## Equity Outlook/Review

The fourth quarter saw increased volatility in many markets, especially in December, leaving many asset classes and major indexes down for the year, including the S&P 500 and Dow Jones Industrial Index. In last quarter's commentary we stated that, "As the Federal Reserve continues to normalize short-term interest rates, we believe that the environment for value investing should improve. Higher rates may begin to impact at least two categories of companies: high growth and low quality, especially those with leverage." We believe that this prediction began to play out in the fourth quarter. Higher interest rates and a continued flattening of the yield curve[i] coupled with quantitative tightening, have caused some of the more highly valued growth and concept stocks to decline, and has led to the largest decline in relative valuation of cyclicals vs. the S&P 500 multiple since at least 1980[ii]. In fact, few stocks and few asset classes were unscathed through December 20th, with 93% of global asset classes registering a negative total return (in USD terms)[iii]. The good news is that valuations of many companies are beginning to appear quite attractive to us; for a value investor, the current environment is very exciting. We believe that after several challenging years for active managers, the environment has become more rewarding for active managers and especially for value investors. Anchor's investment process was designed to weather the sort of turbulence that we saw in the fourth quarter, and to take advantage of volatility, thus we remain optimistic about the year ahead.

## Strategy Review & Positioning

Anchor's REIT strategy underperformed the FTSE NAREIT ALL REITs Index in the fourth quarter. The largest detractors to performance included Weyerhaeuser Company (WY), CoreCivic, Inc. (CXW), Sabra Health Care REIT, Inc. (SBRA), Monmouth Real Estate Investment Corporation Class A (MNR), and RLJ Lodging Trust (RLJ). Omega Healthcare Investors, Inc. (OHI) was the largest contributor to performance in the fourth quarter, followed by Realty Income Corporation (O), National Storage Affiliates Trust (NSA), Welltower, Inc. (WELL), and STORE Capital Corporation (STOR).

Anchor Capital's REIT fourth quarter returns were unfavorably impacted as negative returns ranging -20% to -31% from timber REIT, Weyerhaeuser, prison REIT, CoreCivic, health care REIT, Sabra Health Care, warehouse REIT, Monmouth and lodging REIT, RLJ Lodging more than offset positive contributions from health care REITs, Omega Health Care and Welltower, triple-net single-use retail REITs, Realty Income and Store Capital and self-storage REIT, National Storage Affiliates.[iv]

Outfront Media Inc. (OUT) was added to the portfolio during the fourth quarter. Welltower, Inc. (WELL) was sold out of our concern that the growing supply of assisted living facilities would continue to negatively impact individual facility rents and occupancies. Outfront Media is the second largest billboard and transit display advertiser. Outfront converted from a full tax paying corporation to a REIT in 2014. Outfront should grow earnings and dividends as analogue billboards are converted to digital. Its greater focus on transit displays should result in higher growth as transit displays are in a much earlier stage of conversion to digital. Anchor feels that Outfront should continue to capture an increasing share of the U.S. advertising market.

REIT share price volatility in 2018 and continued growth of REIT dividends supported by favorable real estate fundamentals has resulted in the average dividend yield for the FTSE NAREIT ALL REIT Index rising to 4.8% up from 4.3% at the start of the 2019.[v] REIT dividend yields relative to the often used comparison of 10 Year Treasury yields widened to 211 basis points from 186 basis points. Over the last thirty years REITs yield on average 112 basis points above 10 year treasuries. As of 12/31/18 Anchor's REITs on average yielded 5.8% or 100 basis points greater than REIT averages.

Anchor has observed that REIT volatility is greatest during times of economic and interest rate uncertainty. However, the long-term positive investment characteristics of REITs remain very much in place. Namely, the

disciplined deployment of capital into real estate related investments.  Real Estate in 2018 became its own sector in the major indexes in recognition of the REITs trillion dollar market capitalization and its control of 20% of the U.S. commercial real estate.  As a value based investment firm, Anchor applies its disciplined investment process to identify REITs selling at discounts to the private market value of its real estate or operations.  Anchor REIT portfolios are characterized by lower Price to Funds From Operations (P/FFO), lower Enterprise Value to cash flow (EV/EBITDA)[vi] less maintenance capital spending and higher yields than the broader REIT averages.

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[i] Factset financial data and analytics; Research systems
[ii] Compustat, FactSet financial data and analytics, I/B/E/S, and Goldman Sachs Global Investment Research
[iii] Deutsche Bank, Bloomberg Finance LP, GFD
[iv] Ibid.
[v] Ibid.
[vi] Price to Funds From Operations (P/FFO):  A funds from operations (FFO) multiple is the multiple of the FFO per share of a particular organization. This is calculated by dividing the price of the shares by theFFO per share. The FFO multiple is a very important concept in real estate investment trust (REIT) valuation. Entertprise Value to cash flow (EV/EBITDA): EV divided by EBITDA or earnings before interest, taxes, depreciation, and amortization. EV (the numerator) is the company's enterprise value (EV) and is calculated as follows: EV = market capitalization + preferred shares + minority interest + debt - total cash

For a complete listing of all strategies contact Anchor Capital Advisors LLC (617) 338-3800.

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