ANCHOR
CAPITAL ADVISORS LLC

GLOBAL MARKETS REVIEW Q3 2020

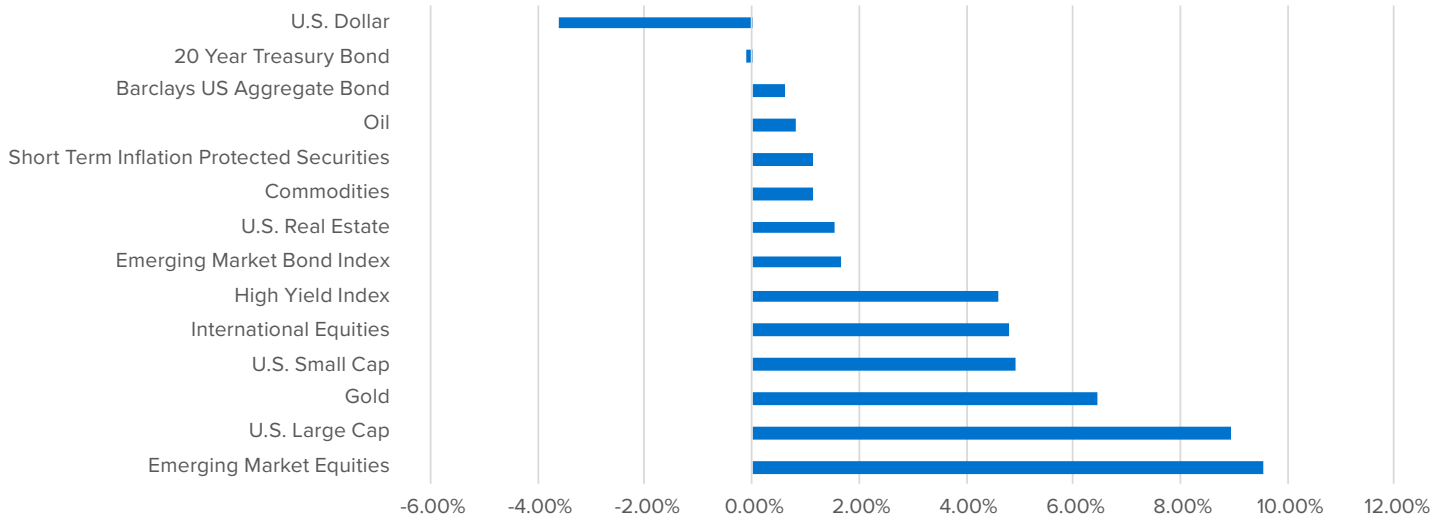
The views expressed below are those of Anchor Capital Advisors, LLC ("Anchor") as of the stated date and are subject to change at any time. They are based on our proprietary research and general knowledge of said topic. The below content and applicable data are in support of our views on said topic.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

Overview

The U.S. equity markets continued to climb in July and August before retracing a portion of the gains in September. COVID-19 infection levels and deaths peaked in July, and then started to decline. However, with the return to school this fall they have started to rise again in many parts of the globe. It now appears that disruptions to people's lives and the U.S. economy are likely to continue until an effective vaccine for COVID-19 is approved by the FDA.

The leader in the equity markets has been Emerging Markets, rising over 9% for the quarter, which was closely followed by the S&P 500 at 8.9%[1]. U.S. Mid and Small Caps were also positive for the quarter while Developed International followed at 4.8%.[2]

Third Quarter 2020 Returns



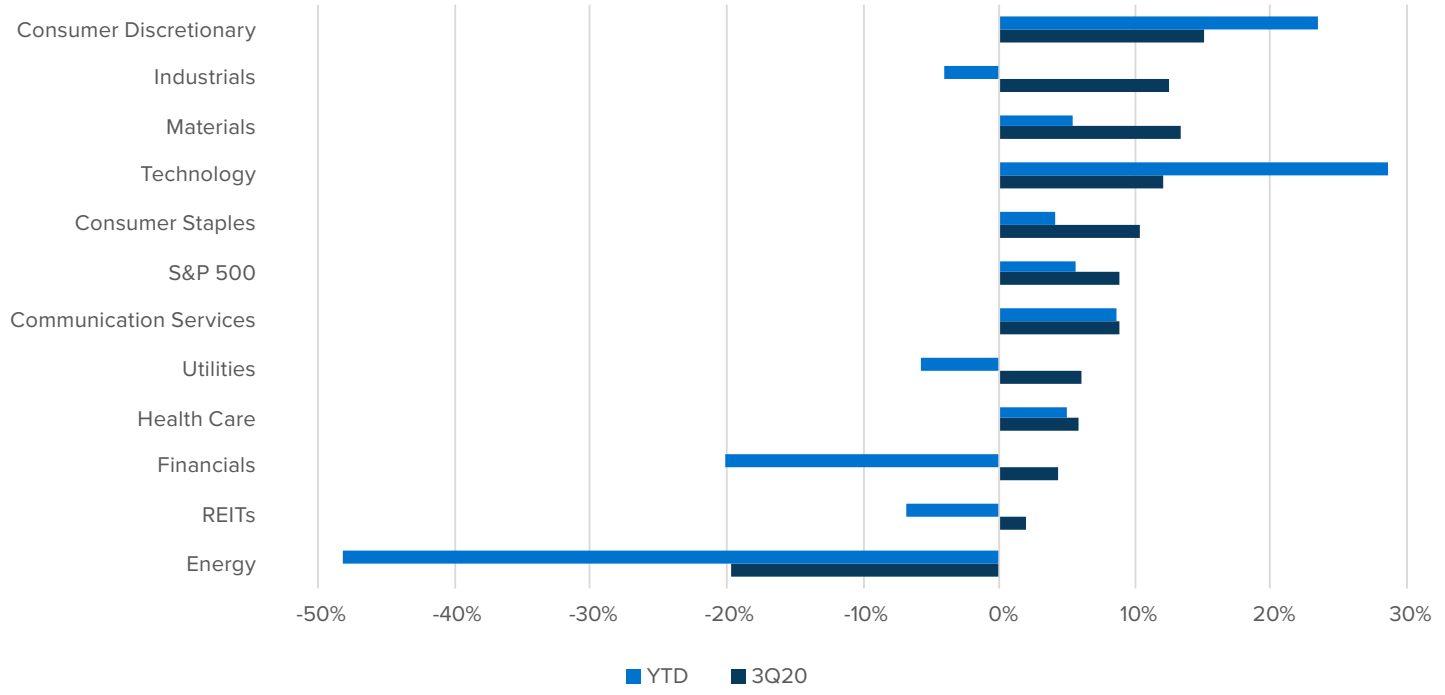
Source: FactSet financial data and analytics

U.S. Markets

It is notable that both the MSCI China and S&P 500 indexes are heavily concentrated in large cap technology related stocks. The rise in the U.S. stock markets in July and August was the result of large cap technology and growth stocks going nearly parabolic, widening even further the gaps between the returns for growth versus value and large cap versus mid and small cap stocks. The five largest companies, Apple, Microsoft, Amazon, Alphabet (Google) and FaceBook account for 23% of the S&P 500 and 47% of the Russell 1000 Growth, and were up on average 39.8% YTD contributing to most of the S&P 500 Index's 5.6% return through September 30th[3]. Returns in the equity markets continue to vary widely with more stocks down versus up. YTD the Russell 1000 Growth was up 24.3% while the Russell 1000 Value was down 11.6%[4]. The S&P Mid Cap was down 8.6% and the S&P Small Cap was down 15.3% and YTD the equal weight S&P 500 was down 4.8%[5].

Many ask what has been driving this massive run in technology related stocks. Indirectly, we believe it can be attributed to government cash payments and consumers spending more time at home. As we have learned over the course of this year, and most notably this summer, personal trading with zero commissions at Robinhood, E-trade, and Charles Schwab reached levels not seen since the dot.com era.[6] Trading at Robinhood doubled in the second quarter and it had 4.3 million in daily average revenues trades (DARTs) in June – the highest of all retail trading platforms.[7] The other aspect affecting the market was Japan's SoftBank, which reportedly put $4 billion to work in call options in these technology stocks.[8] In call option contracts, the person writing the option needs to have the shares available to sell at the strike price, which causes more buying of the stock and results in higher prices. Finally, another aspect driving the prices in technology stocks were stock splits.[9] Tesla and Apple stock split on the same day.

Third Quarter 2020 and YTD 2020 S&P 500 GICS Sector Returns



Source: FactSet financial data and analytics

Early in September, the market frenzy appeared to reach a peak as Anchor's investment team members were sharing articles on the extremes in the markets. Very quickly, the NASDAQ index, dominated by technology stocks, pulled back over 10%. On an encouraging note, we have observed the start of a rotation to value oriented sectors. The better performing sectors in September were industrials and materials. We think a transition to value would be a very healthy development for the overall equity markets and those invested in these names, many of which seemingly remain in bear market territory. The spread between the large cap growth and large cap value indices has reached historically wide levels, which have not been seen since the dot.com period. We do not think technology is going to implode, as it is an integral part of the economy and generates significant earnings relative to the end of the 1990s. However, at these elevated valuations, we project this sector's returns will do less well. Also, in an economic recovery, value oriented sectors tend to outperform.

U.S. Economy

Outside of the equity markets, the U.S. economy is gradually improving, but remains far below the levels reached in 2019. After the massive decline in March, there was a strong rebound in retail sales, housing, and manufacturing.[10] Low interest rates and the desire to move out of densely populated urban centers during the pandemic have propelled housing, especially in more suburban and rural areas.[11] Retail sales have been strong due to stimulus checks and stay-at-home orders, but it appears the levels we saw from April to August are starting to level off.[12] Despite these positives, many industries, especially those related to tourism and entertainment, continue to be impacted and will take time to recover.

Fixed Income

To support the economy and to fulfill the mission of full employment, the Federal Reserve has extended its zero rate policy to a timeline of 2022, and even 2023, and has adjusted its inflation targets to let inflation move well above the 2% (its historic target) level before taking action. Over the last six months, the fixed income market has fully recovered – supported by Federal Reserve bond buying and historic levels of incremental liquidity.[13] The 10-Year Treasury yield remains range bound between 0.60% and 0.70%.[14] In addition to offering effectively no real return, many strategists have noted that Treasury bonds that have historically provided a safe haven when equity markets have sold off, no longer provide that downside protection given the low level of Treasury bond yields.[15] Other parts of the fixed income market have also fully recovered with credit spreads on investment grade corporate bonds close to the levels we saw in January.[16] This does not provide great opportunities in bonds in general, especially when the stock market is providing a 2% yield relative to the 10-Year Treasury bond yield at 0.70%.[17]

China

The Chinese economy appears to be recovering from the COVID-19 virus and shutdown with most economic indicators turning positive. The Caixin China General Manufacturing PMI increased in August to 53.1, with numbers above 50 indicating economic expansion.[18] Retail sales turned positive in August for the first time this year at +0.5%.[19] The expectation from the IMF is that China will have a positive GDP growth of 1.2% for 2020 whereas most of the rest of the world will have negative GDP growth for the year.[20] While China is recovering, they still need the rest of the world to regain strength to buy Chinese goods. Currently, there is still some question over whether the Chinese will buy U.S. soybeans or Boeing airplanes and we believe they are waiting to see the outcome of the presidential election.

Europe

Europe appeared to have recovered much more quickly than the U.S. after a very stringent shutdown. However, Europe seems to be having a resurgence of virus infections more recently. Overall, Europe has worked together during this time and in July they came to agreement for the European Union to sell $892 billion in bonds to support the struggling economies of Italy and Spain.[21] Individual countries have also provided government support. In France, Europe's second largest economy, they have provided $118 billion in government aid.[22] Generally, the European economy has weathered this crisis with the support of social payments and a national healthcare system. Despite the support, Europe continues to deal with demographic issues and lower growth, which will impact GDP growth for the region for many years to come.

U.S. Dollar

The U.S. dollar has continued its decline this year and many attribute that to the rising U.S. federal debt levels and potential for inflation.[23] The decline of the U.S. dollar is beneficial for countries outside the U.S. as investments in foreign currencies are now worth more. In addition, dollar denominated debt is more attractive when the U.S. dollar is weaker, which is beneficial for foreign countries. If we continue to see a lower U.S. dollar, we may see a rally in emerging and international markets. Furthermore, as those economies recover they tend to be higher consumers of energy, materials, and industrial goods.

Oil

While the price of oil rose to $40 barrel during the quarter, it has remained fairly range bound since it dropped in April.[24] The expectation for lower oil prices remains as we have relatively weak demand for oil at the moment. That outlook could change as economies recover. However, our longer term outlook on oil is not great given the larger focus on electric vehicles and regulations requiring renewable energy.

Gold

The price of gold climbed above $2,000/oz. in early August – the highest price it has been – and now has settled below $1,900/oz.[25] Many investors have been adding gold to their portfolios, deeming it a safe haven asset or an asset that holds value given the potential for higher inflation. However, there have been a number of studies on gold showing that it can have moderately high volatility and is not necessarily the safe haven asset everyone expects. In addition, investors have had trouble assigning a true valuation to it. But it is a diversifying asset and could potentially play a role in portfolios.

Our Observations

While the market has rallied since March, it has been more concentrated in certain stocks and certain sectors.[26] Despite headlines touting strength, there are broad parts of the market that are still down year-to-date and still very much in recovery mode, especially in small and mid-cap stocks. While Anchor believes there is significant opportunity for many smaller companies, with continued economic recovery supported by both Fiscal and Federal Reserve policies, in the near term we may see choppiness going into the November elections. Outside the U.S., the weaker U.S. dollar and lower valuations should provide a tailwind to international markets.

1. FactSet Data & Analytics, Charting
2. Ibid.
3. FactSet Data & Analytics, Charting
4. Ibid.
5. Ibid.
6. https://www.bloomberg.com/news/articles/2020-08-06/robinhood-craze-born-in-america-is-now-moving-stocks-everywhere?
7. https://www.cnbc.com/2020/08/10/robinhood-reports-more-monthly-trades-than-rivals-charles-schwab-e-trade-combined.html
8. https://www.wsj.com/articles/softbanks-bet-on-tech-giants-fueled-powerful-market-rally-11599232205?mod=searchresults&page=1&pos=12
9. https://www.wsj.com/articles/apple-tesla-shares-keep-rising-after-stock-splits-11598900644
10. https://www.prnewswire.com/news-releases/pmi-at-56-0-august-2020-manufacturing-ism-report-on-business-301121423.html
11. https://www.wsj.com/articles/millennials-help-power-this-years-housing-market-rebound-11598520601
12. https://www.wsj.com/articles/us-economy-august-retail-sales-coronavirus-recovery-11600200513
13. FactSet Data & Analytics, Charting
14. Ibid.
15. GMO Quarterly Letter 2Q20
16. https://fred.stlouisfed.org/series/BAMLC0A0CM
17. FactSet Data & Analytics, Charting
18. https://tradingeconomics.com/china/manufacturing-pmi
19. https://tradingeconomics.com/china/retail-sales-annual
20. https://www.imf.org/external/datamapper/NGDP_RPCH@WEO/OEMDC/ADVEC/WEOWORLD/CHN
21. https://www.cnn.com/2020/07/21/economy/eu-stimulus-coronavirus/index.html
22. https://www.cnbc.com/2020/09/03/france-unleashes-100-billion-euro-stimulus-to-revive-economy.html
23. FactSet Data & Analytics, Charting
24. Ibid.
25. Ibid.
26. FactSet financial data and analytics

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

ANCHOR CAPITAL ADVISORS LLC
Two International Place, 21st Floor
Boston, MA 02110

telephone 617.338.3800
facsimile 617.426.6871
email info@anchorcapital.com

ANCHORCAPITAL.COM