in inflationary pressures and long-term interest rates, but the labor market slack should balance commodity inflation caused by rising demand. Investors have historically anticipated rising inflation, but central banks usually remain dovish longer than markets have anticipated.

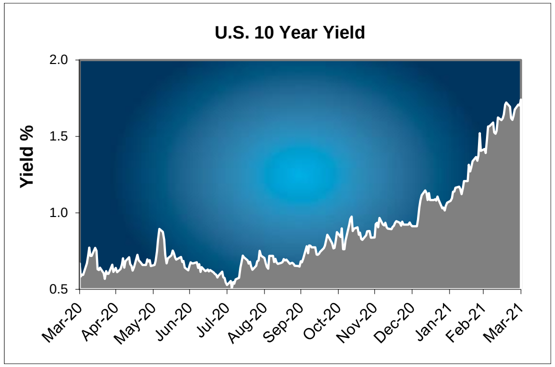
The background appears conducive to strong profit growth, but some industries look expensive after the latest 12 months rally. We believe that being security selective is important, and valuation matters, especially as interest rates rise. The rally in the market has led to the busiest quarterly new issue market in more than 20 years. The increased supply of shares is starting to weigh on some of the more extended market sectors, including technology and communications. The combination of IPOs, SPACs, secondary issuance, and insider selling will likely place pressure on the market until the supply spigot is turned off. Falling interest rates had fed demand for shares, but investors may reallocate back into bonds as interest rates normalize.

Fixed Income Analysis

Inflation Expectations Rise



Merrill Lynch US Corporate & Government Index



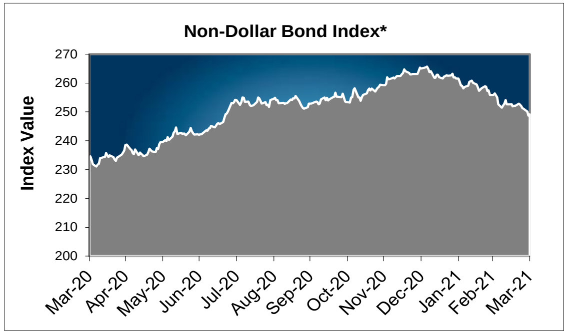
U.S. 10 Year Treasury Yield

Credit spreads were largely unchanged in March, reflecting continued strong demand for yield. High yield debt issuance reached a new record in the first quarter of 2021, as witnessed by Verizon's $25 billion bond sale in the U.S., which garnered $109 billion of orders. Treasury yields continued to rise in March, led by the longer end of the yield curve. The 10-year Treasury yield rose +0.36% to 1.7%, while the 2-year yield was unchanged. As a result, the yield curve continued to steepen. This was the story of the first quarter. The Fed has been very explicit about keeping the Fed Funds Rate on hold; a message Chairman Powell drove home in the March Fed press conference. They insist they will not preemptively lift the Fed Funds rate to stifle inflation. Instead, the Fed will only raise rates when it believes inflation, as measured by the Personal Consumption Expenditure index (PCE), remains persistently above 2% and full employment resumes. Considering the swift pace of vaccinations and another round of stimulus, it makes sense for the yield curve to steepen. We expect this trend to continue, however not at the break-neck pace witnessed for much of Q1.

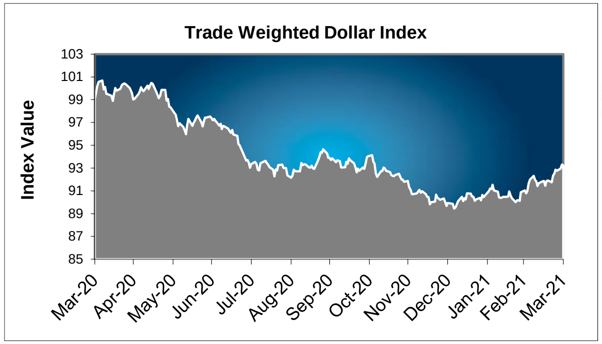
As with the latter half of 2020 and January 2021, the March rise in rates was driven by higher inflation expectations as evidenced by U.S. 5-year/5-year forward breakeven inflation rate, which reached six-year highs in the month. This differed to February when higher growth expectations drove the leg up in treasury yields. Thus, in February, real yields (adjusted for inflation) rose more than nominal treasury yields. As we move into the second quarter, it will be interesting to see how the market reacts to the large inflation prints that are inevitable given the base effects – activity fell off a cliff in Q2 2020 and inflation with it. There are already signs of budding inflation pressures in an array of economic data points (ISM PMI prices paid, Producer Price Index prices paid, and the Empire Survey) as well as a variety of commodity prices (lumber, copper). Additionally, the Suez Canal blockage, which disrupted global trade for six days, and U.S. west coast port delays will likely add fuel to the flame. The Fed expects the inflation prints in Q2 to be transitory due to the weak labor market. The inversion of the inflation breakeven curve would suggest the market agrees, but we cannot rule the potential for volatility in any case.

Fixed Income Analysis

Inflation Expectations Rise



ICE BofA Global Broad Market Excluding US Dollar Index



The U.S. Dollar Index

The U.S. dollar decline that characterized the second half of 2020 came to a halt in the first quarter of 2021. The dollar was essentially flat in January and February; however, it strengthened in March. This coincided with improved U.S. economic data and the widening interest rate differential favoring the U.S. versus G10 peers. Hedged yields for Japanese and European investors to buy nominal 10-year treasuries are the highest in five years. The U.S. economy has held up very well compared to western developed market peers. The U.S. has been open while the U.K. and many European countries are still in Covid lockdown. Once European countries open-up and quicken the vaccination pace, we would expect the U.S. dollar to resume its weakening trend. We also expect the twin deficits (current account and government budget) to weigh on the dollar over the medium term.