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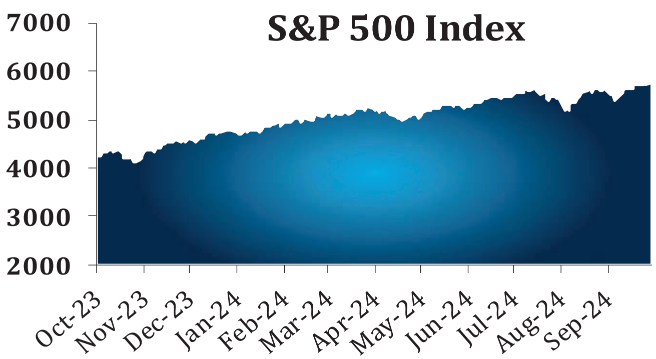
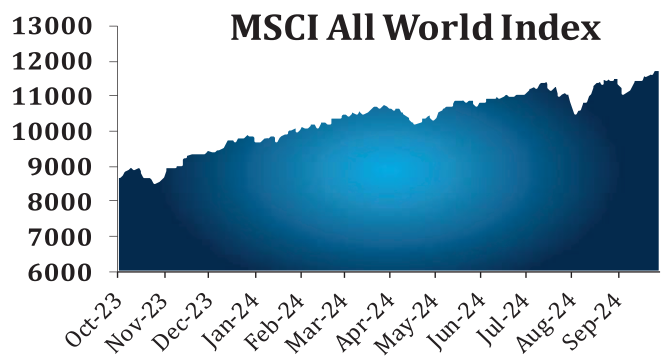
Stock Market Analysis

Fed Keeps the Party Going





ANCHOR
Investment Management

The U.S. Federal Reserve’s supersized 50 basis point interest rate cut fueled strong third quarter stock returns. The major global stock market indices hit new records in the quarter. The S&P 500 Index produced its best return in the first three quarters of the year since 1997, surging 21.7%. The stock market is now discounting an acceleration in the global economy as pressure from rising inflation and interest rates ease. Global shares were also bolstered by the Chinese government instituting a significant stimulus program at the end of September to reinvigorate its flailing economy. The MSCI ACWI Net Total Return benchmark returned 18.7% in the first nine months of the year. Importantly the health of the bull market, measured by breadth, improved in the latest quarter. The MSCI ACWI Equal-Weighted benchmark outperformed the capitalized weighted benchmark by 5.60%. This reverses a period when a narrow list large mega cap companies produced most of the stock indices’ gains. Despite the quarterly reversal the cap-weighted benchmark has produced a 26.3% return over the past three years versus 3.0% for the average company in the benchmark. We believe that there continues to be good value in the market for investors who look beyond the mega-cap leaders.

Investors are betting that the recent monetary stimulus will help the earnings of companies in economically sensitive sectors. These sectors have been hurt by high inflation, rising interest rates and the economic slowdown. The Industrial, Consumer Discretionary, Financial, Real Estate and Utility sectors led the market gains in the third quarter. It is notable that the Information Technology and Communication Services sectors lagged in the quarter. These sectors have significantly out- performed over the past two years, driven by companies linked to artificial intelligence “AI”.

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As we pointed out last quarter, we expect the interest rate headwinds to dissipate slowly. With tamer inflation rates, the Fed, ECB and most central banks have begun lowering rates. US short-term interest rates should continue to gradually decline. The Federal Reserve has indicated that it will reduce the Fed Funds rate to just under 3.0% by 2026 from the recent 5.5% peak. Falling interest rates are historically positive for the equity market.

Elections and conflicts around the globe continue to create some uncertainty. The U.S. election is too close to call, but it appears that there will continue to be a divided House and Senate which will limit major policy damage. Former President Trump has pledged radical policies on China and immigration, but it is difficult to separate political posturing from his true policy agenda. While many analysts are currently busy making market calls based on political polls, we have discovered that it is very difficult to make accurate stock predictions based on political events. Most well-managed companies focus on growing their businesses faster than their competitors by making better products and services.

The Anchor Equity Composite rose 6.8% in the third quarter and returned +27.6% over the past 12 months, compared to +6.6% and +31.4% respectively for the MSCI ACWI Total Return benchmark. The equity composite has produced a 13.3% average annualized return over the past 5 years compared to 12.4% for its benchmark. Quality dividend shares outperformed the major benchmarks in the third quarter due to falling interest rates and improved market breadth. The Anchor High-Quality Income Composite returned +15.9% in the quarter compared to +12.8% for the SG Global Quality Income benchmark. The portfolio has produced an +8.7% annualized return over the past five years compared to +7.4% 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 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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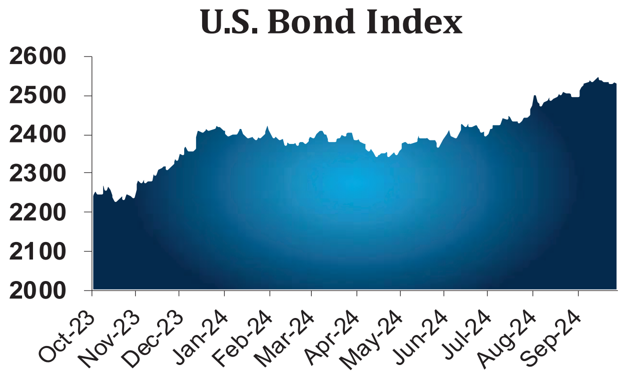
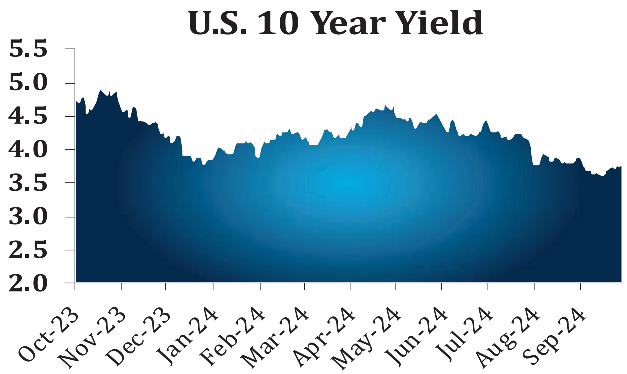
Fixed Income Analysis

Central Bank Bonanza





September was a month jam packed with central bank meetings…

On September 4th the Bank of Canada (BoC) cut its policy rate by 0.25% to 4.25%. The BoC has now cut the policy rate three times in 2024. In Governor Macklem's press conference he remarked that the BoC now "care[s] as much about inflation being below the target as we do above." This was a change in stance from more concern of inflation overshooting to the upside in previous meetings. This sentiment shift was considered dovish by the market. Inflation data released later in September came in below expectations, solidifying market expectations for more cuts going forward. At the time of writing short term interest rate markets are expecting another policy rate cut in October – practically a 50% likelihood of a 0.25% or 0.50% cut, followed by further cuts in the December and January meetings.

On September 12th the European Central Bank (ECB) cut the deposit rate by 0.25% to 3.50%, cutting the deposit rate for a second time in 2024. Unlike the BoC, the ECB is still worried about inflation overshooting to the upside. In the press conference President Lagarde suggested the ECB will be data dependent and didn’t give much away with regards to future interest rate decisions. The ECB is weighing sticky services inflation (much like the Fed), elevated negotiated wage growth, and weak growth data in deciding future policy. Since the meeting, economic data releases confirmed this slowing growth. The ZEW Germany Assessment of Current Situation survey data came in at the lowest reading since May 2020 (COVID-19 induced). This was further echoed by weaker than expected PMI’s (both the manufacturing and services). At the time of writing short term interest rate markets are pricing a 93% chance of a 0.25% rate cut in the October 17th meeting.

In the United States, coming into the Federal Open Market Committee’s (FOMC) meeting on September 18th, the market was pricing a 60% chance of a 0.50% rate cut. As such there was considerable uncertainty heading into the meeting. The FOMC did decide to lower the fed funds rate (upper range) from 5.50% to 5.00%. In the press conference Fed Chair Jerome Powell suggested that if the FOMC had known the July payrolls data before the July 31st meeting, they may have started the easing cycle at that time.

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So in that sense, the 0.50% cut was a bit of catch-up. In the press conference Chair Powell was noncommittal with regards to further 0.50% cuts, instead stressing data dependency and that it would make decisions on a meeting by meeting basis. Nonetheless, further cuts are expected as evidenced by the FOMC's updated the dot plot - individual member's projected path of the fed funds rate over the next few years. The updated median dot for year-end 2024 now stands at 4.375% compared to 5.125% in June, while the 2025 dot stands at 3.375% suggesting four 0.25% rate cuts next year. The FOMC also updated their economic projections. Most notably the unemployment rate expectations were revised higher for 2024 from 4.0% to 4.4% (4.2% currently), and is expected to remain at 4.4% in 2025. Thus, the FOMC is expecting a 'soft landing.' Historically once the unemployment rate begins to rise it continues to do so. If this turns out to be the case, in contrast the FOMC's expectations, there could well be more interest rate cuts and/or a faster pace than currently anticipated by the FOMC. Perhaps this is why fed fund futures are pricing six cuts in 2025 (vs four on the Fed's dot plot).

The following day, September 19th, the Bank of England (BOE) left the policy rate unchanged at 5.0%, as expected by the market. The UK is still experiencing strong services inflation (5.6% YoY) and wage growth remains robust (5.0%) – both series notably higher than in the US. As such the BOE is in no rush to cut rates. As per the BOE, "in the absence of material developments, a gradual approach to removing policy restraint remains appropriate." Short-term money markets are pricing in a 0.25% rate cut in the November meeting. The BOE cut the policy rate by 0.25% in August - their only cut thus far in 2024.

The Bank of Japan (BOJ) met on September 20th, and as expected left the policy rate unchanged at 0.25%. This is in stark contrast to their last meeting on July 31st when they surprised markets by raising the policy rate and announced plans to reduce the size of their balance sheet (buy less Japan government bonds). In contrast to the July meeting, the September meeting was characterized by dovish language from Governor Ueda suggesting that the BOJ was in no rush to lift rates further. This despite CPI inflation ex fresh food at an elevated 2.8% YoY. It's worth noting that after the BOJ's July meeting the Nikkei (Japan equity market) fell 19% over the course of five days. Despite the Nikkei having largely retraced the decline, the BOJ is keen not to rock the boat again. BOJ Governor Ueda commented in the post-meeting press conference, "The outlook for overseas economic development is highly uncertain. Markets remain unstable. We need to scrutinise such developments carefully for the time being." At the time of writing the short-term interest rate market isn't expecting a 0.25% rate hike by the BOJ until late 2025. As a reminder the BOJ is the only major central bank in a rate hiking cycle (an admittedly slow moving, shallow one).

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On September 24th, China unleashed their most concerted effort at providing stimulus since COVID. On top of reducing the short-term policy rate by 0.20% and cutting bank's reserve requirement ratio by 0.50%, the People's Bank of China (PBOC), in coordination with financial regulators, announced a number of measures aimed at stabilizing and stimulating the economy. Specifically, the announcement included measures to stimulate the housing market and support/rouse the equity market. Real estate accounts for 70% of Chinese household wealth per Reuters. China housing prices have been falling since 2020 due to a lack of demand and over supply. Meanwhile the Chinese equity market has badly underperformed other markets. The announcement has had the desired effect on the equity price front thus far. Since the announcement the iShares China Large Cap ETF was up 15% through September 30th. Nonetheless, it remains to be seen whether the announced measures will have the desired effect over the medium to long term. China is facing deflation stemming from a lack of demand in the near term and has terrible demographics to contend with over the long-term.

As we exit September the central bank directionality is clearly dovish. From the central banks we wrote about we had a oversized rate cut (0.50%), meeting-on-meeting dovish shifts, and even outright stimulus announcements. Additionally, the Riksbank (Sweden's central bank) cut its policy rate 0.25% and suggested a 0.50% cut may be on the cards in one of its remaining two meetings this year. The Reserve Bank of Australia held its policy rate steady in September, however there was a dovish rotation in its rhetoric. There were also rate cuts in emerging markets in September including the central banks of Chile, Mexico, Peru, Indonesia, and South Africa. Rates moved lower in Q3 across the developed world (ex Japan) as markets anticipated central bank rate cuts. For example, the 2-year treasury yield declined by 1.11% to 3.64%, while the 10-year treasury yield declined 0.68% to 3.78% in Q3. In the US, the 2-year to 10-year portion of the yield curve is no longer inverted. A similar dynamic played out the rest of the developed world (ex Japan) - rates on the short end of the curve fell by more than the long-end. Q3 was a strong month for bondholders. Credit spreads were largely flat, and interest rates were overwhelming lower. Looking forward, outside of an exogenous shock, we'd likely need to see the economic data (namely growth, labour market and/or inflation data) meaningfully disappoint to the downside to see a similar magnitude of move in rates in Q4. Nonetheless, the path forward for central banks (excluding the BOJ) is monetary easing going forward.

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