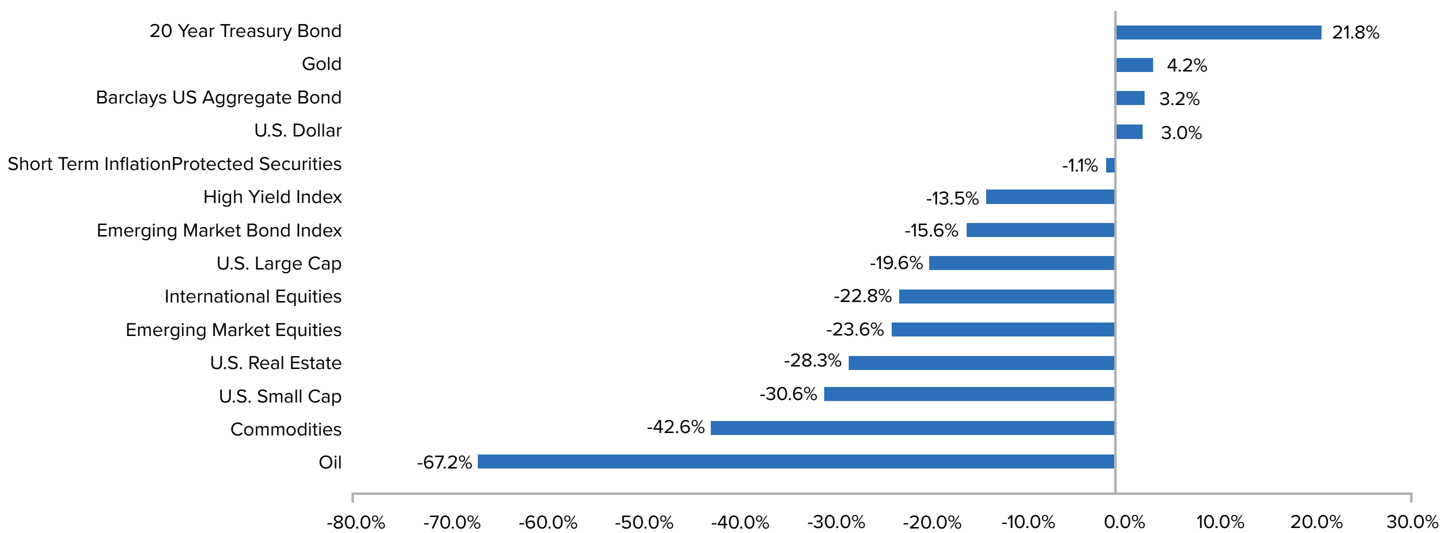
The views expressed below are those of Anchor Capital Advisors, LLC ("Anchor") as of the stated date and are subject to change at any time. They are based on our proprietary research and general knowledge of said topic. The below content and applicable data are in support of our views on said topic. Please see additional disclosures at the end of this publication.

Q1 Review

We hope that you and your families are staying safe and healthy through the COVID-19 outbreak. It is times like these that remind us to appreciate our families, friends, clients, and colleagues. While a timeframe on when the virus may be contained remains uncertain, with increased testing, the U.S. should follow a similar path as some of the Asian countries and Germany who have managed to tamp down spread of the virus[i]. In the meantime, we are all dealing with a great deal of uncertainty and disruption. The sudden closure of so many businesses and increase in unemployment is placing a tremendous strain on families as well the economy as a whole. Given how dramatically this crisis has impacted not only people's health and the healthcare system, but also the worldwide econ-omy, the post virus world could look very different. As the timeframe lengthens, some businesses will have trouble restarting, and many that do will emerge with increased levels of debt.

First Quarter 2020 Returns



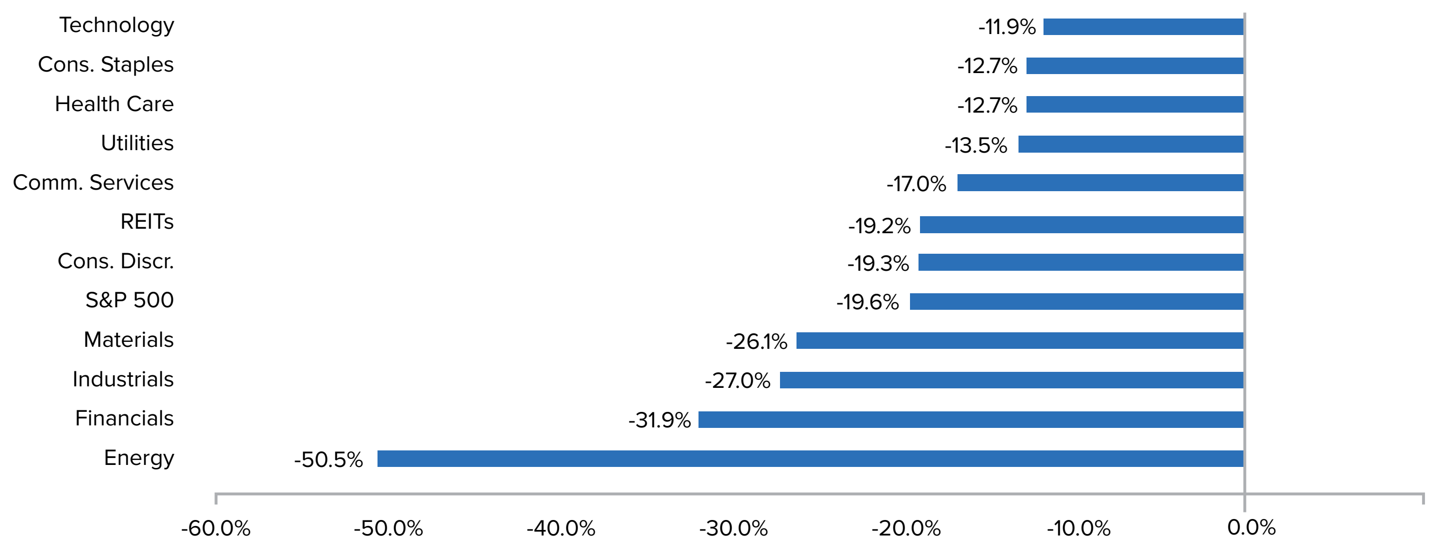
Source: FactSet financial data and analytics

U.S. Markets

The U.S. equity markets peaked on February 20th[ii] and have been in rapid decline as COVID-19 started to spread from Asia to Europe and then the United States. Cities in Northern Italy started to lockdown, and by March 8th the entire country was locked down[iii]. At the end of February, we saw an outbreak of cases in Washington state, and since then, the infection rate has increased exponentially across the U.S.[iv], but most notably in New York[v]. Several states have imposed stay-at-home orders, with work outside the home only permitted for essential industries[vi]. President Trump, once hopeful for a return to work by Easter, has extended restrictions to the end of April[vii]. As a result, huge parts of the economy, including airlines, cruise lines, hotels, restaurants, retailers, and other small businesses have halted with no certain end date in sight[viii].

Small and mid cap stocks have been impacted more than large cap stocks, as many of the businesses hardest hit tend be smaller[ix]. Companies with higher levels of leverage are also impacted, as there are concerns over declining cash flows and potential defaults[x]. From a sector perspective, energy has been the hardest hit, with oil prices dropping more than 60% this year[xi]. Banks have also been hurt by declining interest rates and loan exposure to the worst-hit areas[xii]. However, banks are in much better shape than 2008 and are well-capitalized to handle this downturn[xiii]. But there are some bright spots in industries that are benefitting from the work-from-home environment and the race to develop a vaccine. Technology, grocery stores, consumer products, pharmaceutical, medical supplies and testing, web streaming, and communications companies are seeing gains[xiv]. Energy and financials are larger sectors in the value indexes, and with both sectors currently underperforming, value continued to underperform growth during the quarter[xv].

First Quarter 2020 S&P 500 Sector Returns



Source: FactSet financial data and analytics

China and Asia

Before COVID-19, China was struggling to deal with the effects of the two-year trade war with the U.S. Many industries in China, like housing[xvi] and auto sales,[xvii] had declined year over year and GDP growth had hit the lowest level in 29 years at 6.1%[xviii]. It is believed that COVID-19 originated in the Wuhan province of China, where 11 million people live[xix]. The country went into lockdown at the beginning of January, around the time of the Chinese New Year[xx]. In late February, factories started to reopen and are now believed to be fully functional[xxi]. Students are just beginning to return to classes, but many residents are still cautious about being in public. While economic signs are starting to improve, it is expected that the Chinese economy will be in a sluggish state for some time, and GDP growth may be low single-digit for the year[xxii]. One interesting outcome is that the China A share stock market was only -9.1% for the quarter, which was one of the best performing equity markets[xxiii]. Other large Asian economies such as South Korea adopted high levels of testing and quarantining to contain COVID-I9, and it appears they have done a good job controlling it, but their economies are hit equally hard[xxiv].

Europe

As mentioned, the COVID-19 outbreak in Europe started in Italy and expanded rapidly to France, Spain, U.K., Switzerland, Germany, and Portugal. All of these countries are in total lockdown, with no travel in or out[xxv]. With the shutdown, GDP growth across the eurozone is expected to be negative for the first and second quarters, with the impact continuing into the summer travel season[xxvi]. There is a concern whether Italy may default on its debt[xxvii]. The European Central Bank (ECB) did not reduce its interest rate, as the benchmark rate is already at -0.5%[xxviii], but they did approve an $850 million bond buying program of both government and corporate debt[xxix]. In similar fashion to Mario Draghi's effort in 2012 to save the euro, the ECB's current President Christine Lagarde has stated: "There are no limits to our commitment to the euro."[xxx] We expect that we will see more stimulus programs if the European economies continue to be shut down for extended periods of time.

Oil

In addition to COVID-19 stress, Saudi Arabia and Russia, two of the largest oil producers, refused to extend the production cuts that expired at the end of March[xxxi]. Furthermore, Saudi Arabia has indicated it will increase production and has slashed customer prices [xxxii]. The oil price has declined from $60/barrel to $20/barrel[xxxiii]. Even the best U.S. oil producers don't have cost levels that low, and energy company shares have declined by 50% or more this year[xxxiv]. Energy production is critical to the U.S., and we believe there will be increased bankruptcies and consolidations the longer oil prices remain this low.

U.S. Fixed Income

While the bond sector tends to have lower returns and lower volatility than equities, we saw more volatility than normal in March. The 10-year U.S. Treasury bond yield fluctuated from 1.5% at the beginning of the yield down to 0.5%, back up to 1.2% and now back to 0.7%[xxxv]. Meanwhile, bonds with any credit exposure, such as investment-grade corporate bonds, high yield, leveraged loans, and even municipal bonds sold off as investors raced to move money into money market accounts over concerns of rating downgrades and borrower defaults[xxxvi]. There were even liquidity issues in the overnight commercial paper and repo markets as the banks were reluctant to lend[xxxvii]. As a result, the only "safe place" was longer dated Treasury bonds during the quarter[xxxviii]. Even shorter-term Treasury bonds were trading at negative rates, given how low interest rates have gone[xxxix].

U.S. Federal Reserve and Government Stimulus

In response to the volatile equity markets and liquidity concerns in the fixed income markets, the Federal Reserve has taken a series of measures that were last seen in the 2008 Great Financial Crisis (GFC)[xl]. The Fed reduced interest rates twice in March, so the benchmark interest rate is close to 0%. They have provided unlimited support to the repo market and have increased quantitative easing (QE) by making large scale purchases of all bonds, including investment-grade corporate bonds and ETFs[xli]. Through all of these measures, the Fed's balance sheet is over $5.3 trillion[xlii]. The highest the Fed balance sheet got previously was in May 2016 at $4.6 trillion[xliii]. The Fed reiterated it would do whatever it takes to support the markets. On the fiscal side, Congress passed the $2 trillion CARESares Act[xliv] at the end of March. This is supposed to provide individuals with cash payments and extra unemployment benefits, loans for small businesses and corporations directly impacted by the shutdown, as well as to state and local governments responding to COVID-19[xlv]. We expect that Congress will step in with additional fiscal stimulus.

Safe Havens: Gold /U.S. Dollar

Through the volatility, the real safe havens have been gold and the U.S. Dollar, but even those asset classes fluctuated in price over the quarter. The U.S. Dollar Index (DXY), which stood at $96.85 at the beginning of the year, reached $102.82 in March before dropping to $99.05 at quarter-end, but ended up 3% for the quarter[xlvi]. Gold was equally up and down, but the $/oz ended up 4.2% for the quarter[xlvii].

Economic Outlook

Given the amount of uncertainty, it's very difficult for economists to give a firm outlook, although many are trying. Second-quarter GDP forecasts are expected to be down significantly with a rebound in the second half of the year[xlviii]. A lot of this depends on testing and containment of the virus and the duration of the shutdown. What we do know is that we expect the Federal government to provide as much stimulus and backstops as the country needs to get through this period. Some people are worried about the growing debt levels, but many economists have said we can't worry about that at this time, given the circumstances.

Conclusion

At Anchor, we view this as an opportunity to invest as we see attractive valuations. The investment team is encouraged by what they are seeing and will buy when others are selling. Anchor has seen clients through these market downturns before, and one of the important things we learn each time is that markets do recover, and it's important to stay invested.

We are here to help, and we are available to talk about whatever is on your mind. Please don't hesitate to reach out. Stay safe and healthy.

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