

This Month in the Markets

December 2009



EQUITY COMMENTARY

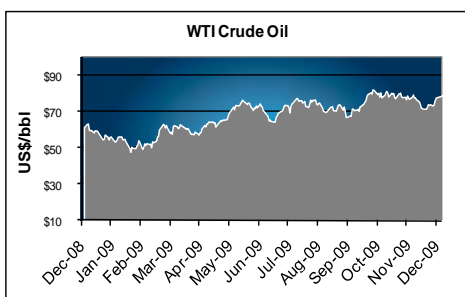
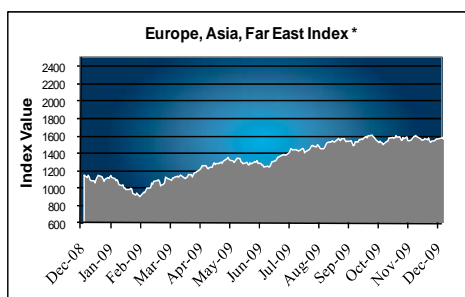
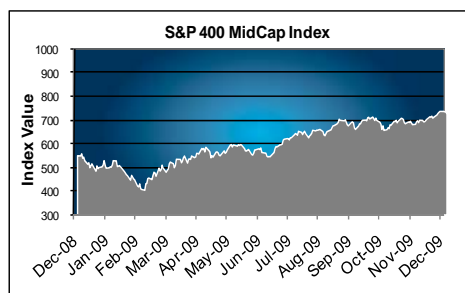
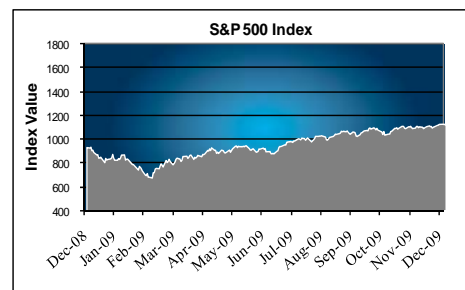
A more stable decade

2009 was a recovery year for most investors completing the tumultuous first decade of the twenty first century. As investors look forward, many of them are hoping for a few less fireworks over the next ten years. The decade began with the bursting of the technology bubble and ended with a rapid implosion of the real estate and credit markets causing the collapse of some of Wall Streets' largest and most venerable institutions. Stock indices produced their worst decade performance since the 1930's. These events exposed the Achilles heel of capitalism – greed. Unfortunately free markets are driven by a combination of fear and greed and when the latter is left unrestrained the results are usually unpredictable and occasionally catastrophic.

The restoration of integrity to the financial system is vital due to the trust factor bestowed on the participants and mandated by investors. Legislators, regulators and industry representatives around the world are busy attempting to tackle the difficult issue of regulation. It appears that growth especially in the financial service sector will be constrained going forward by increased capital requirements and regulation. What is less clear is whether the impact of lower leverage in the financial system will have a positive impact on stock valuation as both growth and risk premiums decline. It is our opinion, that there will be a slow recovery in global economic activity due to constrained credit growth over the next three years but that the combination of productivity gains during the economic downturn, passive inflation and globalization will lead to consistent earnings expansion over the next decade.

Corporate balance sheets remain healthy but fiscal and financial deleveraging present significant risk to sustained growth. Credit constraints will benefit larger well capitalized companies with a global footprint. Opportunities remain for these companies in developing economies while prospects in deleveraging mature economies with high tax burdens are less appealing. China is a wildcard, as the government's unprecedented fiscal stimulus program has caused risk to the nation's financial system and could present a Japan style prolonged economic downturn as the banks are forced to slowly unwind bad loans. A global economic rebound should revitalize China's exports and mitigate some of the financial risk but China's "grand experiment" remains at risk. Brazil, India and other emerging markets represent growth opportunities but Anchor believes that buying leading multi-nationals is the prudent way of playing these markets.

Inflation is another wildcard looking forward as central banks around the world tackle the difficult task of gradually unwinding their various stimulus packages without causing another economic downturn. Excess stimulus carries the potential consequence of causing another bubble in risky assets and commodities. This possibility became evident in 2009 when high risk assets soared as investors sought out higher returns than the paltry yields offered by U.S. Treasury securities and money market funds. Anchor believes investors will benefit from holding shares in commodity companies as central banks remain accommodative in 2010. The managers added positions in agriculture to their energy and industrial metals share holdings. While this currently represents an opportunity, inflation is also one of the major risks that Anchor will monitor during the second decade of the twenty first century.



*MSCI EAFE Index

For more information about Anchor Investment Management and our services please visit our website at www.anchor.bm or contact us directly at info@anchor.bm or (441) 296-3515

FIXED INCOME COMMENTARY

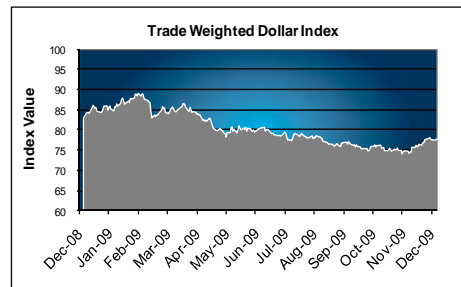
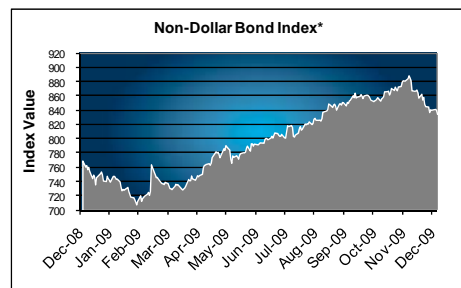
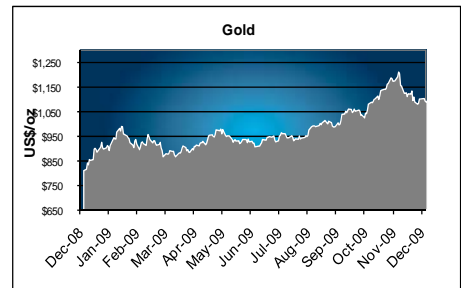
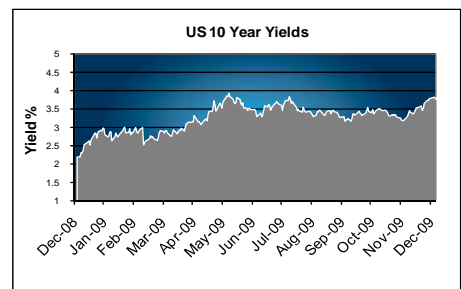
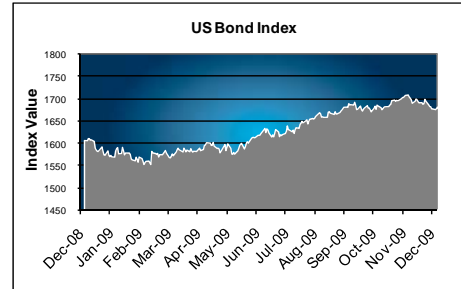
U.S. Dollar

Opportunities are always the greatest when fear rules Wall Street. 2009 was a classic example of fear being replaced by greed in the credit markets. The threat of financial Armageddon at the beginning of the year was reversed in March and risk-assets recouped most of their 2008 losses during the rest of the year. The riskier the asset class, the better the 2009 performance. High yield bonds returned over 57 percent in 2009. That is by far the best yearly performance since the introduction of junk bonds. Corporate bonds outperformed U.S. Treasury securities with the Merrill Lynch Corporate Bond Index rising nearly 20 percent. U.S. government bonds were the only major fixed income asset class which posted a negative return over the course of the year. The yield of the 10-year U.S. Treasury security rose by over 160 basis points due to higher inflation expectations and a glut of government issuance from a large fiscal deficit. On the other side of the yield curve, short-term interest rates remained at record low levels. The Fed Funds target rate was held unchanged at 0 to 25 basis points for the entire year and one-month T-Bills basically offered zero percent interest. As a result, the U.S. yield curve rose to its steepest level in more than 30 years, with the ten-year bond 270 basis points higher than the two-year note. Historically, such a steep yield curve was the harbinger for strong economic growth in the following year.

The economic recovery has gained more traction towards the end of the year. An extremely accommodative monetary policy and huge fiscal stimulus have put the U.S. (and global) economy back on track. Leading indicators have pointed to a V-shaped economic recovery for a couple of months and lagging indicators like unemployment has finally shown some slight improvement. The U.S. housing sector seemed to have bottomed out at very low levels. While there are still mixed signals coming out from the residential real estate sector, some progress from lower inventory levels and slight price increases could be observed. The commercial real estate sector on the other hand is still weakening with default rates increasing. Bigger financial institutions should be able to handle defaults from commercial real estate (CRE) since this segment usually represents a small portion of their entire revenue stream. The Anchor managers are more concerned about the U.S. regional banks which have traditionally been the lender of choice for commercial real estate. It is not uncommon that regional banks' exposure to CRE is over 50 percent of their entire loan book. The Anchor managers have become more constructive on debt and preferred securities issued by big financial institutions but will avoid regional banks. Most large banks raised significant capital in 2009 to survive a prolonged economic downturn.

The risk premium between corporate and government bonds has been reduced materially from the peak last year but there is still some more room for outperformance. By year end the global default rate hit 12.7 percent, a level unseen since the Great Depression. While many smaller and weaker companies are still likely to fail, rating agencies forecast a drop of the default rate to 4.5 percent by September 2010. While we believe that this forecast may be overly optimistic, this fundamental improvement should allow corporate bonds and preferred securities to continue to perform well in 2010.

The U.S. dollar and Japanese yen were the currencies of choice during the financial crisis. The U.S. dollar benefited from its world reserve status and its liquidity, while the yen was simply supported by Japanese investors repatriating funds invested abroad (reverse "carry trade") and by Japan's current account surplus. As fears caused by the financial crisis abated, the relative safety of the U.S. dollar was no longer needed and the greenback underperformed significantly. The Anchor managers expect that 2010 could be the year of the U.S. dollar, despite the fundamental challenges facing the currency. The greenback has become one of the cheapest currencies of the developed economies. U.S. rates are expected to rise in 2010 and this would reduce the interest rate differential to other currencies and hence support the U.S. dollar. The Japanese yen will likely once again become the funding currency of choice, since the Bank of Japan extended its monetary stimulus and hence it is hard to envision a scenario with higher interest rates in Japan anytime soon. Several countries have already started to raise interest rates and some more central banks will follow in the first half of 2010. The Anchor managers still see value in the Australian dollar, the British pound, Norwegian krone and Swedish krona. The biggest change to the international bond portfolio has been a shift from euro to U.S. dollar.



*Merrill Lynch Non-US Dollar Bond Index