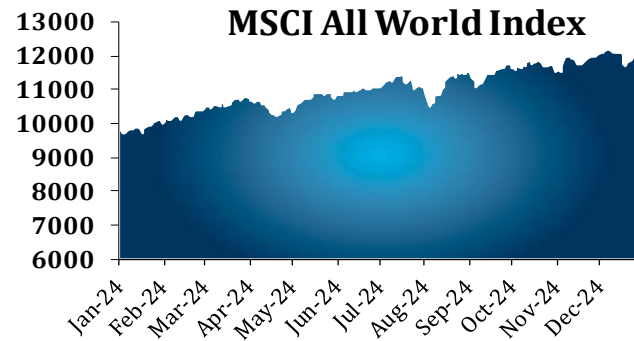
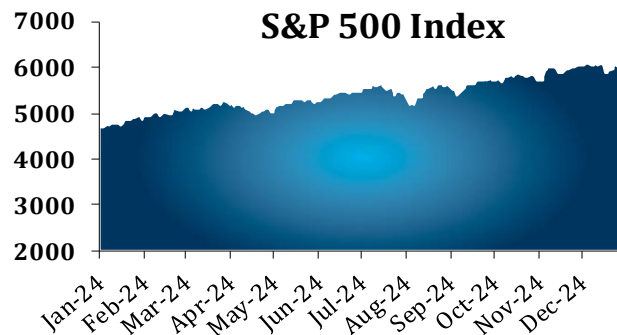


# Stock Market Analysis

2025 will be a Stock Pickers Market



Most investment publications theorize that investors should be rewarded for taking more risk and smaller companies should produce higher returns than larger companies since they are riskier. This was certainly the case for the 20-year period up to 2019. The average company in the MSCI All Country World Index (“ACWI”) out-performed the market-cap weighted index by almost 2.5% annually from 1999 to 2019. But over the past five years mega-cap companies have thrown this basic market theory into the waste basket. Five companies (Alphabet, Amazon, Apple, Meta and Nvidia) now represent half of the total market capitalization of the S&P 500 Index. Their dominance in the marketplace has led to strong out-performance and distortion in both the U.S. and global index weightings and performance. Most global indices are market capitalization weighted. U.S. market supremacy has driven the U.S. stock weighting in the MSCI ACWI Index to 67% from 30% in 1988. The trend to passive index investing has accelerated this distortion.

Over the past five years the MSCI ACWI Index has returned 61.5% while the average company in the same index has returned just 17.4% (10.1% versus 3.3% annualized return). The Mega caps have driven even higher returns for the S&P 500 index which has produced a 92.4% return adjusted for withholding tax (14.0% annualized return) over the five-year period. While there are clear fundamental reasons for this performance (artificial intelligence, growing advertising and internet market share), the law of large numbers will eventually slow their growth. There is also rising concern about the crowding out impact as they dominate competitors due to their size. From a valuation perspective the market distortion has created some interesting opportunities for prudent stock pickers. We prefer to invest in undervalued stocks with strong economic moats, high returns on investment capital and attractive free cash flow generation.

While the market set new records in 2024, the market breadth continued to weaken. The MSCI ACWI Index outperformed the MSCI ACWI Equal Weight Index by almost 10% during the year (17.5% versus 7.6% return). The Anchor Equity Composite returned 11.4% in 2024. This performance was disappointing, as Anchor’s diversified equal weight strategy was impacted by the weak market breadth. The equity composite has produced a 10.7% average annualized return over the past five years compared to 10.4% for its benchmark. The Anchor High-Quality Income Composite returned 14.0% in 2024 compared to 9.4% for the SG Global Quality Income benchmark. The portfolio has produced a 6.6% annualized return over the past five years compared to 4.7% for the benchmark. \*

# Stock Market Analysis



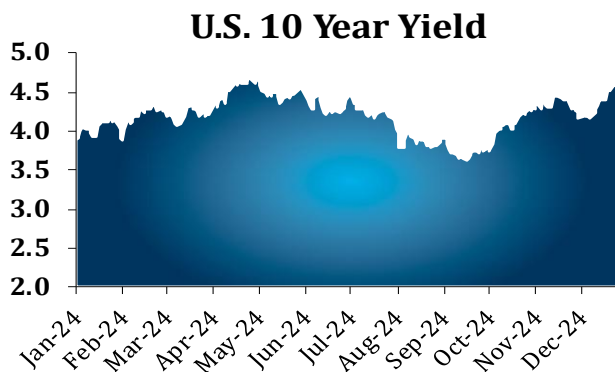
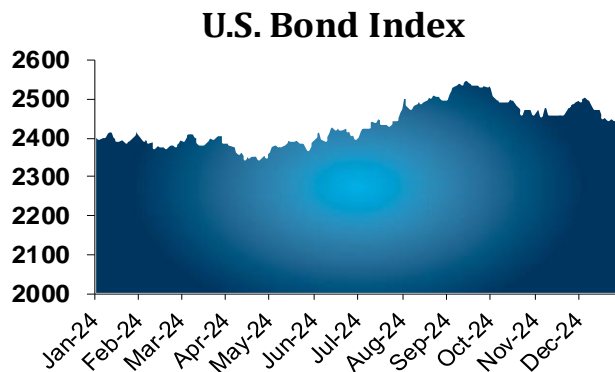
As we look forward, we are positive about the growing use of artificial intelligence which should lead to major productivity gains over the next decade, similar to the impact of internet innovation in the 1990's. The S&P 500 produced an 18.2% annualized average return over that decade. Lower inflation and interest rates should also be a tailwind this year. Tamer inflation rates have allowed the Federal Reserve, ECB and most central banks to lower short-term interest rates. While the Fed has indicated that it will slow the reduction in the Fed Funds rate from the recent 5.5% peak, global monetary stimulus and falling interest rates are historically positive for the equity market. This stimulus will help the earnings of companies in economically sensitive sectors which were hurt by high inflation and rising interest rates. The US should benefit from its AI leadership and the pro-growth policies under the Trump 2.0.

Political risk and protectionism are our largest concerns. Democracy and free markets face some historic challenges as the authoritarian states of China and Russia continue to recruit new partners who do not support western values. The two communist states teamed up with traditional NATO foes, including North Korea and Iran, and increased their influence in Africa and South America. Conflicts in Ukraine, Africa and the Middle East have only widened the divisions. "Bully Politics" has raised the risk of conflicts but also may reverse the major gains from global trade. Protectionism has gained political support but comes with the cost of higher prices and lower selection. We will likely see rising trade tariffs and counter tariffs in 2025. While it is important to limit subsidized dumping which damages domestic industries, tariffs and other trade protections can have serious economic consequences. Free markets are most effective when there is open and unrestricted competition.

\*Performance is based on Anchor equity composite portfolios. Returns include changes in unit value, reinvestment of all distributions, investment management fees, execution, custodial and other charges. Investment results are best judged over the long term. Performance should be evaluated with consideration of the client's specific goals and investment objectives. Past performance is not necessarily indicative of future results. Returns for indices or benchmarks are provided in U.S. dollar terms and solely for informational purposes. These indices or benchmarks are non-managed indices that do not accrue advisory or transactional expenses. Benchmarks are based on the client's selected asset allocation and are calculated in U.S. dollar terms. The Anchor Equity Portfolio benchmark uses the MSCI AC World Total Return Index. The Anchor High Quality Income Portfolio benchmark uses the SG Global Quality Income (USD) Index.

# Fixed Income Analysis

## A Hawkish Cut to End the Year



In the December 2024 FOMC meeting they lowered the U.S. fed funds rate by 0.25%. In the three meetings since September, they reduced the target rate by 1.0% to 4.50%. However, the rate action was widely viewed as a hawkish cut given the changes in the Summary of Economic Projections, dot plot, and Powell's rhetoric. In the Summary of Economic Projections individual members give their expectations for growth, the inflation rate, and the unemployment rate. Compared to the September release, the FOMC's median estimate for real GDP for 2025 was revised higher, while the unemployment rate was revised lower. Additionally, the median estimate for PCE inflation rate showed a notable 0.4% increase to 2.5%. These changes reflect the resilience of the U.S. economy and suggest less need for rate cuts going forward. This notion was reflected in the updated dot plot – individual FOMC member's projection for the path of the fed funds rate over the next few years. The median dot for 2025 now suggests just two 0.25% rate cuts compared to four cuts for 2025 in the September dot plot. The median 2026 dot was 0.50% higher, while the median long-term dot rose from 2.875% to 3.0% (though there remains considerable variance in the 2026 and long-term projections). The dot plots suggest FOMC members have taken a more cautious stance towards cutting rates further.

Chair Powell said as much in press conference, "To cut further after this point, I would say it this way. We reduced our policy rate now by 100 basis points. We are significantly closer to neutral. At 4.3% and change, we believe policy is still meaningfully restrictive. As for additional cuts, looking for further progress on inflation as well as continued strength in the labour market. And as long as the economy and labour market are solid, we can be cautious as we consider further cuts."

# Fixed Income Analysis



The yield curve steepened after the FOMC meeting. The 2-year yield rose 0.09% to 4.24%, while the 10-year yield rose 0.40% to 4.56%. As a result, the slope of the 2Y-10Y portion of the yield curve ended 2024 at the steepest it had been all year at 0.32%. This steepening was likely driven by a couple factors. Firstly, the Fed intends to continue cutting the policy rate while inflation is still above their 2% target (currently 2.7% and revised higher to 2.5% at year-end 2025) at a time when the U.S. economy is ticking along. The Atlanta Fed's real GDP tracker for 1Q25 is currently 2.45%, suggesting continued strength in the domestic economy. Indeed, the rise in the 10-year treasury yield in December was led by an increase in the real yield component suggesting the bond market expects further economic resilience. Second, are fears surrounding the fiscal deficit under President Trump. Specifically, the net effect of tariffs and tax cuts on the deficit. As of the end of November the fiscal deficit was 7.0% of GDP. Theoretically investors should demand a higher return from an obligor with deteriorating financial standing. On a couple occasions in the last few years the bond market quickly pushed U.K. rates higher rebelling against the British government's budget/spending plans. On those occasions, the Sterling concurrently weakened as UK rates moved higher. In the U.S., when treasury rates rose in 2024, the U.S. dollar strengthened. The fear from some market commentators and participants alike is that the U.S. could be reaching the point where U.S. government deficit spending leads to higher rates and a weaker dollar. The counter to this fear is that the U.S. dollar is the world's reserve currency, dominating both world trade and global central bank FX reserves (Russia excluded!).

As we exit 2024, we have central banks across the globe cutting policy rates. The Bank of Japan and Bank of Brazil are the two outliers. In the U.S., the labour market continues to weaken at the margin but is generally holding up well as shown by subdued initial jobless claims. Indeed, the ratio of job openings to unemployed has stabilized at 1.1x since June 2024 and is in line with the pre-COVID-19 level. Inflation has continued to decline, however the pace of disinflation has slowed, while growth has held up well. Against this backdrop credit spreads are near historically tight levels. While we have benefited from this spread tightening, we continue to focus on companies with attractive risk/return profiles as opposed to blindly reaching for yield.



## Disclaimer

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