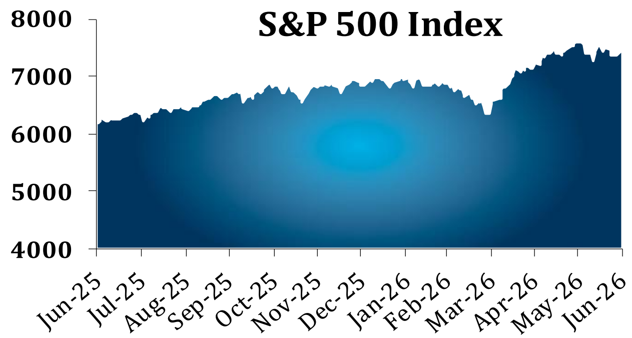
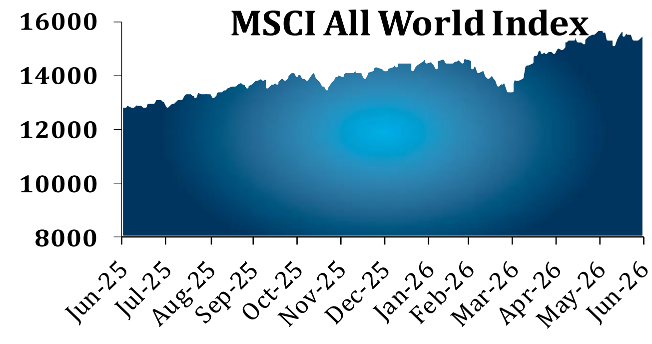
Public

Stock Market Analysis

Warning Lights





ANCHOR
Investment Management

The second quarter stock rebound reinforced our view that markets are rewarding a narrow set of AI-related winners while underpricing the cyclical and credit risks that often emerge after periods of heavy capital investment. Our positioning remains disciplined: we recognize the long-term productivity potential of AI, but we are cautious about extrapolating today's margins and valuations into the future.

Global stock markets rebounded from March losses in the second quarter as the Iran War ended and energy shipments resumed through the vital Strait of Hormuz, but the environment remains challenging for active managers. While geopolitical risks remain present, investors are increasingly focused on the opportunities and disruption created by artificial intelligence. Periods of transformative innovation can produce lasting productivity gains, but they can also cause markets to misprice risk. The internet era offers a useful parallel: it created benefits that continue today, but it also produced extreme valuations that eventually deflated from late 2000 into 2002, when the S&P 500 lost 44% of its value. When too much capital flows into a narrow set of sectors, booms can turn into busts. We are concerned that the billions of dollars flowing into AI investments could create unexpected consequences, particularly as rising losses in private credit markets highlight risks in areas with fewer guardrails than the more regulated financial services sector.

We have conviction that AI presents many opportunities for investors and that innovative technologies should aid overall productivity. At the same time, we are concerned that some market leaders, including memory chip stocks, may be vulnerable after rising more than a thousand percent over the past three years. These are cyclical industries that are currently producing record operating margins because supply remains constrained. Although operating profits have exceeded analyst expectations, margins are likely to move back toward historical levels when supply and demand normalize. The difficult question for investors is how long these excess returns can persist, a challenge that was also evident during the tech bubble. The S&P 500 rose 218% during the five-year period from 1995 to 1999, producing a 28.4% average annual return before the bubble burst.

Stock Market Analysis

Portfolio Performance

In the second quarter, market leadership remained very narrow, with AI beneficiaries driving positive returns. At the same time, investors sold historically profitable software and service companies based on potential competitive risks from new AI entrants. Corporate profits benefited from significant growth in spending related to the artificial intelligence boom, and rapid data center growth caused a spike in demand for computer and memory chips. The MSCI ACWI Net Total Return benchmark rose 14.6% in the second quarter and finished the first half of the year with an 11.2% return. International and high-quality income indices underperformed the technology driven U.S. equity benchmarks during the second quarter. The S&P 500 Index returned 15.2%, while the MSCI Europe Asia Far East Index gained 11.1% and the SG Global Quality Income benchmark lagged with a 1.8% return in the period.

This backdrop helps explain our relative results. A market led by a small group of speculative growth and AI-related companies can create short-term headwinds for a disciplined, quality-focused process, even when that process remains well suited to protecting capital and compounding returns over a full cycle. Anchor's approach to managing through volatile periods is to remain disciplined and conservative. We are disappointed with Anchor's relative performance in our equity portfolio this year, but we have underperformed in the past during periods of high speculation and narrow market breadth. We are confident that our quantitative approach will allow us to continue to produce strong results over the long term. The Anchor Equity Composite returned 8.4% in the second quarter and 13.2% over the past 12 months. The Anchor High Quality Income Portfolio returned -1.8% in the second quarter after a strong start to the year and returned +5.7% over the past 12 months. We believe uncertainty will create opportunities to selectively take advantage of any market dislocation. *

*Performance is based on Anchor equity composite portfolios. Returns include changes in unit value, reinvestment of all distributions, investment management fees, execution, custodial and other charges. Investment results are best judged over the long term. Performance should be evaluated with consideration of the client's specific goals and investment objectives. Past performance is not necessarily indicative of future results. Returns for indices or benchmarks are provided in U.S. dollar terms and solely for informational purposes. These indices or benchmarks are non-managed indices that do not accrue advisory or transactional expenses. Benchmarks are based on the client's selected asset allocation and are calculated in U.S. dollar terms. The Anchor Equity Portfolio benchmark uses the MSCI AC World Total Return Index. The Anchor High Quality Income Portfolio benchmark uses the SG Global Quality Income (USD) Index.

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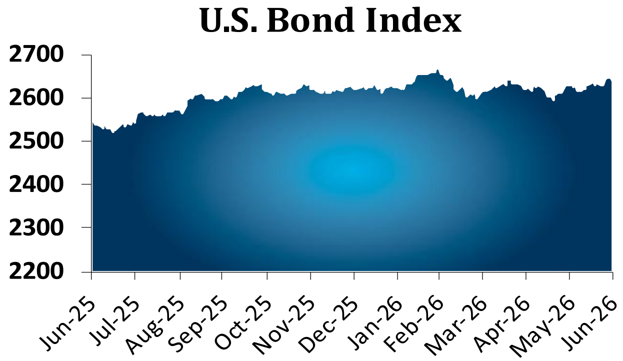
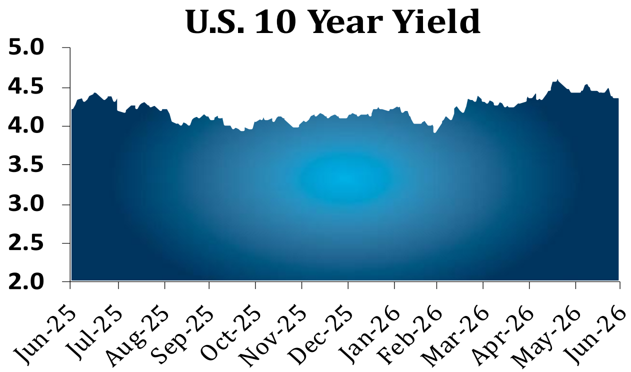
Fixed Income Analysis

“War, What Is It Good For?”





ANCHOR
Investment Management

Seinfeld fans will recall Jerry convincing Elaine that this was Tolstoy's original title for War and Peace. For markets, at least, the answer this quarter was “absolutely nothing”: despite the Iran–U.S. conflict dominating headlines, inflation expectations ended the quarter below where they stood before the fighting began. Instead, the second quarter was defined by risk-on sentiment, a sharp repricing of Fed expectations, and fading geopolitical risk. Credit markets absorbed record issuance with ease; the Treasury curve flattened as real rates rose; and a Warsh-led Fed signaled a clear departure from the guidance-heavy playbook of the post-GFC era. The dollar strengthened as markets priced out cuts and began contemplating hikes — a dynamic we believe has now largely run its course.

That risk-on backdrop was clearest in credit. Spreads tightened in the second quarter as strong demand for corporate bonds met a heavy new-issue calendar. June set a record for the month, with $207 billion in issuance, led by the technology, media, and telecom sector at $66 billion. Heavily oversubscribed Nvidia and SpaceX deals underscored that the bond market is having little difficulty financing the AI build-out. Rates told a complementary story. The Treasury curve flattened over the quarter as short-term yields rose more than longer-term yields: the 2-year yield climbed 38 basis points to 4.16%, while the 10-year yield rose 15 basis points to 4.45%. Softer-than-expected April PCE data, a downward revision to Q1 GDP, and de-escalation with Iran were ultimately outweighed by strong payrolls, an energy-driven rise in CPI, and an FOMC — Chair Warsh in particular — perceived as hawkish.

Importantly, despite fear-stoking headlines, the move higher in rates was driven by real rates rather than inflation expectations. This is evident across multiple measures: both the 10-year breakeven inflation rate and 10-year inflation swaps now sit below their levels before the onset of the Iran conflict. In our view, this reflects both the anticipated impact of AI on the U.S. economy and a growing sense of Fed independence under Chair Warsh.

Public

Fixed Income Analysis

The June FOMC meeting reinforced that shift. The Committee held the federal funds rate steady, while Chair Warsh announced task forces to review the Fed's communications, balance sheet, economic data framework, productivity and employment assumptions, and inflation framework. The emphasis on real-time data and AI's impact on productivity points to a Fed preparing to rethink how it assesses both the economy and monetary policy. The dot plot was mixed: nine participants penciled in a hike for 2025, while ten favored holding rates steady. The dots, however, do not reveal which participants hold votes. Warsh declined to submit a dot, noting that “submissions were coming in with pencils; you know those kinds with the big erasers. That's to say that I think my colleagues around the table, when they submitted their dots, understand the world is changing quite quickly.”

Taken together, the message is that the Warsh-led Fed will offer markets less forward guidance — a decisive break from the post-GFC playbook. By the end of June, markets were pricing in roughly one and a half 25-basis-point rate hikes for 2026. We disagree with this view. With the task forces reviewing the Fed's operating framework, the Iran–U.S. ceasefire agreement now signed, and peak inflation fears fading, we believe Chair Warsh has ample cover to remain on hold.

Currency markets reflected the short-term interest rate market's hawkish view. The dollar appreciated in Q2, with the Bloomberg Dollar Spot Index rising 0.56%. The Australian dollar was the best performer among G10 currencies, eking out a 0.28% gain against the dollar, while the Norwegian krone fell 2.12% as oil prices declined following the ceasefire agreement. Broad dollar strength began in March 2026, when safe-haven flows buoyed the currency amid the Iran–U.S. conflict. After giving back much of those gains through April and early May, the dollar rallied again on resilient U.S. economic data — particularly in the labor market — even as inflation prints moved higher. Markets responded by pricing out rate cuts and beginning to price in hikes, shifting interest rate differentials between the U.S. and other developed economies in the dollar's favor. We believe this process has now largely run its course, which should favor a weaker dollar going forward.

The quarter was ultimately less about geopolitical shock than about the market's confidence in growth, Fed credibility, and the disinflationary potential of AI. Credit markets remained resilient despite heavy issuance, rates rose primarily through real yields rather than inflation expectations, and the Warsh-led Fed signaled a less predictable, more data-dependent policy framework. While the dollar benefited from the repricing of U.S. rates, we believe that adjustment is now largely complete, leaving room for a softer dollar as peak inflation concerns fade and the Fed remains on hold. In short, geopolitical shocks can dominate headlines without ultimately driving markets when real rates, Fed credibility, and risk appetite are doing the heavier lifting.

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