ANCHOR CAPITAL ADVISORS LLC

Managed Accounts
Balanced Value Investment Review
As of September 30, 2020

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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.

Large vs. Small/Mid and Growth vs. Value

Managed Accounts Model Performance[i]

Past performance is not indicative of future results. Inherent in any investment is the possibility of loss.

Strategy Performance	3Q20	YTD	10 Year Annualized
Anchor Balanced Value (Pure Gross)	3.50	-5.24	6.65
Anchor Balanced Value (Net)	2.73	-7.36	3.49
60/30/10 (R1000V/BCIGC/CG90TBIII)	3.56	-4.74	7.10
Russell 1000 Value	5.59	-11.58	9.95

Notably, during the rise in the stock markets in July and August, the growth of many large cap technology and growth stocks went nearly parabolic, widening even further the gaps between the returns for growth versus value and large cap versus mid and small cap. The five largest companies, Apple, Microsoft, Amazon, Alphabet (Google) and Facebook – which account for 23% of the S&P 500 and 47% of the Russell 1000 Growth – were up on average 39.8% YTD through September 30.[ii] With inclusion of these names, the S&P 500 Index was up 5.6%. Without them, the S&P 500 was down 1.8%.[iii] The Russell 1000 Growth increased 24.3% while the Russell 1000 Value was down 11.6%. The S&P Mid Cap was down 8.6% and the S&P Small Cap was down 15.3%.[iv]

Technology

Prices and valuations have leaped ahead of the most optimistic projections for earnings growth. Tesla is one of just a number of companies that has served as a poster child for this trend. Tesla has increased over 400% this year alone and has a market capitalization of over $400 billion.[v] While the growth in electric vehicles is very dramatic and deserving attention, it is remarkable that Tesla will produce only 400,000 vehicles this year and yet has a market capitalization greater than all the other major auto manufacturers (Toyota, VW, Daimler, BMW, GM and Ford) combined, which on average collectively produce over 20 million vehicles a year.[vi]

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. 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.[vii] 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.[viii] The other aspect affecting the market was Japan's SoftBank, which reportedly put $4 billion to work in call options in these technology stocks.[ix] 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 the technology stocks were stock splits.[x] Tesla and Apple stock split on the same day.

Additional examples of this exuberance include cloud computing company Snowflake that recently went public. On the first day of trading, Snowflake reached an $81 billion market capitalization.[xi] Yet, the company has only $400 million in revenues and no earnings.[xii] In contrast, Amazon went public in 1997 at a market capitalization of $442 million.[xiii] It took another 14 years for Amazon to reach a market capitalization of $80 billion and at that time it had $34 billion in sales.[xiv]

Our Observations

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.[xv] 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.[xvi] 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.[xvii] 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.[xviii] 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.[xix] 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.[xx] The 10-Year Treasury yield remains range bound between 0.60% and 0.70%.[xxi] 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.[xxii] 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.[xxiii] 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%.[xxiv]

Presidential Election

Many clients have been asking our thoughts on the upcoming presidential election. While it is very difficult to predict the outcome, there are four main areas of potential market impact we are watching out for if the Democrats do regain control. The big one, which could be the most impactful to the markets overall, would be a change of the corporate tax rate from 21% back to 28%.[xxv] JP Morgan has noted that this would be a $9 hit to the S&P 500 earnings.[xxvi] However, JP Morgan notes that an increase in Federal minimum wage and infrastructure spending could offset some of that impact.[xxvii] The other three areas that could potentially be impacted are sector specific: drug pricing related to the pharmaceutical industry; changes in defense spending; and changes to fracking policy.[xxviii] Anchor has taken the approach that it is best not to be overly exposed to any one of these industries prior to the election.

Adjusting to a New Normal

Currently, there are over 1000 vaccines and treatments going through FDA trials around the globe,[xxix] with several that appear promising. The hope is that we will have a vaccine approved by the FDA early next year. Several Anchor portfolio companies are developing a COVID-19 vaccine, including Pfizer and Johnson & Johnson.

It is notable that both people and the economy as a whole are adjusting to a new normal. Rather than focusing on the changes that are occurring, at Anchor we are more focused on how long these changes will last. As we noted earlier, retail sales have been fairly strong, but mainly related to housing. One of our portfolio companies, the home improvement store Lowe's, reported double digit same-store sales increases as consumers were more focused on home improvement during the lockdown. Off-priced retailers, such as Ross Stores and Burlington Stores, reported solid strength in their home furnishings section as they re-opened stores. Other companies such Wayfair and Restoration Hardware also reported strong sales.

ESG

Another area gaining both individual and institutional investor attention are companies that have strong Environmental, Social and Governance (ESG) profiles. In particular, we have been evaluating the utility sector, which had a number of challenges this summer with the wildfires on the West Coast. What has been most noticeable is the outperformance of utilities that are moving quickly towards renewable energy versus utilities that are behind in that area. Utilities tend to be higher carbon emitters and from an ESG standpoint they are less desirable. However, from a fundamental view they tend to have stable cash flows and provide what we feel to be attractive dividend yields. Anchor is very mindful that the equity market is putting pressure on those companies and sectors that are not making sufficient improvements in ESG.

Conclusion

While the market has rallied since March, it has been more concentrated in certain stocks and certain sectors.[xxx] 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. Anchor's holdings and research continue to focus on those companies we think are positioned to have strong business fundamentals in the post COVID-19 world.

STRATEGY DETAIL

Quarterly Attribution[xxxi]

Security Contribution (5 Highest)
Apple Inc. (AAPL)
Lowe's Companies, Inc. (LOW)
Huntsman Corporation (HUN)
TE Connectivity Ltd. (TEL)
Progressive Corporation (PGR)

Security Contribution (5 Lowest)
Hexcel Corporation (HXL)
Texas Pacific Land Trust (TPL)
BP p.l.c. Sponsored ADR (BP)
Marathon Petroleum Corporation (MPC)
Boeing Company (BA)

Sector Contribution (3 Highest)
Consumer Discretionary
Consumer Staples
Technology

Sector Contribution (3 Lowest)
Energy
Basic Materials
Real Estate

Quarterly Purchases

- iShares 3-7 Year Treasury Bond ETF (IEI)
- Vanguard Short-Term Inflation-Protected ETF (VTIP)
- Ross Stores Inc. (ROST)
- Haemonetics Corporation (HAE)

Quarterly Sales

- iShares Short Treasury Bond ETF (SHV)
- Royal Dutch Shell Plc Sponsored ADR (RDS.B)
- First Hawaiian, Inc. (FHB)

Further Insight: Stock Position(s)

Haemonetics Corporation (HAE)

One of the stocks we added during the quarter was a company we had previously owned a few years ago and sold off earlier this year. Haemonetics Corporation (HAE), is a local Boston-based company that builds devices and systems to collect plasma and blood, and they have 80% market share.[xxxii] A few years ago, a new management team came into Haemonetics from Covidian. They were focused on turning around the business and streamlining costs, which resulted in the stock price popping. During the COVID-19 market sell-off in March, Haemonetics stock price declined over 30%[xxxiii] as blood and plasma collection centers saw a huge drop off in supply. Currently, there is a shortage and dire need for plasma and blood. We think that this business will recover. The appealing aspect is that Haemonetics introduced a new plasma collection system called NexSys that has consumables and should collect more plasma per patient, and be more efficient than the current system.[xxxiv] The consumables for the new systems should go from $11 per unit to $15-$16 per unit.[xxxv] The plasma side of the business is expected to grow 7% to 8% per year.[xxxvi] At the current levels the stock is attractive to us and provides us with potential upside.

[i] eVestment Analytics. Gross of fee returns are presented Pure Gross and are calculated before management fees, custodial fees and transaction costs.
[ii] FactSet Data & Analytics, Charting
[iii] Ibid.
[iv] Ibid.
[v] FactSet Data & Analytics, Charting
[vi] Ibid.
[vii] https://www.bloomberg.com/news/articles/2020-08-06/robinhood-craze-born-in-america-is-now-moving-stocks-everywhere?
[viii] https://www.cnbc.com/2020/08/10/robinhood-reports-more-monthly-trades-than-rivals-charles-schwab-e-trade-combined.html
[ix] https://www.wsj.com/articles/softbanks-bet-on-tech-giants-fueled-powerful-market-rally-11599232205?mod=searchresults&page=1&pos=12
[x] https://www.wsj.com/articles/apple-tesla-shares-keep-rising-after-stock-splits-11598900644
[xi] FactSet Data & Analytics, Charting
[xii] FactSet Data & Analytics, Company/Security
[xiii] FactSet Data & Analytics, Charting
[xiv] FactSet Data & Analytics, Company/Security
[xv] FactSet Data & Analytics, Charting
[xvi] FactSet Data & Analytics, Charting
[xvii] https://www.prnewswire.com/news-releases/pmi-at-56-0-august-2020-manufacturing-ism-report-on-business-301121423.html

[xviii] https://www.wsj.com/articles/millennials-help-power-this-years-housing-market-rebound-11598520601
[xix] https://www.wsj.com/articles/us-economy-august-retail-sales-coronavirus-recovery-11600200513
[xx] FactSet Data & Analytics, Charting
[xxi] Ibid.
[xxii] GMO Quarterly Letter 2Q20
[xxiii] https://fred.stlouisfed.org/series/BAMLC0A0CM
[xxiv] FactSet Data & Analytics, Charting
[xxv] 2020 Mid Year Outlook JP Morgan
[xxvi] Ibid.
[xxvii] Ibid.
[xxviii] Ibid.
[xxix] https://www.raps.org/news-and-articles/news-articles/2020/3/covid-19-vaccine-tracker
[xxx] FactSet financial data and analytics
[xxxi] FactSet financial data and analytics; Attribution. Security level contributors and detractors derived from equity only portion of the portfolio.
[xxxii] https://haemonetics.gcs-web.com/static-files/e600f044-f47d-41c1-891c-3f1159a447ed
[xxxiii] FactSet Data & Analytics, Charting
[xxxiv] https://haemonetics.gcs-web.com/static-files/e600f044-f47d-41c1-891c-3f1159a447ed
[xxxv] Ibid.
[xxxvi] Ibid.

Balanced Model Disclosures

MODEL DESCRIPTION: The Anchor Managed Accounts Balanced (Bal) model was created on 12/31/05. The model returns do not reflect actual trading. Anchor Capital's Managed Accounts Division created this model for purposes of presenting performance results, which approximate those of the Managed Accounts Balanced sponsor program portfolios in aggregate. The investment objective for the model is to achieve a high rate of return through the purchase of equity and fixed income securities.

MODEL DISCLOSURES: The model transaction history does not reflect all portfolio transaction activity for accounts in the sponsor program. Model transactions correspond with trading activity generated in the course of investment for substantially all accounts in the sponsor Balanced program. Model transactions and holdings do not reflect individual portfolio activity for new account investments, or account activity and holdings in various individual portfolios subject to tax considerations or individual client discretion. Model performance may differ materially from individual client portfolio results.

CALCULATION OF RATES OF RETURN: All securities in the model are valued at last sale price, as provided by independent pricing services. The portfolio valuation is reflected on a trade date basis. Model investment returns include the reinvestment of dividends and other earnings. Effective 1/1/2010, dividends (excluding income on money market securities) are credited on an accrual basis. Time-weighted portfolio returns are calculated for each monthly period in the prior quarter. Monthly model results are linked to determine annual returns. Individual client portfolio results may vary from the results presented for the model because of different investment objectives, tax status and other considerations. Returns of individual client accounts will be reduced by advisor fees and other expenses which might be incurred to provide investment management, custody, administrative, actuarial, accounting or other services to the client. The benchmark indices exclude fees. The Managed Accounts Balanced model returns are by compounding the monthly net returns to calculate the quarterly, YTD and annual returns. The numbers may be slightly different from net returns published in other Anchor Capital materials created outside of Style Advisor prior to 6/30/2017, which were calculated by simply subtracting 3% from the annual gross return. Additional information regarding policies for calculating and reporting model returns is available upon request.

BENCHMARK DESCRIPTION: Information about indices is provided to allow for comparison of the performance of the Adviser to that of certain well-known and widely recognized indices. There is no representation that such index is an appropriate benchmark for such comparison. You cannot invest directly in an index, which also does not take into account trading commissions and costs. The volatility of indices may be materially different from the performance of the Adviser. In addition, the Adviser's recommendations may differ significantly from the securities that comprise the indices. The benchmark is a static blend of: 60% Russell 1000 Value Index; 30% Barclays Capital U.S. Government/Credit Intermediate Bond Index; 10% Citigroup 90-Day Treasury Bill Index. The Russell 1000 Value Index measures the performance of the large-cap value segment of the U.S. equity universe. It includes those Russell 1000 Index companies with lower price-to-book ratios and lower expected growth values. The Russell 1000 Value Index is constructed to provide a comprehensive and unbiased barometer for the large-cap value segment. The Index is completely reconstituted annually to ensure new, growing equities are included, and that the represented companies continue to reflect value characteristics. The Barclays Capital U.S. Intermediate Government/Credit Bond Index measures the performance of U.S. dollar denominated U.S. Treasuries, government-related and investment grade U.S. corporate securities that have a remaining maturity of greater than or equal to 1 year and less than 10 years. Securities have $250 million or more of outstanding face value and must be fixed rate and non-convertible. The Citigroup 90-Day Treasury Bill Index measures the average return of the last three-month U.S. Treasury Bill issues. U.S. Treasury Bills are short-term securities issued by the U.S. government with maturities of up to one year. They are backed by the faith and credit of the U.S. government who guarantees full payment of principal and interest at maturity. Total return comprises price appreciation/depreciation and income as a percentage of the original investment. All benchmark returns include the reinvestment of income.

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

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