ANCHOR
CAPITAL ADVISORS LLC

Mid Cap Value
Portfolio Commentary
As of June 30, 2023

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Overview

During the second quarter markets seemingly shrugged off the news of a banking crisis and a highly anticipated recession to move forward. In anticipation that earnings would be down, and that additional bad news was coming, many investors were bearish to start the quarter with higher cash levels and lower net exposures.[i] After three domestic bank failures the U.S. Federal Reserve provided a backstop to prevent more potential regional bank failures.[ii] We believe this provided liquidity to the markets, which coupled with better-than-expected earnings and artificial intelligence (AI) related excitement helped propel the markets.[iii]

In recent months the commercial real estate (CRE) market has garnered increasing investor attention. Over $1.5 trillion of CRE debt is due to be refinanced in the next 18 months and many properties are upside down on their valuation and cost of debt because of the shift in higher interest rates.[iv] We may see some defaults in the CRE market, with office properties being especially vulnerable. However, we believe that this environment presents interesting opportunities for those with available capital. Lending to CRE companies is now at double-digit interest rates. Additionally, we are seeing potential opportunities in the public REIT market, which tends to bottom four to six quarters before the private real estate market.

Investors and economists have shifted their perception of a recession. The probability of a recession seems to be greater than 50%, but many now believe that it will be milder, especially relative to what we saw in 2008 and 2020.[v] We have had the fastest Fed rate hiking cycle in history, interest rates are at the highest levels in 15 years and inflation remains above what we have seen for two decades.[vi] Stock market valuations are trending above long-term averages.[vii] Many consumers and companies have healthy balance sheets and the Fed believes that most consumers have enough savings to carry them through year-end. .[viii] Furthermore, employment levels have remained robust.[ix] Given all of this, a recession or slowdown could be pushed out until next year. Given the level of uncertainty, we remain cautious rather than full-on enthusiastic.

U.S. Equity Markets

U.S. equity indices were positive for the second quarter led by large-cap stocks, then small-cap stocks and finally mid-cap stocks. The best-performing sectors were Technology, Consumer Discretionary and Communication Services. The underperforming sectors were Energy, Consumer Staples, and Utilities.[x]

The excitement of artificial intelligence (AI) is benefitting companies associated with the technology. The enthusiasm has propelled some stocks to new highs and unreasonable valuations.[xi] Nvidia, which develops the computer graphic interfaces that are predominately used in AI, guided up second-quarter revenue from $7 billion to $11 billion.[xii] Just this year, the stock has increased over 180% and the price to sales is at 40 times.[xiii] Other stocks like Microsoft have also benefitted from this excitement and are now trading at stretched valuations. The seven largest stocks in the S&P 500 have a combined 31% weighting in the index, showing how much the big technology stocks have run.[xiv] Our analysts are now seeing the initial increased usage of features like ChatGPT coming down. We believe a bubble has formed related to this theme and we will most likely see some normalization in stock prices.

During earnings season, many companies reported better-than-expected earnings.[xv] The price increases that companies passed through over the last several quarters have helped support revenue growth, while falling commodity and freight costs have helped support the cost side. However, for retailers, we saw a large impact from organized theft that has impacted margins and we believe will be embedded in the cost structure going forward.

U.S. Fixed Income

U.S. fixed income price performance decreased for the quarter. As a result of the Feds belief that a recession is not imminent, interest rates continued to shift higher. The short end of the yield curve remains attractive, with yields over 5%.[xvi] Volatility related to interest rates should be more muted as the Fed winds down expected increases.

Commodity Markets

We are seeing a pullback in commodity prices following a post pandemic surge last year. This pullback is helping to bring down inflation. Oil prices have stayed relatively range bound around $70/barrel but are down 11% year to date.[xvii] The home improvement retailers noted a sharp decrease in lumber prices, which are off over 50% from the high. Copper prices have also decreased, despite the demand and need in electric batteries.

Inflation

The Consumer Price Index reading for May increased 4% year-over-year, which is down significantly from the 9.1% year-over-year increase in June 2022.[xviii] Declining commodity costs have had an impact on the falling inflation levels.[xix] However, this is still above the Federal Reserve's desired 2% inflation rate, which leaves open the possibility for more interest rate increases this year.[xx]

Interest rates/Fed/Economy

The Federal Reserve has raised interest rates ten times since March 2022 to combat inflation but decided to pause at its June meeting.[xxi] The Fed Funds Rate, or the short-term borrowing rate, is in the target range of 5% to 5.25%.[xxii] However, Fed Chairman Powell has noted that one or two more rate increases are on the table for the remainder of the year.[xxiii] The Fed, as we have noted, is data-dependent, and continues to see overall strength in the economy.

The U.S. economy has remained resilient with positive GDP growth despite higher interest rates and higher inflation levels.[xxiv] However, we are seeing pockets of economic weakness, like manufacturing, with the Purchasing Managers Index (PMI) in contraction levels[xxv] and many companies are reporting slowing order books. Retailers are reporting that the lower-income consumer is stretched and significantly reducing discretionary purchases. The job market, while a lagging indicator, remains robust[xxvi] and consumers continue to spend.[xxvii] Housing, which pulled back last year, seems to be recovering especially for new homes and with the millennial population forming households.[xxviii] That said, because of the banking crisis lending standards have tightened. We are starting to see increased bankruptcies/defaults, which could ultimately slow the economy.[xxix]

Performance Overview

The Anchor Mid Cap Value Portfolio underperformed the Russell Mid Cap Value Index for the quarter. On a relative basis, the Portfolio benefited the most from security selection in Consumer Staples and Financials as well as an overweight allocation to the Industrial sector. Security selection in Real Estate and Consumer Discretionary as well as an underweight allocation to Consumer Discretionary were the greatest detractors from relative performance.[xxx]

Quarterly Attribution Highlights[xxxii]

Sector - Top 3 Contributors	Sector - Bottom 3 Detractors
Industrials	Consumer Discretionary
Consumer Staples	Basic Materials
Financials	Utilities

Security - Top 5 Contributors	Avg. Weight %	Contribution %	Security - Bottom 5 Detractors	Avg. Weight %	Contribution %
Hubbell Incorporated (HUBB)	2.43%	0.80%	Dollar General Corporation (DG)	1.96%	-0.49%
McKesson Corporation (MCK)	2.83%	0.54%	Ulta Beauty Inc. (ULTA)	1.88%	-0.31%
Watsco, Inc. (WSO)	2.78%	0.53%	Waters Corporation (WAT)	1.71%	-0.27%
Booz Allen Hamilton Holding Corp. (BAH)	2.39%	0.49%	Royal Gold, Inc. (RGLD)	2.07%	-0.24%
Vontier Corp (VNT)	1.90%	0.33%	Ubiquiti Inc. (UI)	0.26%	-0.18%

Quarterly Transactions

Purchased	Sold
Charles River Laboratories Intl. Inc (CRL)	Ubiquiti Inc (UI)
W R Berkley Corp (WRB)	
National Storage Affiliates Trust (NSA)	
Eversource Energy (ES)	
Bio-Rad Laboratories, Inc. (BIO)	
Norfolk Southern Corp (NSC)	

Purchases

Charles River Laboratories (CRL) is a drug discovery, non-clinical development, and manufacturing organization with global operations. CRL has been a leader in helping clients discover new drugs. The company is organized across three segments: 19% of revenues in Research Models and Services; 60% of revenues in Discovery and Safety Assessment and 21% of revenues in Manufacturing Solutions. CRL has #1 market share in Research Models and Services. Manufacturing Solutions is a relatively newer part of the business and seeing strong tailwinds from the industry. Pharmaceutical and biotech companies are working on new research like cell gene therapy and looking to outsource to providers like CRL. We believe the business can grow revenues in the low double digits for the new several years. The stock pulled back recently on concerns over biotech funding and issues surrounding importing research models, but we believe those are temporary issues for the company.

W.R. Berkley (WRB) is a specialty property and casualty insurance (P&C) company with primarily a U.S. footprint. 80% of the business is insurance and 20% is reinsurance. WRB manages around 30 different P&C segments. We believe the company is focused on profitability rather than chasing growth. If they see margins compress in a segment, they will pull back and wait for a better opportunity. The industry has been benefitting from strong pricing and the increased need for different types of insurance including cyber, D&O, specific property types. Furthermore, the investment portfolio is benefitting from higher interest rates. The stock pulled back more recently on concerns of slowing growth. The company has noted that the hard pricing market is still in place but moderating in certain segments. We viewed this as an opportunity to enter a strong operator in the insurance market.

National Storage Affiliates (NSA) is a REIT dedicated to owning and operating self-storage facilities. At present, the company holds ownership interests in over 1,100 self-storage facilities located in 42 states + Puerto Rico with approximately 72.8 million rentable square feet. We believe NSA is

unique among its self-storage peers for several reasons. First, NSA has favorable geographic exposure given approximately 2/3rds of its properties are located outside of the top 20 MSAs where competition and supply are typically less. Secondly, NSA has a unique ownership and operating structure that incentivizes private self-storage operators to join NSA to share operating expenses and realize the benefits of scale. These advantages have allowed the company to drive exceptional internal growth while also growing its portfolio at a rapid pace since going public in 2015. We believe that can continue for many years to come. As such, we took the opportunity to purchase a stake in the company at what we believe is a highly attractive valuation following a large sell-off in its share over the last 18 months caused by the rapid rise in interest rates and a normalization in its growth rate following a period of unprecedented growth during the pandemic. Notably, NSA also pays a healthy dividend that yields over 6.0% at present.

Eversource (ES) is the largest utility in the Northeast and one of the largest utilities in the U.S. It is a transmission/distribution company, which provides a different type of exposure in the utility space. Historically, Eversource has been, in our opinion, a quality utility company which has dealt with some overhangs that have affected the stock price. ES had invested in building offshore wind projects, that have been affected by delays and cost overruns. The projects are close to completion and the plan is for ES to sell those projects. The other major overhang has been the rate environment in Connecticut, which contributes 20% of the revenues. It is expected that the rate environment should improve in Connecticut and help ES going forward. Due to these issues the stock is trading below the peers, and we believe that there is opportunity for the stock to rerate.

Bio Rad (BIO) is a leading global life sciences tools and diagnostic equipment company. BIO also owns a 37% ($9Bn) stake in the German based Sartorius, which makes bioprocessing solutions used in drug development. Sartorius is controlled by a trust, which expires in 2028, and BIO has indicated that it will buy the remaining shares at that point. BIO had a large increase in sales related to covid vaccine development and testing but has cycled through those revenues. In addition, all the life sciences and tools companies stock prices pulled back this year when concerns over biotech funding following the Silicon Valley Bank collapse. The outlook for drug development and spending is strong with several new research areas such cell gene therapies and large molecule and cancer related drugs. BIO is expecting revenue growth of 6% to 8% over the next several years. With a pull back in the share price and lower valuation, it presented an opportunity for the portfolio.

Norfolk Southern (NSC) is one of the largest U.S. railroads with 19,500 route miles across 23 states and serves every major container port. NSC's largest volumes are in intermodal and grains and fertilizers. Rails are slower to

transport, but less expensive than trucking. Rail stock prices were impacted due to lower volumes and higher operating ratios because of increasing expenses. NSC was also impacted by a train derailment in Ohio February 2023 that required clean up and new safety measures. We believe that rail volumes should improve, and the cost side normalize. Mid-single digit revenue growth should be achievable. Historically rail stock prices bottom around two quarters before volumes pick up.

Sales

Ubiquiti Inc (UI) is a unique, engineering focused business model that sells WLAN, routers, switches, and more hardware/software products. The CEO and founder Robert Pera owns over 90% of the company. Ubiquiti disrupts traditional competitors as they have nearly no salesforce with customers

buying the products due to their superior performance and lower price. Ubiquiti is able to disrupt traditional hardware players by having lower priced items and better quality. We purchased the company in 2017 at a below market P/E. We decided to sell as it had gone up 3 to 4-fold since purchase and was at a very full valuation.

Anchor's Positioning

Our portfolios have been defensively positioned for most of the year. Three things have impacted performance for the quarter and year-to-date. First, we have maintained higher cash levels as we have been looking for opportunities and better valuations in the markets. Second, some of our top-performing stocks from the last two years have been underperforming in sectors like retail, energy, and insurance. Finally, we did not own some of the more volatile stocks that increased the most and drove market performance.

We continue to add stock positions where we see attractive valuations. In the healthcare sector, life sciences and tools companies were impacted by cycling through covid related revenues and a pullback in biotech spending. The stock prices have been down significantly from the highs. Overall, there is a lot of spending on new drug discoveries. We anticipate a recovery in pharmaceutical research will benefit the life science and tools companies.

As mentioned earlier, we are watching the CRE market. U.S. public REITS, which tend to be sensitive to rising interest rates, are down over 30% on a one-year basis. There are areas of real estate that we believe could rebound as interest rates stabilize, and we have been adding there.

Finally, we have seen a pullback in railroads with lower volumes and higher operating ratios due to increasing expenses. As valuations level, dividend yields stabilize and volumes recover, we use these opportunities to add to our portfolios.

On the fixed-income side, we continue to be positive on bonds with short-term yields around 5%. We have maintained a neutral duration with exposures front-loaded on short-term bonds and backloaded on longer-dated bonds. We continue to be more tilted towards Treasuries versus Corporate bonds given that credit spreads remain muted. We also are looking to use cash alternatives to generate yield in the portfolio when appropriate.

Outlook

While it is difficult to forecast recessions and market pullbacks, as evidenced by the first half of the year, we remain cautious because there is a lag to rising interest rates and their effect on the economy. Parts of the market look expensive right now and the overall market valuation is trending above historical averages, which keeps us cautious in this current market environment. As mentioned above, we are finding select opportunities, but we are not going into full positions at this point.

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[xxxi] eVestment Analytics, see model disclosures below.
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In order to enhance current and prospective investor understanding of our process, approach and views, this letter includes detailed discussions regarding selected positions in our Strategy portfolios. In doing so, we hope this transparency enhances your understanding of our views on the investment opportunities we see in the marketplace and why we have positioned the Strategy portfolios the way we have. With such information available to you, we believe current and prospective investors are better informed and equipped to understand and/or challenge our views and approach to determine whether an investment in a Strategy is consistent with the mandate of each individual investor.