ANCHOR
CAPITAL ADVISORS LLC

GLOBAL FOURTH QUARTER 2020 COMMENTARY

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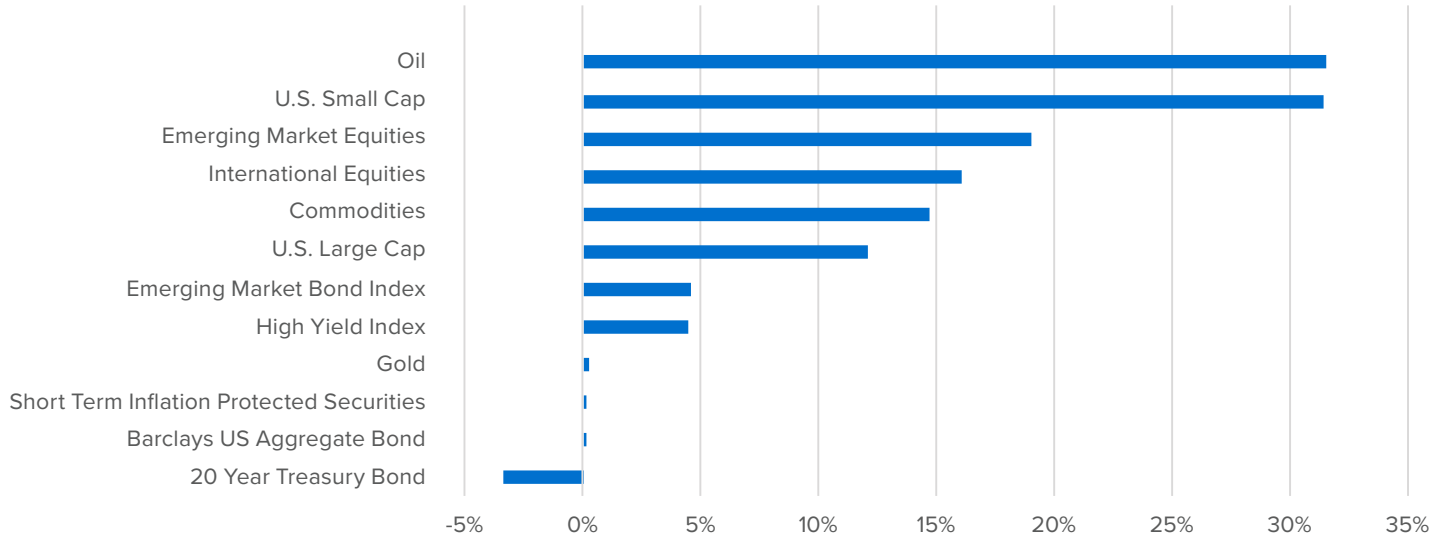
Overview

As we close out a challenging and turbulent 2020, we want to acknowledge our clients, many of whom have been with Anchor for decades. Thank you for the trust you have placed in us, particularly during such an unpredictable time. While we have been unable to meet with you face-to-face, we are grateful that technology allowed us to stay connected and have greatly valued the conversations we have had with each of you. We appreciate your ongoing partnership and look forward to continuing to work together throughout 2021.

In November, most major asset classes rallied when Pfizer and BioNTech announced greater than 90% efficacy of their COVID-19 vaccine in drug trials[1]. Shortly after that, Moderna announced equally promising results[2]. This allowed investors to look out to 2021 and 2022 for a global economic recovery. U.S. small-cap equities had the best market performance during the quarter after being down significantly earlier in the year[3]. Emerging markets, specifically the Asian economies which have a better handle on COVID-19, have been recovering and posted strong equity market results[4]. China, in particular, has performed very well[5]. The U.S. large-cap stocks and European stocks were also positive[6]. Outside of equities, commodities also had a strong run on the news of the potential recovery[7]. Meanwhile, interest rates started to rise and that affected bond performance[8].

Fourth Quarter 2020 Returns

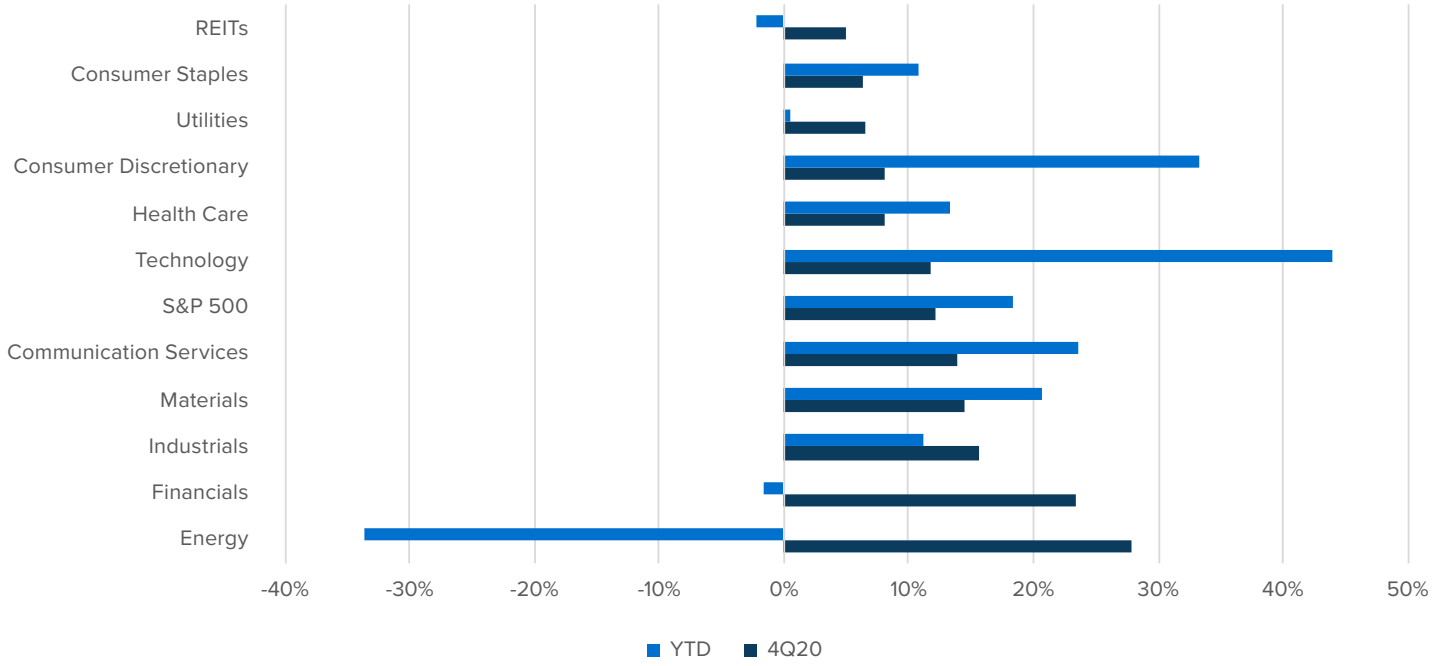


Source: FactSet financial data and analytics

U.S. Markets

In October, the markets turned cautious ahead of the uncertainty of the U.S. elections, the absence of additional government support, and the lack of news about vaccine progress. Then in November, the Dow Jones Index had its best month since 1987 and the Russell 2000 Index (small-cap companies) had its best month ever[9]. Early in November, there was increasing certainty about Biden's election and the prospect for balanced legislation associated with a split party government. On November 9, Pfizer and BioNTech announced greater than 90% efficacy of their COVID-19 vaccine in drug trials[10]. Shortly after that, Moderna announced equally promising results[11]. Many Value stocks that were hurt most by the economic impact of the pandemic, including Mid Cap and Small Cap companies, rallied the strongest. What many people may not have noted, is that on November 9 the markets experienced the largest ever single-day rotation from Growth to Value[12]. In November, while the S&P 500 Index was up 11%, the Russell 1000 Value increased 13.5%, the S&P 500 Mid Cap increased 14.3%, and the S&P Small Cap increased 18.2%[13]. The rally continued into December.

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



Source: FactSet financial data and analytics

U.S. Economy

The U.S. economy has rebounded from the worse decline in GDP since the 1920's Depression with an equally strong rebound in GDP during the third quarter[14], and it would appear the rebound is v-shaped. Many economic data points have rebounded with manufacturing in expansion[15], retail sales positive[16] and housing sales very strong due to low-interest rates and the first time millennial buyer[17]. However, there are large parts of the economy that are still negatively impacted by the COVID-19 restrictions and shutdowns – such as hotels, airlines, cruise lines, entertainment, restaurants, and elective surgeries – and continued higher unemployment. The government has stepped in to help with the $2 trillion Cares Act[18] passed in April and the most recent $900 billion stimulus package[19] that has helped individuals get through this tough period.

China

China showed a strong rebound in GDP growth during the third quarter to 4.9%, which is only slightly lower than the 6% GDP growth China had seen in the last few years[20]. China did a good job at controlling and isolating the COVID-19 virus, so their economy was able to recover faster than other parts of the world[21]. The government also stepped in with stimulus to help get the economy through this period of time[22]. We expect that China will continue to grow in 2021. With President-elect Biden coming into office, we believe that the tone of relations with China will change. However, the U.S. is committed to implementing changes in trade with China, and Biden will have to stand firm[23].

Europe

Europe, like the U.S., has struggled with rising COVID-19 infection rates and more serious lockdowns. European Central Bank (ECB) has provided the stimulus and ongoing bond buying to support the economies and markets[24]. One of the biggest risks going into the end of 2020 was the U.K.'s Brexit negotiations, which were mostly completed[25]. Further complicating the situation is a complete shutdown of the U.K. due to a new strain of the COVID-19 virus[26]. We expect that the European economies will gradually improve as the vaccine is rolled out and they get the virus under control.

Federal Reserve and Fixed Income

The Federal Reserve stepped in during the March sell-off to provide support and liquidity to the bond markets. The Fed has been buying up to $120 billion in bonds each month[27] and its balance sheet expanded from $4 trillion at the beginning of the year to over $7 trillion currently[28]. It also reduced interest rates to 0%[29]. This massive amount of liquidity has prevented companies from going out of business and it has allowed companies to borrow cheap debt. The investment-grade bond market had its highest issuance raise in 2020 to $1.9 trillion, and the high yield market had an equally record-breaking year at over $500 billion[30]. Even companies that were near or in bankruptcy were able to sell bonds. As a result, the credit spreads, which widened to high levels in March, have now compressed back to below average. Even overall yields, which tend to be higher for the corporate bond markets, are hovering around 1%.

On the Treasury bond side, we saw yields on the 10-year bond climb from 0.68% to over 0.90% during the quarter, an increase of over 30%[31]. Analysts expect that interest rates will continue to rise as the economy improves. Between rising rates, which impact bond prices and performance, and tight credit spreads, there is little opportunity in the bond markets. Furthermore, the spread between the S&P 500 Dividend Yield and 10-Year Treasury Yield is at such wide levels[32], and it pays more to be invested in equities.

Commodities

As we have started to see economies around the world recover, commodities have rallied as demand increased, especially for oil and industrial metals. WTI crude oil increased over 31% for the quarter to $48/barrel[33]. Other industrial metals like copper and aluminum are up over 18% each[34]. These metals are also used for electric vehicles and demands have increased significantly worldwide. Gold, which tends to behave more defensively and has had a strong run this year, was essentially flat for the quarter[35]. The big standout in the commodities space has been lumber, which was up over 38% over the quarter[36]. Due to low-interest rates and the millennial buyer, housing prices and demand for housing have both increased. As a result, lumber prices have skyrocketed. If we continue to see this synchronized global rebound, we expect that commodity prices will remain strong, which is a departure from what we have seen over the last decade.

U.S. Dollar

The U.S. Dollar peaked in April and has been on a steady decline since then, down 7% for the year[37]. U.S. Multinationals benefit from a weaker dollar. A weaker dollar and a strengthening global economy tend to be positive for commodity-related industries. We believe that with the U.S. Government deficit and potentially higher interest rates, the U.S. Dollar will continue to be weak.

IPOs/SPACs

Additional indications of excessive speculation are the initial Public Offerings (IPO) market and attraction of Special Purpose Acquisition Companies (SPACs). Funds raised from these has reached over $11 trillion in 2020, which is 27% above the last market peak in 2007 and three times the levels the peak year 1999[38]. In just this quarter, we saw DoorDash and AirBnB experience historic IPOs while SPACs issuance has eclipsed all prior records[39]. SPACs are essentially shell companies established to raise blind pool capital to purchase yet unidentified companies and businesses. Companies often choose this route versus an IPO when they cannot meet SEC-mandated standards for an IPO. More and more firms are embracing SPACs, encouraged by the recent success of DraftKings and Virgin Galactic. We expect this trend will continue into 2021[40]. While we do not buy IPOs or SPACs at the time of issuance, we use it as an opportunity to learn and build our knowledge about new companies or sectors.

Conclusion

We believe Anchor's portfolios are well-positioned for 2021. Transitions in the market and potential volatility do present challenges but reinforce the importance of understanding the longer-term attribute of each investment. As people return to offices, travel and socialize in person, a combination of higher interest rates, potentially higher inflation and a weak dollar are positives for Value oriented industries and small cap companies. Many of which are currently selling at very attractive valuations. As we wrap up a turbulent and eventful year in the markets, we are grateful that we can be stewards of your capital, and we look forward to the New Year.

Top Ten to Watch in 2021:

Resigning of the Paris Agreement/Climate Change – President Trump pulled out of the Paris Agreement in 2017[41]. The Paris Agreement, which was declared in 2015, aims to keep the global temperatures this century from rising 2C above pre-industrial levels and to pursue efforts to limit the temperature increase even further to 1.5C[42]. President-elect Biden has said he will resign the agreement[43]. In the last two years, there has been an elevated focus on climate change, which has become more pronounced with a highly active hurricane season and multiple wildfires. More companies and investors are focused on reducing carbon emissions and certain investments into companies not focused on this are becoming off-limits.

Income Inequality – After several years of American workers making strides with wage gains and better employment opportunities, 2020 reversed that for many. While the rising stock market benefits the rich, many of the poorest members of society do not benefit or have access to retirement assets[44]. This growing divide between the richest and poorest in America could impact government policy and programs, as well as the make-up of communities, and how money is spent and saved. As investors, we watch these trends and how different parts of the economy are affected.

Electric vehicles – A big story in 2020 was the 700% increase in Tesla stock and its addition to the S&P 500 index[45]. The market capitalization of Tesla is now greater than all the other car manufacturers in the world[46]. This signals that the world is rapidly moving towards electric vehicles. Tesla is clearly an early leader in the technology, but other companies are catching up. Tokyo, Japan recently announced that all new cars purchased will be electric by 2030 and the city has a stated goal of having zero carbon emissions by 2050[47]. In the investment world, we are looking at electric vehicle companies, but also those companies that manufacture components that go into manufacturing them.

Philanthropy – A lot of interest was generated by MacKenzie Scott, ex-wife of Amazon founder Jeff Bezos, when she gave away $6 billion to different organizations in 2020 – mainly smaller charities and universities[48]. Also of note, the founder of Duty Free, Chuck Feeney, who planned to give his entire fortune away before he died, finally closed his foundation in 2020[49]. His foundation has given away $8 billion[50]. We note this because the appreciation we have seen in the stock market has in some cases allowed an increase in charitable giving.

Work/school from home – While everyone quickly had to adapt to working from home, we believe that this trend will continue well after the pandemic. We are already seeing competitors to Zoom Video Communications, Inc. popping up and other online tools are allowing workers and students to collaborate better. We are keeping an eye on this trend, looking for opportunities with emerging companies or those that may benefit from the trend. However, we are also evaluating parts of the market that could be impacted longer term like office space, college education, or work-related travel.

A renewed enthusiasm for travel and entertainment – One of the most searched topics on the internet right now is travel. People are looking forward to the ability to travel safely again and thinking about potential destinations. This is supportive of the travel and tourism industry and those related investments.

Changes in medicine/drug development – 2020 was a phenomenal year in drug and vaccine development with the record-breaking time to develop the COVID-19 vaccine. We believe that the research from this work will be used in other therapeutic areas as well. There is a lot of innovative research going into multiple areas, including cancer, and cell and gene therapy. Many large pharmaceutical companies are buying biotechnology companies for their research platforms. The whole ecosystem has important implications for investors.

U.S./China tensions – With the U.S. and China fighting for dominance, we expect that the trade tensions will continue. There are still a number of outstanding issues like IP protection and Taiwan. In the latest round, the U.S. is preventing domestic investors from holding U.S. listed Chinese stocks that support the Chinese military, which includes large telecom companies like China Mobile[51]. Many U.S. companies still have sizable supply chains in China or sell directly to the Chinese consumer, so we will keep an eye on potential impacts or benefits from changes in trade.

Break up of big tech – The Justice Department and multiple states have filed antitrust lawsuits suits against Facebook and Google[52]. There is concern that these companies are anticompetitive and are buying up competitors to prevent competition. We think that these lawsuits can potentially have an overhang on the stock prices along with the other large technology stocks. In addition, we believe valuation has become stretched for these large technology stocks, and it will be harder for them to grow as fast in the future.

Inflation – Forecasters are expecting that with the economic recovery and high levels of government stimulus the U.S. should see inflation in 2021. We primarily expect to see inflation in commodities and positive stock prices. However, given the environment, other companies may be able to pass along price increases, which leads to inflation. In our opinion, the most impactful level of inflation would be wage increases.

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

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