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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.

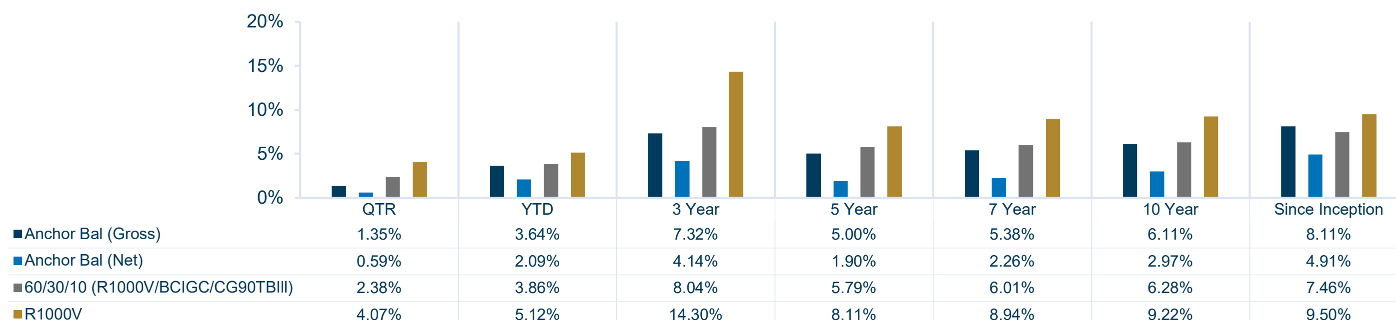
The U.S. economy has remained resilient with positive GDP growth despite higher interest rates and higher inflation levels.[xxiv] However, we are seeing pockets of economic weakness, like manufacturing, with the Purchasing Managers Index (PMI) in contraction levels[xxv] and many companies are reporting 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 Balanced Value Portfolio returned 1.35% (gross of fees) and 0.59% (net) during the quarter, underperforming the 60/30/10 Index, which returned 2.38%.

On a relative basis, the equity portion of the Portfolio benefitted the most from security selection in the Health Care and Consumer Staples sectors, as well as an underweight allocation to the Telecommunications sector. Security selection in Technology, Financials, and Consumer Discretionary were the greatest detractors from relative performance.[xxx]

## Managed Accounts Model Performance[xxxiv]




| | QTR | YTD | 3 Year | 5 Year | 7 Year | 10 Year | Since Inception |
|---|---|---|---|---|---|---|---|
| Anchor Bal (Gross) | 1.35% | 3.64% | 7.32% | 5.00% | 5.38% | 6.11% | 8.11% |
| Anchor Bal (Net) | 0.59% | 2.09% | 4.14% | 1.90% | 2.26% | 2.97% | 4.91% |
| 60/30/10 (R1000V/BCIGC/CG90TBIll) | 2.38% | 3.86% | 8.04% | 5.79% | 6.01% | 6.28% | 7.46% |
| R1000V | 4.07% | 5.12% | 14.30% | 8.11% | 8.94% | 9.22% | 9.50% |

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

## Quarterly Attribution Highlights – Equity Portion of Portfolio[xxxi]

| Sector - Top 3 Contributors | Sector - Bottom 3 Detractors |
|---|---|
| Industrials | Energy |
| Technology | Utilities |
| Health Care | Consumer Discretionary |

| Security - Top 5 Contributors | Avg. Weight % | Contribution % | Security - Bottom 5 Detractors | Avg. Weight % | Contribution % |
|---|---|---|---|---|---|
| Microsoft Corporation (MSFT) | 1.86% | 0.33% | Marathon Petroleum Corp. (MPC) | 1.15% | -0.24% |
| McKesson Corporation (MCK) | 1.52% | 0.29% | AbbVie, Inc. (ABBV) | 1.31% | -0.22% |
| Apple Inc. (AAPL) | 1.73% | 0.29% | Dollar General Corporation (DG) | 1.03% | -0.17% |
| Parker-Hannifin Corporation (PH) | 1.67% | 0.28% | Ulta Beauty Inc. (ULTA) | 0.97% | -0.16% |
| Booz Allen Hamilton Hldg Corp. (BAH) | 1.37% | 0.28% | Progressive Corporation (PGR) | 1.60% | -0.13% |

## Quarterly Transactions

| Purchased | Sold |
|---|---|
| Union Pacific Corp (UNP) | Willis Towers Watson PLC (WTW) |
| Thermo Fisher Scientific Inc (TMO) | |
| Sun Communities Inc (SUI) | |

## Purchases

**Union Pacific Corp (UNP)**[xxxii] operates North America's largest railroad franchise, covering 23 states in the western two-thirds of the United States. We have long admired the rail industry for its high barriers to entry, pricing power, high margins, and robust free cash flow generation. Specifically, UNP's rail network has several unique advantages, including its longer length of haul and geographic location. The longer length of haul widens its fuel advantage over trucking competitors and its geographic location in the west and south give it access to higher growth markets, including Mexico. Despite these advantages, UNP has been the worst performing railroad from both an operational standpoint as well as a total shareholder return standpoint over the last 8 years, under the current leadership of the company. However, with a push from an activist, UNP's current CEO has decided to step down and the Board is currently searching for his replacement. We believe new leadership at UNP can unlock significant shareholder value by simply getting the company back on track and recapturing a portion of its underperformance vs. peers. Additionally, we think the rail industry is set to experience an acceleration of growth over the coming decade driven by a resurgence in U.S. industrial production helped by reshoring, public infrastructure spending, and energy transition initiatives. As such, we took advantage of the opportunity to by an above average business in an above average industry. In our opinion, UNP has a solid growth outlook at a below market valuation with an attractive dividend yield.

**Thermo Fisher Scientific Inc (TMO)** is a leading global life sciences tools and diagnostic company. It operates across the complete ecosystem in the research and development process for pharmaceutical and biotechnology companies. In the last few years TMO has made several strategic acquisitions such as Pantheon, a contract drug manufacturing organization, which is now the largest CDMO after the large pharmaceutical companies. TMO also acquired PPD, a clinical research organization, which is an outsourced drug development group for pharma companies. Another attractive element of TMO is that over 70% of revenues are recurring consumables and services,

one of the highest percentages in the life sciences and tools space. The company 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 with the concerns over biotech funding following the Silicon Valley Bank collapse. TMO has a small percentage of revenues tied to small biotech firms. The outlook for drug development and spending is strong with focus on several new research areas such cell gene therapies, large molecule and cancer related drugs. TMO is expecting revenue growth of 7% to 9%- and double-digit EPS growth over the next several years. With a pull back in the share price and lower valuation, it presented an opportunity for the portfolio.

Sun Communities Inc (SUI) is a REIT that operates in manufactured home communities segment, focusing on the recreational vehicles (RV's), and marinas. In manufactured homes they own, operate, and develop communities. In RV they own over 170,000 developed sites and in marina they own over 47,000 wet slips/dry storage spaces. All properties which they rent out have the same characteristics of low supply, outsized demand, and high barriers to entry. For example, there was 96% occupancy in the manufactured homes they own with 55,000 applicants in 2022. In RV there are 11 million households that own an RV but only 1.7m RV campsites. In marinas there are over 12 million boats but only 1 million leasable storage spots with a large waitlist in most marinas. We believe Sun Communities is the highest quality REIT due to the high demand and limited supply in every aspect they play. Further the stock has been hit due to interest rates and integration of a UK acquisition. It sells at a low on a valuation basis. We believe the company can grow rent at 4% to 5% as they have, 6% to 7% NOI growth and dividend growth in line. We believe SUI should see shares re-rate to historic valuation as interest rates stabilize and the company goes back to strong margin expansion in 2024. Overall, we took advantage of this situation to buy, what we believe to be, the highest quality REIT in the space with a solid growth at a below historic valuation.

### Sale

Willis Towers Watson PLC (WTW) is a global insurance broker and health care benefits consultant. When we first purchased the stock, the company had terminated its acquisition from AON, replaced the CEO and set out a path for increased profitability. With cash from the AON breakup fee and the sale of the reinsurance business, Willis invested in the business to bring on additional people/books of business, as well as buy back shares. While the business is stable, management has had a history of missing guidance and upside from cash deployment and cost savings appears to have run out. We sold Willis on the premise that we have better opportunities.

### 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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Balanced Value 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 is hypothetical. 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. 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 Russell Indices exclude fees. The Managed Accounts All Cap Value model returns are calculated on a pure gross of fee basis before the deduction of Anchor Capital management and sponsor wrap fees. For all periods presented, the net of fee returns are presented after debiting the gross or pure gross of fee results by 3%, which represents the highest known annual wrap fee charged by any of the sponsors of the Separately Managed Account program that Anchor participates in. Effective 12/2019 through 12/2020, the net returns presented were calculated using eVestment. These monthly net returns were compounded to calculate the quarterly, YTD and annual returns. The numbers may be slightly different from net returns published prior to 6/30/2017, which were calculated by simply subtracting 3% from the annual gross return. Effective 3/2021, the net returns presented are calculated by subtracting the 3% highest known annual wrap fee among sponsors, compounded monthly. 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 and 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.

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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.