ANCHOR CAPITAL ADVISORS LLC

Dividend Income Value
Portfolio Commentary
As of September 30, 2024

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.

Overview

During the third quarter there were dramatic swings in the markets. For a two-week period the S&P 500 index dropped by 8%, only to rebound and end the quarter at new highs.[i] Three key factors drove this market volatility. First, technology stocks surged fueled by investments in artificial intelligence (AI).[ii] However, third-quarter earnings for some tech companies were below expectations, leading to a pullback in their share prices. Second, employment figures came in weaker than anticipated, causing the unemployment rate to rise to 4.3% in July.[iii] This triggered the Sahm rule, a potential recession signal, when the three-month moving average of the unemployment rate was .53 percentage points above its 12 month low.[iv] Lastly, the Bank of Japan raised interest rates, strengthening the Yen and triggering a major market sell-off.[v] In spite of these disruptions, markets quickly recovered.

Despite the noise, equity markets performed well, with a shift from large technology stocks to other areas, most notably value and small cap stocks.[vi] Overall, third-quarter earnings were positive, with average earnings per share (EPS) growth exceeding 11%, and fourth-quarter EPS is forecasted to grow by 4.6%.[vii] At the company level, there are no major signs of an economic slowdown. The primary concerns have been the valuation of the S&P 500 index and concentration risk. S&P 500 index has reached 21x next twelve months earnings - well above the historical average of 16x, and the top 10 stocks account for 34% of the index, an all-time high.[viii] Encouragingly, valuations outside of these top stocks have been more reasonable, indicating broader market participation.

While worries about a potential recession exist, we believe that scenario is likely avoided. Many investors have held cash, attracted by short-term interest rates of 5% or more. Bonds also attracted assets this year due to higher interest rates and expectations of Federal Reserve rate cuts. Equities have remained relatively stable, with no significant inflows. The Fed has started reducing interest rates, which could benefit both companies and consumers, as equity markets have historically done well during cutting cycles. Additionally, with a presidential election approaching – a period historically positive for the stock market – investor sentiment could remain upbeat.

U.S. Equity Markets

The U.S. equity markets extended their positive run into the third quarter, though under new leadership. While large-cap technology stocks, especially the "Magnificent Seven" (the seven largest by market capitalization), dominated earlier in the year driven by substantial AI investments, many of these stocks pulled back in the third quarter. As a result, the Nasdaq index ended the quarter with only modest gains.[ix] The standout performance during the quarter came from a broadening market rally, particularly benefiting value and small cap stocks. As interest rates declined, small caps and the bond proxy sectors (REITs and Utilities) were the best performers.

U.S. Fixed Income

Following a peak in April 2024, the yield on the 10-year Treasury has been steadily declining, leading to improved bond prices and overall positive fixed income performance. The 10-year Treasury yield dropped from 4.48% on July 1 to 3.73% by the end of the third quarter, a substantial shift that supported bond markets.[x] Investment-grade corporates, high-yield bonds, leveraged loans, and securitized credit have all delivered solid returns in response. With the Federal Reserve cutting rates, we expect investors will move from short-dated bonds towards those in the mid-range of the curve (3-7 years), which stand to benefit most from falling yields.

Inflation / Interest Rates/Fed Reserve / U.S. Economy

Inflation, as measured by the Consumer Price Index (CPI), continues to decline, with August's reading at 2.5%.[xi] Lower energy and food prices have contributed to this trend. Shelter costs, a lagging indicator, have shown an increase recently but are expected to decrease soon. There has been an uptick in unemployment, which remains low by historical standards, and there have been downward revisions to payroll numbers. The combination of easing inflation and a potentially weakening labor market led the Federal Reserve to cut interest rates by 0.50% in September. Most analysts believe that the economy is headed for a "soft landing", and the Fed appears focused on being less restrictive rather than forced into stimulating growth to avoid a recession.

The significant shift in interest rates also resulted in a modest re-steepening of the Treasury yield curve. The curve, which represents Treasury yields at different maturities from 0 to 30 years, had been inverted (2-year yields exceeding 10-year yields), historically a sign of a potential recession. However, with the 2-year yield now below the 10-year yield, the curve is beginning to normalize.[xii] Historically, a re-steepening yield curve can precede a recession, but there have been instances where this was not the case.

U.S. Economic Outlook

The US economy has shown remarkable resilience given all the challenges, though there is a divide between high- and low-end consumers. High-end consumers have benefited from greater household wealth due to gains in the rising stock market and home values, while low-end consumers continue to struggle with higher costs for essential goods like gas, food, and rent. Despite this, it has been retail sales remain on the rise, though some retailers have noted reduced spending from lower-income consumers.[xiii] Industrial production has softened, with the Purchasing Managers Index (PMI) showing weaker expansion, and the housing market has seen a modest rebound with lower interest rates.[xiv] Overall, the economic environment remains solid, with GDP growth projected to stay above trend levels.

Anchor's Positioning

Given current market volatility and high valuations in some sectors, we have been cautious about adding new holdings. Anchor strategies remain balanced, with some cash on hand to protect and mitigate volatility risks. Despite these challenges, we continue to seek compelling opportunities and look for interesting ideas. One area of focus has been healthcare, where we have been adding to in portfolios. Post-pandemic normalization is benefitting healthcare firms as they return to previous growth trends. Additionally, several companies have spun off their healthcare divisions, creating new investment opportunities for the portfolios.

We are closely monitoring the consumer sectors, where there is a noticeable divergence between lower-and higher-end consumers in terms of spending habits and shopping preferences. Many consumer trends have shifted over the past year, creating a more challenging environment for companies that experienced large gains during the pandemic.

Conclusion

With the Federal Reserve beginning its rate-cutting cycle, employment levels stable, and earnings growth continuing we remain generally positive about the outlook for equity and bond markets. As previously noted, we believe money could flow from money market funds into stocks and bonds, helping to sustain the markets' upward momentum. As long as employment remains strong and key macroeconomic trends are favorable, we expect positive market performance for the coming quarters.

Performance Overview

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

Quarterly Attribution Highlights[xvii]

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

Security - Top 5 Contributors	Avg. Weight %	Contribution %	Security - Bottom 5 Detractors	Avg. Weight %	Contribution %
Kellanova (K)	1.13%	0.73%	Shell Plc Sponsored ADR (SHEL)	1.99%	-0.15%
Lockheed Martin Corporation (LMT)	2.18%	0.52%	Chevron Corporation (CVX)	1.71%	-0.10%
RTX Corporation (RTX)	2.26%	0.46%	Marathon Petroleum Corp. (MPC)	1.59%	-0.09%
PNC Financial Services Group, Inc. (PNC)	2.34%	0.46%	Microsoft Corporation (MSFT)	2.07%	-0.09%
McDonald's Corporation (MCD)	2.31%	0.44%	Analog Devices, Inc. (ADI)	2.12%	0.01%

Quarterly Transactions

Purchased	Sold
Mid-America Apartment Communities Inc (MAA)	Kellanova (K)

Purchases

Mid-America Apartment Communities Inc (MAA) is very well-managed REIT. It owns, manages and builds apartments in the fast-growing sunbelt markets. We saw an opportunity to buy one of the highest quality companies in the space when it was out of favor, and before interest rates started to come down. MAA has the best balance sheet in the multi-family space and can take advantage of any disruptions in the marketplace. Population growth, immigration, and a shortage of housing in the US makes for a very strong fundamental outlook for the company and the industry.

Sales

Kellanova (K) is a global snack foods company with brands including Pringles, Cheez-It, Pop Tarts, Eggo, and Rice Krispies. It spun off the North America cereal business in 2023, leaving a more growth-oriented portfolio of brands with leading market share. During the quarter, Mars announced plans to acquire Kellanova, and we sold our shares as they approached the takeout price.

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[i] FactSet Data & Analytics, Charting
[ii] https://www.forbes.com/sites/us-bank-wealth-management/2024/09/18/investing-in-tech-stocks-is-now-a-good-time/
[iii] https://budget.house.gov/press-release/july-job Chs-report-unemployment-rate-rises-for-fourth-consecutive-month#:~:text=The%20report%20showed%20114%2C000%20new,unemployment%20rate%20since%20October%202021.
[iv]https://www.google.com/search?q=sahm+rule&rlz=1C1GCEA_enUS1096US1098&oq=sahm+rule&gs_lcrp=EgZjaHJvbWUyBggAEEUYOdIBCTI5ODhqMGoxNagCCLACAQ&sourceid=chrome&ie=UTF-8&safe=active&ssui=on
[v] https://www.cnbc.com/2024/09/09/carry-trade-unwind-could-replicate-august-mayhem-suggests-bks-lein.html#:~:text=This%20carry%20trade%20began%20unwinding,dollar%20to%20trade%20at%20141.9.
[vi] FactSet Data & Analytics, Charting
[vii] https://insight.factset.com/earnings-insight-infographic-q2-2024-by-the-numbers
[viii] https://am.jpmorgan.com/content/dam/jpm-am-aem/americas/us/en/insights/market-insights/guide-to-the-markets/daily/protected/mi-daily-gtm-us.pdf
[ix] FactSet Data & Analytics, Charting
[x] Ibid
[xi] https://www.cnbc.com/2024/09/11/cpi-inflation-report-august-2024-.html#:~:text=The%20CPI%2C%20a%20broad%20measure,the%20lowest%20since%20February%202021.
[xii] FactSet Data & Analytics, Charting
[xiii] https://www.reuters.com/markets/us/us-retail-sales-unexpectedly-rise-august-2024-09-17/
[xiv] https://www.pmi.spglobal.com/Public/Home/PressRelease/78070699cd654baeb61c7a6dca339f58
[xv] FactSet financial data & analytics; attribution
[xvi] 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.
[xvii] 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.