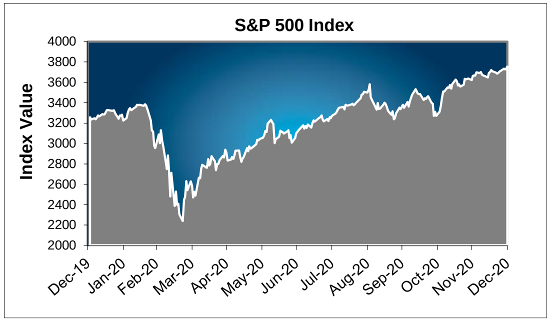
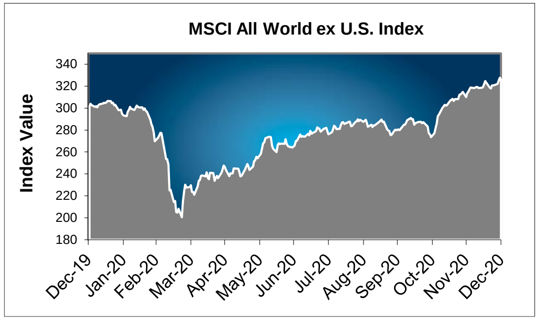
Stock Market Analysis

The Year of the Great Pandemic





Every generation has an event that leaves an indelible memory. 2020 will always be remembered as the year of the Covid-19 pandemic when people around the World were forced to change their regular lifestyles to save lives. Most of us were not around during the Spanish flu in 1918, and we are fortunate that advanced medicine has kept most infectios outbreaks to specific regions of the World over the past century. Vaccines have been developed to keep the most devastating illnesses at bay. We are all hopeful that the concentrated focus of the medical industry to introduce vaccines to contain this lethal virus will be successful in 2021. While many mistakes were made over the past year, humanity has the remarkable ability to adapt and many important lessons have been learned.

The resources concentrated on the health sector will be valuable to not only fight viruses but other medical conditions. Messenger RNA therapy is a major medical breakthrough that was brought to market at record speed to fight Covid-19. RNA therapies have been studied for decades to develop personalized cancer treatments and vaccines for infectious diseases. Both Moderna and Pfizer/BioNTech recognized early in the pandemic that their mRNAs could be adapted to target the virus. Few health experts believed that they could introduce an effective treatment in less than a year. While we are all saddened by the current record number of daily deaths around the World, these medical breakthroughs have given us hope that normalcy will likely return in 2021.

Investors ignored the potential economic risk caused by the pandemic and drove stocks higher in 2020. Initially, the markets recovered thanks to record fiscal and monetary stimulus. Indices then climbed higher on the back of positive vaccine news and the hopes for economic recovery as the World reopens. Stay at home restrictions created a surge in day trading with a 55% jump in trading on U.S. exchanges last year, a record $120 trillion in stock value. A new generation of "Robin Hooders" chased momentum shares higher, with valuations in many of their favorites reaching alarming levels. This brought memories of the "Tech Bubble" to more experienced investors. During 2020, we discussed the widening gap between value and growth stocks. The MSCI ACWI Growth Index net return was 33.7% last year, while the equivalent Value Index lost 0.7%. Over the past three years, this gap has widened to nearly 60%. A look back at the post-dot.com bubble period shows that the Russell 1000 Growth Index lost half its value in the three years from June 30, 2000 to June 30, 2003 while the Russell 1000 Value Index was flat. Market timing is always difficult but George Santayana's quote is timely: "Those who cannot remember the past are condemned to repeat it."

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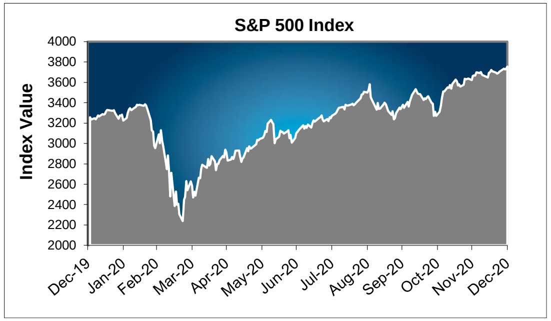
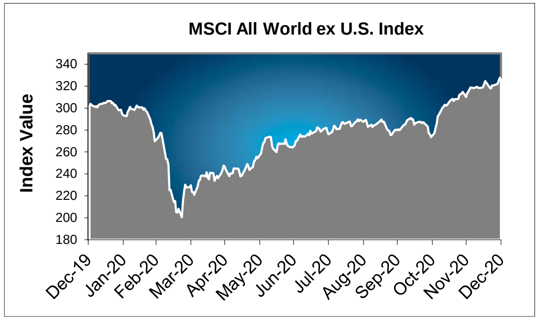




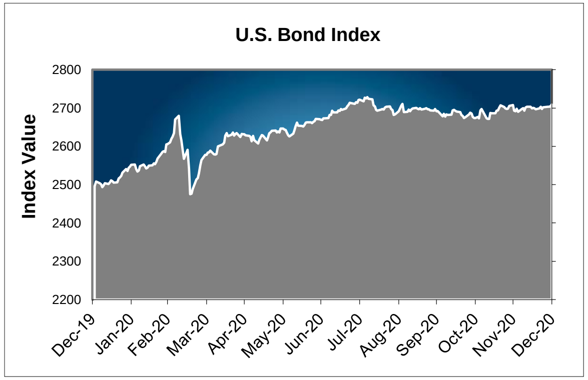
Anchor's valuation approach to stock investing has hurt Anchor's equity performance relative to the cap weighted indices in 2020, which has been driven by narrow leadership in select large-cap growth stocks. While many of these companies have strong fundamentals that justify market premiums, the good news is already discounted in their prices, and in many cases, the large premiums are not justified. We believe the rotation into more cyclical value stocks that began in the fourth quarter will continue as investors become more comfortable with the economic recovery. This will be driven by the vaccine rollouts and the gradual lifting of the Covid lockdowns and restrictions. We believe that we are positioned well going into 2021 for the market rotation.

The big 2020 lesson is that staying invested during a crisis is important. According to Bank of New York, investors who were not invested in the S&P 500 during the five best days of the year would have lost 20% in 2020 compared to a 15% gain for the index, a 35% differential. As we pointed out in our second-quarter report, "Fear can be an investor's greatest enemy…. It does not matter how long you have been in this business, when everyone is running for the door it is tough not to hit the sell button. The Anchor team spent the past several months reminding our nervous clients that their asset allocation is based on their long-term risk/reward appetite and not to change this allocation based on market timing. We are not in the market timing business and the "talking heads" telling investors to lower risk and move to cash in the second quarter once again did their viewers a disservice." The MSCI All-World Net Total Return Index surged 14.7% in the fourth quarter and returned 16.3% in 2020, recovering the 21% first-quarter loss and more.

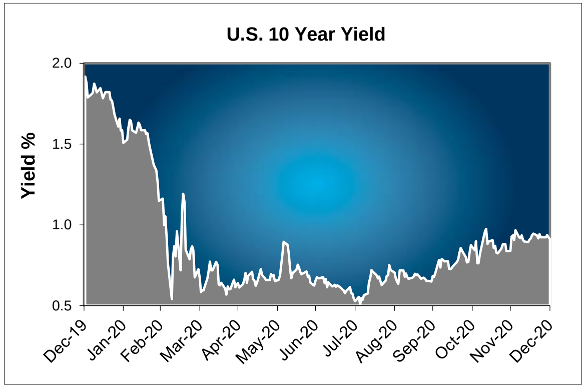
Looking ahead, we believe there are opportunities and risks in the market. Stock selection has never been more important, and valuation will matter in 2021. The MSCI ACWI Technology sector led the market with an impressive 44.3% gain in 2020 and a 25% annualized return over the past five years. However, in the fourth quarter, investors focused on a broad economic recovery and rotated into some of the sectors which were hit hard by the pandemic. The MSCI ACWI Financial Sector climbed 23.5% in the period and the MSCI ACWI Energy Sector rebounded 23%. We expect volatility to remain high in the first quarter driven by news flow but there remains value in the market for those investors who can gauge the strength of the economic recovery over the next three years and the impact on individual businesses.

Fixed Income Analysis

A Year for the Ages



Merrill Lynch US Corporate & Government Index



U.S. 10 Year Treasury Yield

It is safe to say 2020 was a truly outrageous year spanning all facets of life. This was certainly true with regard to financial markets. One could be forgiven for thinking, "what global pandemic?" when looking at the levels of equity markets, corporate bonds, and currencies (vs the USD). Broadly speaking, each of these asset classes ended the year more richly valued than when 2020 started, despite the massive sell-off in March. This performance was largely driven by decisive actions taken in March - massive, bi-partisan government spending (CARES Act) and unprecedented monetary support programs from central banks. On the other side of the coin, the wounds from the (still ongoing) global pandemic are clear for all to see in the real economy, which has been ravaged by business closures and elevated unemployment. Indeed, interest rates in developed countries are at/near historic lows, reflecting subdued expectations. The contrast is striking.

In 2020 the Fed followed the ECB and BOJ in 'crossing the Rubicon' into supporting corporate credit markets. This occurred on March 23rd when the Fed announced that it would support investment-grade corporate bonds (through primary and secondary market programs). The primary issuance market began to thaw, and it marked the peak in credit spreads (rising credit spreads are bad for corporate bonds). Credit spreads had exploded higher in March despite a plethora of Fed actions including rate cuts, larger treasury and MBS purchases, initiating USD swap lines with foreign central banks, and an alphabet soup of support programs (commercial paper, municipal debt, and primary dealers). On April 9th the Fed expanded the Secondary Market Corporate Credit Facility to include high yield ETFs and BB-rated debt that was investment grade rated as of March 22nd. This was important as several large companies with heavy debt loads (Ford, Occidental Petroleum, and Delta to name a few), were downgraded below investment grade (known as "fallen angels") after the March 23rd announcement date. As such, without the expansion these companies would not have qualified for Fed support.

Fixed Income Analysis

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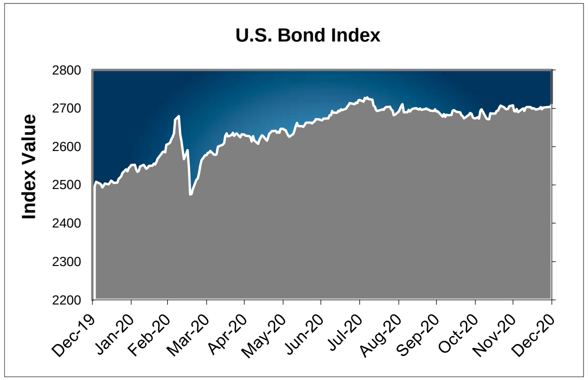
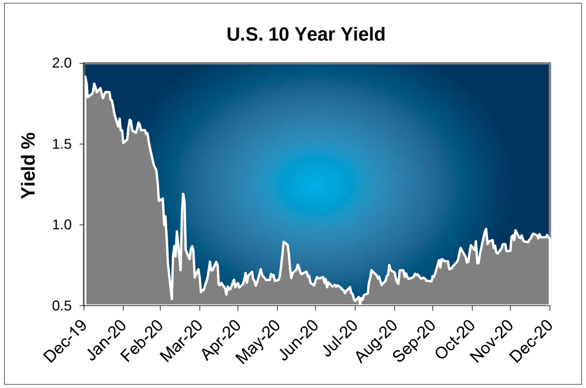


Merrill Lynch US Corporate & Government Index



U.S. 10 Year Treasury Yield

The investment grade credit market is far larger than the high yield market. In fact, the BBB-rated cohort alone (the lowest rating bucket in investment grade) was 2.7x the size of the entire high yield market at the end of February 2020. Many investment manager's mandates do not allow them to buy high yield bonds. Thus, without the expansion, a wave of BBB-rated bonds being downgraded to high yield risked exacerbating the sell-off in an already perilous economic climate. If credit spreads of fallen angels blew out, it would have indirectly pushed credit spreads wider for all corporates impacting funding costs for many companies. The Fed was desperate to avoid a liquidity issue evolving into a solvency crisis. As evidenced by the strong rally in corporate credit and record corporate debt issuance in 2020, the Fed achieved its objective. However, it has done so at the cost of moral hazard. In the future, if/when a similar violent sell-off occurs, the market will expect the Fed to step in. In addition, while the Fed's actions aided the economy in the short-term, it also allowed for the creation of more "zombie companies" that cannot support their excess debt but were kept afloat by Fed support.

Looking forward, we expect the U.S. Federal Reserve (and other central banks) to remain very accommodative. However, there is little more they can do to stimulate with interest rates historically low. More fiscal spending will be needed in 2021. Christine Lagarde (ECB President) and Jerome Powell (Fed Chair) have both commented as much on several occasions. As the new U.S. Treasury Secretary in the Biden White House, we expect Janet Yellen to promote fiscal stimulus to recover the jobs lost during the pandemic.

Our fixed income portfolios performed well in 2020. We increased our corporate credit allocation, at the expense of treasuries, to take advantage of the favorable support backdrop enacted by the Fed. Although these support programs have now expired and corporate bonds do not offer significant upside, we are in a 'reach for yield' environment and expect corporate credit to remain well bid. We will look for opportunities to switch into more attractive opportunities as they arise.