ANCHOR CAPITAL ADVISORS LLC

Balanced Value
Portfolio Commentary
As of September 30, 2022

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.

Market Review

The equity and fixed income markets continue to be volatile with the back drop of high inflation[i] and high interest rates.[ii] The markets are anticipating that the Federal Reserve will make a misstep and potentially cause a recession,[iii] a result of the Fed's commitment to aggressively bringing down the stubbornly high inflation through increasing interest rates and quantitative tightening.[iv] Questions still remain, can companies and consumers weather this current market landscape as many entered into it, with excess cash on their balance sheets?[v] What would be the potential timing and magnitude of a recession? Through volatile markets such as these, Anchor remains focused on downside protection and defensive positioning.

U.S. Equity Markets

All U.S. equity markets ended negative for the quarter with growth indices down more than value.[vi] The S&P 500 and Nasdaq are firmly in bear market territory as defined by a 20% decline in the markets.[vii] Large cap stocks outperformed mid and small cap stocks.[viii] The markets had a short bear market rally at the beginning of the quarter with the hardest hit stocks and sectors rebounding the most.[ix] In mid-August investors started to get concerned about continued high inflation numbers and how quickly the Federal Reserve would raise rates to combat the inflation, which resulted in a sell-off in the markets in the second half of the quarter.[x] Value sectors continue to perform well with energy and utilities as the only positive performing sectors for the year.[xi] We are also seeing other defensive parts of the market like consumer staples and health care performing well.[xii] Growth parts of the markets like technology and consumer discretionary continue to trade down.[xiii]

Second quarter earnings were generally positive for most companies.[xiv] However, as the quarter progressed, we saw several companies preannounce revised down financials.[xv] Many of these companies are cyclicals and are generally seeing lower volumes and higher inflation-related costs impacting their businesses. On the flip side travel and entertainment remain strong. The airlines are reporting a rebound in business travelers and strong bookings for holidays.[xvi] Concert and ticket promoters are reporting strong ticket sales for concerts and other entertainment.[xvii] Nonetheless, we expect to see more earnings warnings as the year progresses. There hasn't been a recession without a decline in S&P 500 earnings.[xviii]

Inflation

Inflation, as measured by the consumer price index (CPI), peaked on a year-over-year change at 9.1% in June.[xix] It declined to 8.5% annualized in July and 8.3% annualized in August.[xx] The rate of change is continuing to come down and analysts are predicting that it will decrease to 7.5% annualized by year-end.[xxi]

Energy and commodity prices have declined, but food, rent and utilities remain elevated.[xxii] Many companies are facing higher inflation-related costs, which are now starting to destroy demand (volumes). Many of these companies are saying that they can only raise prices so much before the customer balks, which appears to be happening now. We believe structural reasons, such as geopolitical events and onshoring of manufacturing and supply chains, are contributing to inflation remaining higher than we have seen in the past.

Federal Reserve and Interest Rates

The Fed raised interest rates five times in 2022 with the most recent 0.75% increase at the September Fed meeting.[xxiii] The Fed Funds interest rate range is 3.0% to 3.25%.[xxiv] Chairman Powell has stated that he will continue to raise interest rates until inflation comes down.[xxv] The Fed dot plot, which forecasts where interest rates are going, is predicting 4.60% on the 10-year Treasury bond.[xxvi] As of quarter end it was 3.8%, up from 2.98% at the beginning of June.[xxvii]

Many investors believed that the Fed would be forced to stop raising interest rates at the risk of putting the economy in a recession. We believe Powell wants his legacy to be his fight to control inflation. Concurrently, the Fed has been quantitatively tightening, selling $95 billion of Treasury bonds per month to pay down the Fed's balance sheet, which peaked at close to $9 Trillion.[xxviii] The effect is reducing the money supply and increasing interest rates, with the hopes of reducing inflation. As a result, the 30-year mortgage rate is at 6.55%[xxix] and the U.S. dollar has strengthened to levels we have not seen since 2002.[xxx]

In fact, the strength of the U.S. dollar is problematic for U.S. corporations that operate abroad and need to convert profits back into U.S. dollars. It also makes exports less competitive. Japan for the first time since 1984 had to sell U.S. dollars to buy Yen to shore up the currency since the Yen had weakened so significantly versus the U.S. dollar.[xxxi] We believe that a weakening economy, pressures of the currency, and stress in the credit markets could force Powell to pause interest rates in 2023.

Oil

Oil prices have been falling steadily since June with the price per barrel going from $104 to $84 at quarter end.[xxxii] The U.S. government has been releasing oil from the strategic petroleum reserves to help consumers.[xxxiii] In addition, China, which is a major consumer of oil, has a decreased demand due to their Covid shutdowns and slowing economy.[xxxiv] On the other hand, natural gas prices have skyrocketed due to Russia shutting off the gas pipeline to Europe.[xxxv] Europe has been reliant on Russia for its energy needs and is now forced to source gas from the U.S. and elsewhere.[xxxvi] In our opinion, we are seeing a shortage of oil given the underinvestment in the space and we believe that it will take time and capital to shift to renewable energy sources, which will force higher prices.

U.S. Economy

The U.S. economy continues to hold up well as most economic measures remain in positive territory despite slowing down. The most notable sector of the market to see a slowdown is in housing, with the higher mortgage rates and higher prices.[xxxvii] Retail sales, outside of food and energy, were most recently negative.[xxxviii] In the positive camp, credit card sales are back to pre-pandemic levels as consumers have resumed spending on services, travel, and entertainment[xxxix]. Furthermore, many consumers still have excess savings from the Covid time period, employment levels remain strong[xl] and manufacturing indices, while slow are still in expansion mode.[xli]

Performance Overview

The Anchor Balanced Value Portfolio outperformed the 60/30/10 Index for the quarter. On a relative basis, the equity portion of the Portfolio benefitted the most from security selection in the Consumer Staples and Technology sectors, as well as an underweight allocation to the Telecommunications sector. Security selection in Industrials as well as an underweight allocation to Consumer Discretionary and Energy sectors were the greatest detractors from relative performance.[xlii]

Quarterly Attribution Highlights – Equity Portion of Portfolio[xliv]

Sector - Top 3 Contributors	Sector - Bottom 3 Detractors
Consumer Discretionary	Industrials
Energy	Health Care
Basic Materials	Technology

Security - Top 5 Contributors	Avg. Weight %	Contribution %	Security - Bottom 5 Detractors	Avg. Weight %	Contribution %
Marathon Petroleum Corporation (MPC)	1.53%	0.27%	Comcast Corporation Class A (CMCSA)	1.17%	-0.28%
M&T Bank Corporation (MTB)	1.49%	0.14%	SS&C Technologies Holdings, Inc. (SSNC)	1.46%	-0.24%
Ross Stores, Inc. (ROST)	0.40%	0.11%	American Tower Corporation (AMT)	1.53%	-0.24%
Lowe's Companies, Inc. (LOW)	1.25%	0.09%	Alcon AG (ALC)	1.48%	-0.23%
Eaton Corp. Plc (ETN)	1.52%	0.08%	Mondelez International, Inc. Class A (MDLZ)	1.82%	-0.20%

Quarterly Transactions

Purchased	Sold
Diageo plc (DEO)	Ross Stores, Inc. (ROST)
I Shares 1-2 Year Treasury (SHY)	SPDR Gold Trust (GLD)

Purchases

Diageo plc (DEO) is a global international spirits company with a broad-based geographic footprint and strong presence in almost all key categories. The company has been a long-term compounder growing steadily in the premium segment of the market. It has had a stable operating margin between 28% and 32% in the past almost two decades. DEO's marketing and brand building capabilities are among the best in industry and across consumer goods. It is a reliable free cash generator which has grown dividends every year since 2000. DEO is well positioned to deliver a strong operating performance going forward thanks to favorable category and geographic mix of its product portfolio.

Sales

Ross Stores, Inc. (ROST) is a U.S. off-priced retailer. They sell clothing, shoes, home goods, and toys at prices 20% to 70% less than department and specialty stores. Off priced retailers have been gaining market share as consumers have shifted their spending. Consumers enjoy the treasure hunt experience and getting a value. Also, consumers have traded down to off-priced retailers in challenging economic conditions. Given the high inflationary environment consumers are focused on basic goods and not spending on discretionary goods. Given the macro environment we chose to sell ROST for better opportunities.

SPDR Gold Trust (GLD) tracks the gold spot price, less expenses, and liabilities, using gold bars held in London vaults. We sold out of the position given that inflation should start to recede.

Anchor's Positioning

Since the beginning of the year Anchor has been defensively positioned across all strategies.[xlv] We reduced our exposure to higher growth and fully valued companies and sectors that are more likely to be impacted by higher interest rates and rotated into less expensive, more defensive companies and sectors. Certain health care, defense, insurance, utilities, and core consumer companies behaved defensively and performed better during the market sell-off and were positive contributors. We have also brought up cash levels across all strategies, which contributed to performance. We focused our efforts on downside protection and that has played out during the quarter, as we waited to see how inflation and interest rates played out. We believe that much of the excess over the last few years needs to be purged. On the fixed income side, we remain shorter duration, higher cash and defensively positioned to weather through the rates increases. We are being patient, and the investment team is working hard to uncover value-oriented opportunities that we can put to work once we see a bottoming process in the markets.

[i] https://www.cnbc.com/2022/09/13/inflation-rose-0point1percent-in-august-even-with-sharp-drop-in-gas-prices.html
[ii] FactSet Data & Analytics, Charting
[iii] https://www.bloomberg.com/features/2022-federal-reserve-recession-inflation-response/?leadSource=uverify%20wall
[iv] https://www.cnbc.com/2022/09/21/fed-rate-hike-september-2022-.html
[v] https://www.cnbc.com/2022/08/13/ultra-rich-still-shopping-for-luxury-despite-inflation-recession-fears.html
https://www.gsam.com/content/gsam/us/en/institutions/market-insights/gsam-connect/2022/credit-check-in-balance-sheet-status-check.html
[vi] FactSet Data & Analytics, Charting
[vii] Ibid
[viii] Ibid
[ix] Ibid
[x] Ibid
[xi] Ibid
[xii] Ibid
[xiii] Ibid
[xiv] https://www.reuters.com/markets/us/us-corporate-profits-economic-outlooks-surprisingly-upbeat-2022-08-02/
[xv]https://advantage.factset.com/hubfs/Website/Resources%20Section/Research%20Desk/Earnings%20Insight/EarningsInsight_092322.pdf
[xvi] https://www.dallasnews.com/business/airlines/2022/09/13/business-travel-bookings-for-fall-signal-a-blockbuster-season-for-airlines/
[xvii] https://www.nasdaq.com/articles/live-nation-lyv-benefits-from-robust-demand-for-live-events
[xviii] FactSet Data & Analytics, Charting
[xix] https://www.cnbc.com/2022/09/13/inflation-rose-0point1percent-in-august-even-with-sharp-drop-in-gas-prices.html
[xx] Ibid
[xxi] https://www.stlouisfed.org/publications/regional-economist/2022/aug/gdp-growth-decelerating-inflation-us-economic-outlook#:~:text=In%20August%2C%20the%20consensus%20from,and%20to%202.5%25%20in%202024.
[xxii] Ibid
[xxiii] https://www.cnbc.com/2022/09/21/fed-rate-hike-september-2022-.html
[xxiv] Ibid
[xxv] Ibid
[xxvi] Ibid
[xxvii] FactSet Data & Analytics, Charting
[xxviii] https://www.cnbc.com/2022/09/21/fed-rate-hike-september-2022-.html
[xxix] https://www.bankrate.com/mortgages/30-year-mortgage-rates/
[xxx] FactSet Data & Analytics, Charting
[xxxi] https://www.cnn.com/2022/09/22/investing/japan-yen-intervention
[xxxii] FactSet Data & Analytics, Charting
[xxxiii] https://www.energy.gov/articles/doe-announces-notice-sale-additional-crude-oil-strategic-petroleum-reserve
[xxxiv] https://www.reuters.com/markets/commodities/china-oil-demand-may-shrink-first-time-since-2002-covid-curbs-bite-2022-09-09/
[xxxv] https://www.reuters.com/business/energy/no-stream-eu-gas-markets-brace-price-surge-after-latest-russia-gas-cut-2022-09-04/
[xxxvi] Ibid
[xxxvii] https://www.cnbc.com/2022/09/21/existing-home-sales-fall-in-august-and-prices-soften-significantly.html
[xxxviii] https://www.nytimes.com/2022/08/17/business/us-retail-sales-july.html
[xxxix] https://www.cnbc.com/2022/08/05/credit-card-usage-surges-amid-record-inflation.html
[xl] https://www.bls.gov/news.release/pdf/empsit.pdf
[xli] https://tradingeconomics.com/united-states/business-confidence
[xlii] FactSet financial data & analytics; attribution
[xliii] eVestment Analytics, see model disclosures below.
[xliv] FactSet financial data & analytics; attribution
[xlv] FactSet financial data and analytics

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