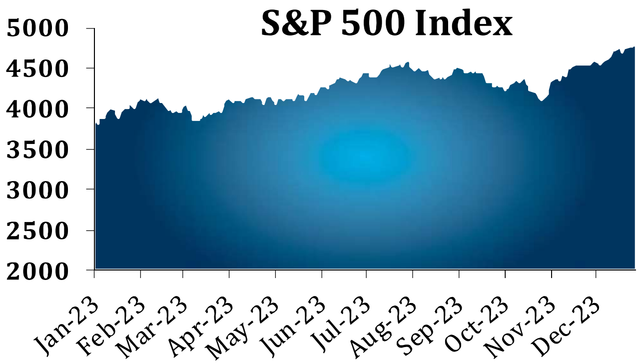
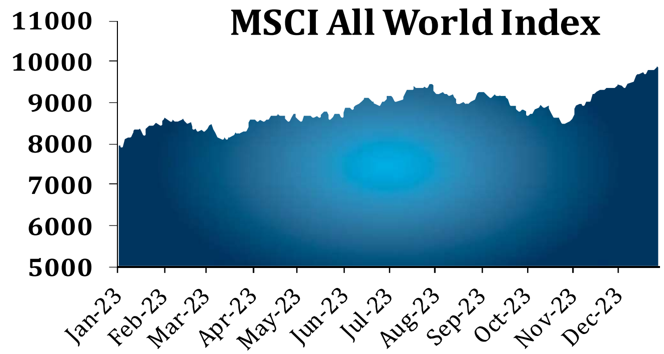
Stock Market Analysis

Magnificent Year for the Stock Market





The "Magnificent Seven" powered strong returns for the equity markets in 2023, with the S&P 500 Index returning 26.3%. Technology shares led the gains, with the Nasdaq Composite surging 44.7%. The seven mega-cap shares (Apple, Amazon, Alphabet, NVIDIA, Meta, Microsoft, and Tesla) led the surge in the Nasdaq and S&P 500 Index, as investors anticipate that artificial intelligence will drive a new decade of growth and productivity. Anchor's equity portfolio benefited by holding Alphabet, Amazon, Meta, and Microsoft. Other technology holdings, including ridesharing and online food delivery company Uber Technology, also helped the portfolio's strong performance, gaining almost 150% in 2023. Palo Alto Networks, which provides network security solutions, surged 111%.

Stock returns accelerated in the fourth quarter as the U.S. Federal Reserve indicated their two-year tightening cycle to fight inflation is likely over. Despite the sharp rise in interest rates over the past two years, the U.S. economy surprised the naysayers, with GDP growth accelerating to a 4.9% annualized rate in the third quarter. The Federal Reserve reversed its hawkish stance and indicated that it would lower the Federal Funds rate three times in 2024. They forecasted that economic growth and inflation would slow in 2024, reducing the need to keep interest rates elevated. A 22% decline in crude oil prices in the fourth quarter eased inflationary pressure. One of the Fed's preferred inflation metrics, the US core PCE Index (excluding food and energy prices) fell to 3.2% in November, the lowest increase since early 2021. Periods of falling inflation and interest rates are historically positive for the security markets, but the question is how much good news has already been discounted. It may be time for investors to shift to a more value-oriented strategy after the MSCI World Growth Index outperformed the MSCI World Growth Index for eight of the past 10 years, with an 11.3% average annualized return versus 6.7% for the value index.

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Stock Market Analysis

International shares participated in the 2023 rally, with the MSCI All-World Index returning 22.2%, driven by strong gains in Europe, Mexico, and Brazil. Asia's performance was mixed, with Japan, India, and South Korea producing strong returns, but Hong Kong and Chinese shares lagged. The Chinese economy suffered from the struggling real estate sector and anticompetitive government policies. Earnings for companies in the MSCI All-World benchmark were flat in 2023, but EPS growth is expected to accelerate to almost 14% in 2024, based on Bloomberg consensus estimates. The breadth of the market was weak for most of 2023, with the average stock in the Russell 2000 being down on the year until mid-December when the rally became more broad-based. The Russell 2000 equal-weighted index finished the year with modest gains (6.7%). Quality dividend shares performance improved in the fourth quarter but also lagged for most of the year.

Looking back on 2023, we reflect on the most market moving, stress event of the year: the March bank run crisis when three large U.S. banks failed (Silicon Valley Bank, Silvergate Bank, and Signature Bank) in quick succession due to a run-on deposits (and later First Republic Bank in May). Bank deposits in the U.S. were facing stiff deposit competition from money market funds, and on the asset side of the balance sheet investors were worried about the scale of potential commercial real estate losses on top of already sizable unrealized losses on their available for sale portfolios. As a result, bank credit spreads blew out and bank equity prices declined sharply. The extreme stress in the banking sector was ultimately resolved by coordinated action when the Fed, Federal Deposit Insurance Corporation (FDIC), and Treasury Department issued a joint statement guaranteeing all deposits of the failed banks (not just FDIC insured deposits, >$250k) and extensive Fed liquidity facilities.

The Anchor Equity Composite rose +12.0% in the fourth quarter and returned +29.2% in 2023, compared to +10.8% and +22.3% respectively for the MSCI ACWI Total Return benchmark. Despite the 2022 selloff, the portfolio has produced an +11.6% annualized return over the past three years compared to +6.2% for the benchmark. Higher interest rates, the strong US dollar, and weak market breadth hurt the performance of global quality dividend strategies. The High-Quality Income Portfolio Composite rebounded +5.7% in the fourth quarter and returned +3.8% in 2023 compared to +7.5% and +9.3% respectively for the SG Global Quality Income benchmark. While it was a difficult year for this strategy, the portfolio has produced a +6.8% annualized return over the past three years compared to +5.6% for the benchmark. *

**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*

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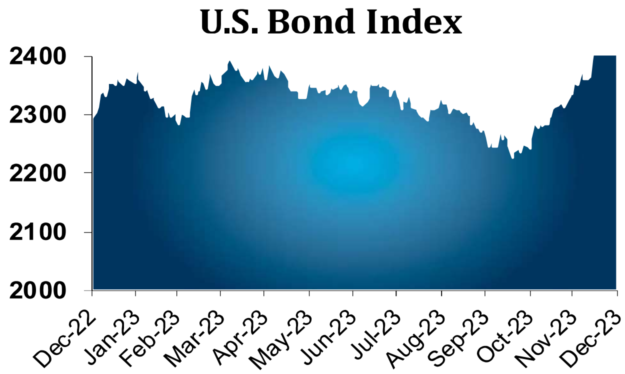
Fixed Income Analysis

Powell Pivot



The large decline in interest rates that characterized November continued in December. The Federal Open Market Committee (FOMC) meeting catalyzed the rate moves in December. Although the FOMC left the fed funds rate range unchanged at 5.25% – 5.50%, Chair Powell's rhetoric was very dovish. He stressed the Fed's dual mandate – a 2% inflation target and maximum employment. During the tightening campaign that began in March 2022, his rhetoric has very much focused on the inflation side of the coin. His press conferences from November and December were very different in this respect. Additionally, the updated DOT plot -where individual members give their projections for the path of the fed funds rate showed a median expectation for three 0.25% rate cuts next year, compared to two rate cuts in the September 2023 DOT plot. On the back of Powell's pivot, rates fell dramatically. In December the 2-year note declined 0.42%, while the 10-year fell 0.44%. Additionally, credit spreads tightened, the dollar fell, and equities rallied – the classic risk-on market move.

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Fixed Income Analysis

The banking stress in the U.S. made its way across the Atlantic to Europe's most vulnerable bank, Credit Suisse, which also experienced a rapid bank run. This saga ended when the Swiss central bank and Swiss government prodded UBS to acquire Credit Suisse (for a sweetheart deal!). In both banking stress situations, the authorities moved very quickly to stem the threat of contagion throughout the banking system. For more information on the bank sector stress please refer to our Q1 review

Coming into the year, the consensus expectation was for a recession in 2023. This clearly didn't play out – the consumer and US economy held up very well. This is best evidenced by the blockbuster 4.9% real GDP growth in the third quarter. Additionally, while the labor market has softened, it has done so from a tight state. For example, the ratio of job openings to unemployed has fallen from 2x to 1.3x – very close to the pre-COVID level of 1.2x. Inflation has also steadily declined through the year. Headline CPI has fallen from 6.5% at the end of 2022 to 3.1%. Goods inflation has vanished, while services inflation, although falling, has been more resilient. The shelter component (+5.5% at present) has played a part here; however, this is a laggard and is expected to decline in 2024, which should continue to push inflation lower, all else being equal. Alternative measures of current inflation are already close to the Fed's 2% target - the inflation rate calculated by Truflation is presently 2.56%. Importantly, this decline in inflation has coincided with a negligible increase in the unemployment rate, which has, in turn, led to the market expecting a soft landing as we move into 2024.

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