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Outlook/Review

The U.S. equity markets continued to rally into the second quarter as companies reported better than expected earnings. S&P 500 companies reported first quarter earnings growth of 1.6% versus expectations for negative earnings growth.ⁱ In late April, it was announced that U.S. and China trade talks had stalled and President Trump was implementing a 25% tariff on \$250 billion of imported goods.ⁱⁱ President Trump also banned U.S. companies from supplying communication equipment to the Chinese company, Huawei.ⁱⁱⁱ As a result, U.S. equity markets declined 6% in May.^{iv} Meanwhile, the 10 Year Treasury Bond rallied with its yield dropping by 0.50% to 2.0%.^v With slowing global economic growth the Federal Reserve has indicated that it may cut interest rates by year end.^{vi} With an expected interest rate cut, the U.S. equity markets have rallied back in June, ending the quarter about where they started.^{vii} While forecasters are expecting slower growth in the U.S. and globally, the economic conditions remain fairly stable with employment continuing to be strong and consumer confidence remaining high.^{viii}

Strategy Review & Positioning

Anchor's Small-Mid Cap Value strategy outperformed the Russell 2500 Value Index in the second quarter. The top three factors that contributed to outperformance were security selection in Financial Services and Health Care, as well as an overweighting in Producer Durables. The largest detractors to performance included an underweighting in Financial Services, and security selection and an overweighting in Consumer Discretionary.

NV5 Global Inc (NVEE) was the largest contributor to performance in the second quarter, followed by Perficient, Inc. (PRFT), Woodward, Inc. (WWD), DENTSPLY SIRONA, Inc. (XRAY), and Cavco Industries, Inc. (CVCO). The largest detractors included KAR Auction Services, Inc. (KAR), Conduent, Inc. (CNDT), Hooker Furniture Corporation (HOFT), Wolverine World Wide, Inc. (WWW), and CDK Global Inc (CDK).

Three names were added to the portfolio during the second quarter, International Money Express Inc. (IMXI), KAR Auction Services, Inc. (KAR), and Winmark Corporation (WINA). Additionally, we exited four names during the quarter, Knowles Corporation (KN), Conduent Inc. (CNDT), Ubiquiti Networks, Inc. (UBNT), and YY, Inc. Sponsored ADR Class A (YY).

International Money Express Inc. is a money remittance company focused on Latin America and the Caribbean. The CEO and other insiders collectively own 56% of the company.^{ix} We believe the company is taking share in Latin America as it recently grew market share from 8% to 17% in Mexico and from 14% to 25.5% in Guatemala.^x We think the company can replicate those market share gains in Africa. Its leading market share, propriety software and technology, and brand position it well for continued growth.

KAR Auction Services, Inc. operates in the whole car and salvage auction markets, as well as floorplan financing.^{xi} The company is splitting into two pieces, and we believe that the sum of the two parts is worth more than the valuation of the company as one entity.

Winmark Corporation is a franchisor of five value-oriented retail store concepts that buy, sell, and trade gently used merchandise. It also operates an equipment leasing business.^{xii} Winmark's distinctive business model and value proposition benefit both the customer and the company. Its business should be defensive in economic downturns. We appreciate the company's franchise model as it generates above average returns and cash flow which the company returns to shareholders via dividends and share repurchases.

Despite a volatile period, smaller capitalization stocks finished positive in the quarter. They did however lag larger capitalization stocks,^{xiii} mainly due to better earnings growth at larger companies. The U.S. economy is healthy and valuations reasonable, but we are watching for further earnings weakness. We expect market volatility to continue, but are prepared to invest should the opportunity arise as we remain positive on the investing environment. As usual, high credit quality, self-funding, sustainable business models, and valuation remain of utmost importance.

ⁱ https://www.trpropresearch.com/pdf/SP500_Earnings_Scorecard.pdf/

ⁱⁱ <https://www.china-briefing.com/news/the-us-china-trade-war-a-timeline/>

ⁱⁱⁱ Ibid.

^{iv} FactSet financial data and analytics; Charting

^v Ibid.

^{vi} <https://www.nytimes.com/2019/06/21/business/economy/fed-trump-interest-rates.html>

^{vii} FactSet Data & Analytics, Charting

^{viii} <https://www.schwab.com/resource-center/insights/content/sector-views>

^{ix} FactSet financial data and analytics; Company data

^x International Money Express Investor Presentation, First Quarter 2019

^{xi} FactSet financial data and analytics; Company information

^{xii} FactSet financial data and analytics; Company information

^{xiii} FactSet financial data and analytics; Attribution

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

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