ANCHOR
CAPITAL ADVISORS LLC

Dividend Income Value
Portfolio Commentary
As of December 31, 2023

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Overview

In the end, 2023 turned out to be a mirror image of 2022 resulting in the net return of the S&P 500 being essentially flat over the two years. During the fourth quarter of 2023 there was a massive rally in both the equity and fixed income markets with inflation and interest rates coming down.[i] The markets seem optimistic that inflation is under control and that business and individuals can weather through the current higher priced environment we find ourselves in. For the time being, structural changes in the labor market have kept employment relatively steady. This coupled with a rising real wage has contributed towards the allowance of continued consumer spending. That said, the willingness to spend has been somewhat surprising given reports about how stretched the consumer is with the higher prices and tighter lending standards.

While we entered and remained very cautious in 2023, many expected a potential recession was on the horizon, it has not materialized. In fact, we have seen a rolling wave of in and out of favor sectors and industries performing well and some that have not. Many companies have been trying to figure out the new normal as it relates to supply chains, pricing/inflation, consumer demand and spending, interest rates, labor dynamics and covid spending. 2024 may the year we start to see a more normalized earnings picture.

Our focus at Anchor Capital remains on risk and downside protection at both the security and portfolio levels. We have difficulty investing in highly speculative or unprofitable companies even if they look attractive from a valuation perspective. Our goal is to find what we consider to be high quality companies trading at a discount to intrinsic value that can grow but also protect in down markets.

In down markets we have done well in executing on the goal of downside protection. It is turning points in the markets where speculative and unprofitable companies significantly outperform where we lag. In November, the markets rebounded higher on news that inflation was relatively contained and had decreased from previous highs. The Federal Reserve not only stopped raising interest rates they indicated that there is the possibility for up to four interest rate cuts in 2024.

While the overall market valuation is trending higher than average there are pockets that are attractive. The interest sensitive sectors of the market like bond proxies, utilities, and REITs, have been hard hit by higher interest rates. With interest rates coming down we are looking and beginning to see a good entry point and more attractive valuations for these sectors. Health Care has also been a laggard this year as numbers have normalized post pandemic and biotech funding pulled back. As a result, we see health care improving and think the space could provide interesting opportunities. The financial sectors, in particular banks, also dealt with high interest rates, funding costs and bank failures, but it appears to be behind them for the time being and seeing upside from here.[ii]

Mega-Cap tech stocks, and more specifically the Magnificent Seven stocks of the S&P 500 (Apple, Alphabet, Meta , Microsoft , Amazon , Nvidia and Tesla) drove performance in 2023.[iii] We believe that current valuations for these stocks are high relative to their growth profile and that significant outperformance from here will be more difficult to achieve.[iv] As we mentioned above, several value sectors have opportunities to recover and outperform in 2024 giving value room to shine.

U.S. Equity Markets

All U.S. equity markets outperformed for the quarter.[v] The markets had a healthy pull back between August 1st and October 31st before rebounding strongly in November and December.[vi] The markets appear to be celebrating that the economy is avoiding a recession and that we will likely see a soft landing. The sectors that outperformed were technology, REITs, and financials.[vii] After consistently raising rates since early 2022, the Federal Reserve has paused and signaled rate cuts could be coming. This pause and any potential cuts sets up to benefit and support those interest rate sensitive sectors impacted most by rising rates. On the flip side, the underperforming sectors were energy, consumer staples and health care.[viii] There continues to be normalization post pandemic, especially in the health care sector where many stocks were outsized beneficiaries of the pandemic.

U.S. Fixed Income

In the span of four months, the yield on the 10-year Treasury bond has moved from 4.09% on August 31st to 5% on October 19th and back down to 3.95% at year end.[ix] A 200 basis points move in interest rates in such a condensed timeframe is significant. The shift down in interest rates has created strength in bonds markets. The iShares Core U.S. Aggregate Bond ("AGG") ended positive for the year[x] with all U.S. bond segments performing well. High yield and leveraged loans performed the best.[xi] Any Fed interest rate cuts in 2024 would benefit bond performance.

Inflation

Inflation levels, as represented by the Consumer Price Index (CPI), remain above the Federal Reserve's targeted 2% annualized level.[xii] The November CPI reading was 3.1% annualized, which was a step down from the prior month. The Personal Consumption Expenditures (PCE) Price Index, a different way of measuring inflation, continues to show high services inflation and a decline in goods inflation.[xiii] Components of inflation like energy prices, food prices and rent are coming down while hourly wages have been increasing and are now outpacing inflation.[xiv] Inflation has is approaching more normalized levels after coming off 50-year highs (2022).

Interest rates/Fed/Economy

In one of the fastest rate hiking cycles in history, the Federal Reserve increased interest rates eleven times from March 2022 through July 2023. The Fed has kept the Federal Funds targeted interest rate between 5.25 and 5.5%.[xv] In December, the Fed indicated that it was done raising interest rates and could potentially cut rates up to four times in 2024.[xvi] We believe that the economy will have to weaken significantly before the Fed starts cutting interest rates given that inflation is still above its targeted 2% level. However, the Fed is also dealing with a massive interest expense on the balance sheet and cutting interest rates would help to relieve that. The U.S. economy has remained resilient despite some soft economic data. Overall, we saw job opening levels and wages soften, bank lending tighten since the Silicon Valley Bank collapse, credit card and auto delinquencies increase, and manufacturing weaken. Consumers are spending savings. This coupled with the return of student loan payments will most likely put pressure on discretionary spending. Some economists are forecasting more economic weakness, but it may not be enough to tip into a full-blown recession.

Performance Overview

The Anchor Capital Dividend Income Value Portfolio outperformed the Russell 3000 Value Index for the quarter. On a relative basis, the Portfolio benefitted the most from security selection in Real Estate as well as an underweighting in Real Estate and overweight an overweight allocation to the Health Care sector. Security selection in Financials and Telecommunications as well as an underweight allocation to the Technology sector were the greatest detractors to relative performance.[xvii]

Quarterly Attribution Highlights[xix]

Sector - Top 3 Contributors	Sector - Bottom 3 Detractors
Financials	Energy
Real Estate	Telecommunications
Industrials	Consumer Discretionary

Security - Top 5 Contributors	Avg. Weight %	Contribution %	Security - Bottom 5 Detractors	Avg. Weight %	Contribution %
Lamar Advertising Company (LAMR)	2.15%	0.59%	Texas Pacific Land Corporation (TPL)	2.20%	-0.35%
National Storage Affiliates Trust (NSA)	1.95%	0.59%	Cisco Systems, Inc. (CSCO)	1.99%	-0.13%
JPMorgan Chase & Co. (JPM)	2.68%	0.47%	Hershey Company (HSY)	1.38%	-0.10%
A. O. Smith Corporation (AOS)	1.90%	0.47%	Air Products and Chemicals, Inc. (APD)	2.23%	-0.07%
American Tower Corporation (AMT)	1.46%	0.46%	Genuine Parts Company (GPC)	1.57%	-0.07%

Quarterly Transactions

Purchased	Sold
Crown Castle Inc. (CCI)	Royal Gold Inc (RGLD)
PNC Financial Services Group (PNC)	
Kellanova (K)	

Purchases

Crown Castle (CCI) is a REIT that owns mission critical shared infrastructure assets (cellular towers, fiber, and small cells). The shared infrastructure model is highly attractive due to high barriers to entry, long-term contracts, low churn, high margins, low capex requirements, and strong credit tenants. CCI's contracts have ~3% annual contractual escalators on average and its portfolio is well positioned for long-term growth given support from secular tailwinds of data growth and technology upgrade cycles such as the ongoing one from 4G to 5G. At the time of our purchase, the stock was trading at a seven-year low due to higher interest rates, large Sprint churn in 2025, slowing carrier 5G capex, and fiber/small cell uncertainty/return drag. This created a rare value entry point into a high quality, low risk business with long-term contracts that was offering a near 7% dividend yield and 5%+ long-term growth driven by secular forces.

PNC Financial Services Group (PNC) is the 6th largest bank in the U.S. It has been a tough environment for regional banks, which led to a large sell-off in PNC's stock over the last two years. This created an attractive entry point into a bank with immense scale, a stable deposit base, a long-track record of expense management, strong capital levels, and an exceptional risk management culture. We think the company is well prepared to navigate the current environment thanks to its defensive balance sheet, diversified loan book, and experienced management team. We also like the diversification provided by PNC's fee-generating businesses, including from its strong franchise in treasury management, as well as the company's acquisition of BBVA. BBVA accelerated PNC's national expansion strategy, making the bank a major player in the faster growing Sunbelt region, and providing it a 10+ year runway for growth. Finally, the company pays a healthy dividend that yielded ~5% at purchase.

Kellanova (K) spun off its US cereal business to focus on its higher growth snacks portfolio. At the core of which are five power brands, including pringles, Cheeze-it, Pop-Tart, Rice Crispy treats and Eggo Waffles. The management is guiding MSD sales growth and 2% margin expansion over a three-year period, which we believe are achievable. The stock trades at an undemanding valuation of under 15 x forward PE yielding 4.4%.

Sales

Royal Gold Inc (RGLD) is a gold stream and royalty company. Historically, these companies trade on P/NAV multiple. We exited the position at close to 2x P/NAV which is the upper end of the valuation range. Based on our research and meeting with the management, we concluded that NAV expansion potential did not justify the stock's valuation. The elevated NAV would also limit the stock's appreciation potential with gold (the metal). Besides, at the time of the sale, the stock's dividend yield was 1.25% which was significantly below than the DY of the portfolio.

Anchor's Positioning

We were defensively positioned for most of 2023 with concerns over how higher interest rates and inflation would affect the economy. As a result, the cash levels of Anchor portfolios increased. The higher levels of cash contributed to relative performance in October when the markets sold off, but subsequently detracted in November and December when the market rallied.

Despite the market volatility we have been active in seeking new stock opportunities to add to the portfolios. We found more attractive entry points for regional banks, REITs, and capital markets, which helped bring up our financials exposure. We trimmed or exited out of positions with higher valuations and those that met our price targets.

Our cash levels came down a little bit nearing year-end. We believe we are positioned well to capture upside from the areas of the market that have underperformed most recently. We remain excited about the existing portfolio holdings as we return to a more normalized environment post-pandemic.

Outlook

We believe our discipline in managing risk and looking for attractive stock opportunities will help performance in 2024. While macro forecasting is not our forte, we consider how different variables may affect companies and different parts of the markets. With interest rates potentially a little lower and growth relatively stable that should support small and mid-cap stocks from valuation and opportunity. We continue to look for businesses that meet our value criteria that can participate on the upside, while protecting better on the down.

[i] FactSet Financial Data & Analytics
[ii] FactSet Financial Data & Analytics
[iii] Ibid.
[iv] Ibid.
[v] Ibid.
[vi] Ibid.
[vii] Ibid.
[viii]Ibid.
[ix] Ibid.
[x] Ibid.
[xi] Ibid.
[xii] https://www.wsj.com/economy/central-banking/how-hard-should-the-fed-squeeze-to-reach-2-inflation-77dbf56f
[xiii] https://www.cnbc.com/2023/11/30/pce-inflation-report-october-2023-.html
[xiv] https://www.youtube.com/watch?v=WtFzaol6yx8, Charlie Bilello, 12/15/2023
[xv] https://www.usatoday.com/story/money/personalfinance/2023/07/26/july-fed-rate-hike-economic-effect/70463169007/
[xvi] https://www.usatoday.com/story/money/personalfinance/2023/07/26/july-fed-rate-hike-economic-effect/70463169007/
[xvii] FactSet financial data & analytics; attribution
[xviii] eVestment Analytics, see model disclosures below. Effective 6/30/2023 the benchmark presented for all periods since inception has been changed from the Russell 1000 Value, which reflects the large-cap value segment, to the Russell 3000 Value, which provides a barometer of the broad value market.
[xix] FactSet financial data & analytics; Attribution

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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.