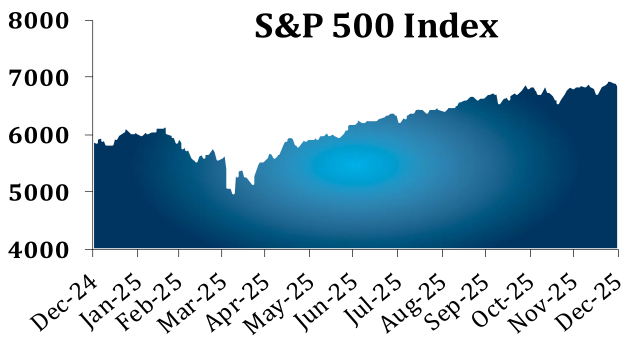
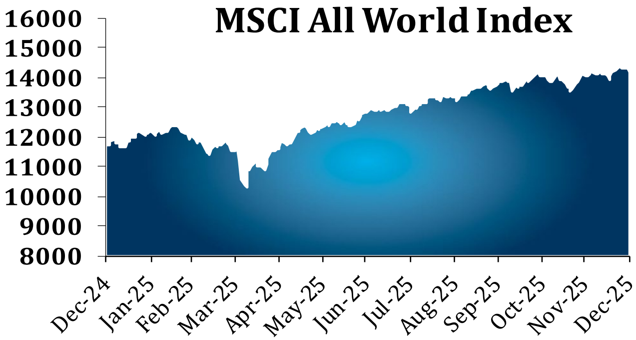
Public

Stock Market Analysis

Peering through the Clouds





ANCHOR
Investment Management

The best investment managers attempt to look beyond the present and assess whether current stock prices adequately discount future cash flows. As Warren Buffett retires from Berkshire Hathaway, it is fitting to reflect on his long-held view of forecasting:

"Within capitalism, some businesses will flourish for a very long time while others will prove to be sinkholes.... It's harder than you would think to predict which will be the winners and losers. And those who tell you they know the answer are usually either self-delusional or snake oil salesmen."

Even in stable environments, forecasting is extraordinarily difficult. Today's unsettled political and economic landscape makes the task even more challenging. Our natural inclination is to absorb vast amounts of data and construct narratives about the future, yet history reminds us that confidence often exceeds accuracy. Traditionally, this exercise has been more reliable in sectors with predictable cash flows—such as Healthcare, Consumer Staples, and Utilities—but even these areas are now experiencing meaningful disruption alongside new sources of opportunity. Periods of rapid innovation tend to reshape entire industries. In such environments, our role as investment managers is to distinguish the likely winners from the losers. The winners include not only direct beneficiaries of Artificial Intelligence, but also indirect beneficiaries—companies that successfully deploy AI to enhance productivity, reduce costs, or reinforce durable competitive advantages. Investors who lived through the dot-com era understand this dynamic well: while innovation can create extraordinary value, many companies and management teams fail to adapt and are ultimately left behind.

Valuation expansion has played a critical role in recent market performance. Despite solid earnings growth over the past three years, much of the market's advance has been driven by multiple expansion, particularly among mega-cap stocks. The S&P 500's trailing price-to-earnings multiple has risen from 17.5x to 25.7x. This level represents a 23.5% premium to the ten-year average of 20.8x and a 36.4% premium to the twenty-five-year average of 18.8x. For perspective, at the peak of the technology bubble in 2002, the S&P 500 traded at 28.2x earnings. Speculative excess during that era was even more pronounced among smaller companies. The Russell 2000 Index's price-to-earnings multiple exceeded 1,000x at the height of the dot-com bubble.

Stock Market Analysis

Today, the Russell 2000 Index trades at 36.6x earnings, compared with a ten-year average of 31.9x. These elevated valuations imply ambitious growth expectations: S&P 500 earnings are forecast to grow approximately 40% over the next three years, while Russell 2000 earnings are expected to roughly double over the same period. International markets have also posted strong gains.

The MSCI EAFE Index returned more than 30% in 2025 and currently trades at 16.8x trailing earnings—a 6.6% premium to its ten-year average of 15.4x. Emerging markets outperformed U.S. indices last year as well, with the MSCI Emerging Markets Index returning 34% and trading at 16.1x earnings, a 13.6% premium to its ten-year average. While valuations outside the U.S. remain lower in absolute terms, the premium assigned to U.S. equities reflects continued investor confidence in American leadership in AI development. Although growth expectations for Europe and Asia have improved, global capital continues to favor North America as the most compelling long-term investment destination.

Portfolio Performance

The Anchor Equity Composite outperformed the MSCI All Country World Index (ACWI) by 3.2% in 2025, delivering a return of 25.5%. Over the past five years, the composite has generated an annualized return of 14.2%, compared with 11.5% for its benchmark. The Anchor High-Quality Income (HQ) Composite returned 11.3% in 2025. This portfolio is designed for U.S. dollar–based investors seeking income through a conservative, high-quality equity strategy. The model adjusts for net dividend yields after accounting for withholding taxes applicable to offshore investors. While no benchmark precisely matches this approach, we reference the SG Global Quality Income Total Return (USD) Index as the closest comparable. There are meaningful structural differences between the benchmark and the Anchor HQ portfolio. Notably, the benchmark allocates only 28% to U.S. equities. The 13.4% appreciation of the euro versus the U.S. dollar in 2025—along with gains in other currencies—significantly boosted benchmark returns. Given that most of our clients are U.S. dollar–based, we have historically maintained a higher allocation to U.S. equities than the benchmark. Over the past five years, the composite has generated a 9.1% annualized return, modestly trailing the benchmark by 0.6%.*

*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.

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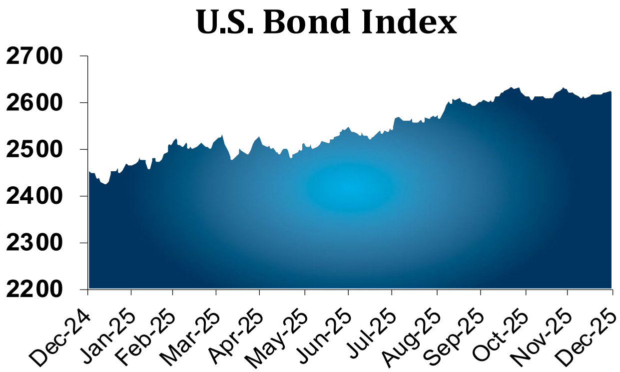
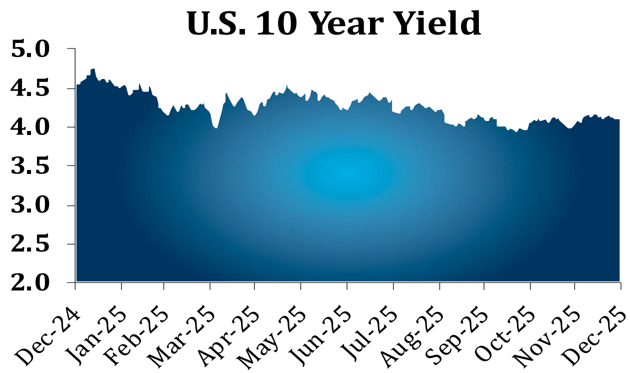
Fixed Income Analysis

Onwards to 2026





Economic growth has remained buoyant, as evidenced by the U.S. third quarter GDP growth print of 4.3% quarter-on-quarter. The Atlanta Fed's GDPNow estimate for Q4 currently stands near 3%. At the same time, the labour market is showing signs of marginal weakening. High-profile layoffs at large companies, including Amazon (14,000 jobs) and Verizon (13,000 jobs), have made headlines, while the unemployment rate for workers aged 16–19 has risen to 16.3%, reflecting the growing impact of AI on entry-level employment.

Personal Consumption Expenditure (PCE) inflation of 2.8% remains above the Fed's 2% target. Goods inflation has picked up following the introduction of President Trump's tariffs, while services inflation has continued to grind lower, led by easing shelter costs. Interpreting these cross-currents has been complicated by the government shutdown in October and November, which disrupted data collection and reduced the reliability of some economic releases. As a result, both policymakers and market participants have been forced to question the signal quality of recent data. For example, the November CPI report came in well below expectations, yet Treasury yields and rate-cut probabilities were little changed, suggesting markets placed limited weight on the release.

Against this backdrop — inflation easing but still above target, and labour market conditions softening but not accelerating — the Federal Open Market Committee cut the fed funds target range by 0.25% to 3.75% (upper bound) at its December 10th meeting, in line with market expectations. In his press conference, Chair Powell noted a degree of division within the Committee, with some members placing greater emphasis on inflation risks and others viewing labour market deterioration as the more pressing concern. This divergence is evident in the Fed's "dot plot," which reveals a wide range of views on the path of policy through 2026, 2027, and beyond, including differing estimates of the neutral rate — the policy rate that neither stimulates nor restrains economic activity. With expectations that President Trump will appoint a more dovish Fed Chair, this unusually broad dispersion of views across multiple time horizons may present a significant challenge for Chair Powell's yet-to-be-named successor when his term concludes in May 2026. Looking ahead, our base case is for the labour market to continue weakening and inflation to grind lower in 2026, which should prompt the Fed to continue easing policy.

Fixed Income Analysis

The dollar weakened notably in the first half of 2025 before stabilizing and then appreciating from September to November. We saw this rebound in dollar strength as an opportunity to add non-dollar exposure. In December, we added an Australian government bond (AUD-denominated) for accounts that can hold non-USD exposures. Relative to the U.S., Australia benefits from a stronger sovereign balance sheet, both in terms of lower debt-to-GDP and a healthier fiscal position. In addition, the Australian yield curve offers higher yields than the U.S. and remains notably steeper, meaning investors are compensated for extending duration. The Reserve Bank of Australia (RBA) is also among the few major central banks that could potentially raise policy rates next year, further supporting Australia's favourable interest rate differential. Finally, the Australian economy stands to benefit from an additional growth "kicker" should Chinese growth surprise to the upside. Such an outcome would likely keep the RBA on a more hawkish footing and could provide further support for the Australian dollar.

Heading into 2026, our portfolios are overweight duration given our expectation for lower rates driven by easing inflation and a weakening labour market. With respect to credit risk, spreads ended 2025 near historically tight levels, leaving little margin for error in the event of an unexpected economic slowdown or exogenous shock. As a result, we remain highly selective in our high-yield exposure, favouring issuers with strong free cash flow generation and/or clear deleveraging paths. Our non-dollar allocation is neutral, consisting of exposure to Norway and Australia — both resource-rich economies offering attractive yields relative to U.S. Treasuries. As always, our focus remains on balancing risk and reward.

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