ANCHOR
CAPITAL ADVISORS LLC

**Value Opportunities**
**Portfolio Commentary**
As of March 31, 2024

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## Overview

During the quarter the U.S. markets continued an upward trend that began last November when the Federal Reserve indicated that it would start cutting the Fed Funds rate in 2024.[i] This accommodative policy has, in part, helped drive global growth and in turn propelled markets to new highs. We now see cash coming off the sidelines into equities and the newly launched Bitcoin ETFs.[ii]

In our opinion, two themes impacting the markets are the push into artificial intelligence (AI), and accelerated computing. We believe we are in the first inning of the AI transformation that will support higher growth rates in the semiconductor industry. Nvidia, the leader in the space has seen exponential growth over the last few years as a result. On their recent earnings call Nvidia made the following comments about AI.[iii]

"The computer industry is making two simultaneous platform shifts at the same time. The trillion-dollar installed base of data centers is transitioning from general purpose to accelerated computing. Every data center will be accelerated so the world can keep up with the computing demand, with increasing throughput, while managing costs and energy."

Accelerated computing in turn enables the second transition to "a whole new computing paradigm, generative AI, where software can learn, understand and generate any information from human language…".

"These two trends will drive a doubling of the world's data infrastructure installed based in the next five years and will represent an annual market opportunity in the hundreds of billions."

In its simplest form, AI takes large amounts of data or language and processes it quickly. It can be used in a variety of fields including medicine, financial services, customer service, and warehouse automation to improve the productivity of decision making and action. To support AI, a new and expensive infrastructure needs to be established. Everything from computers, semiconductors, servers, storage, data centers, electricity and supporting equipment, plus the know-how in areas of consulting and other engineering fields will increasingly be needed. The total addressable market for AI is conservatively estimated to be approximately $2.1 trillion.[iv] As the pie gets bigger there will be increased opportunities for many different companies to participate. While Nvidia has the head start in the core processing of AI, there are several ways for others to meaningfully participate.

Another action of note we are watching is the improvement in the Purchasing Manager's Index (PMI). In 2022 due to supply chain constraints many manufacturers over produced and many companies over bought to make sure that inventory was on-hand and available. Subsequently, a severe de-stocking happened, and manufacturing activity slowed down. Starting late last year manufacturing started to pick up to meet the need of companies restocking inventory. As a result, we are seeing increased demand for oil, copper, and other commodities as inputs into the manufacturing process. Lastly, infrastructure spending has ramped up supported by government subsidized programs.

## U.S. Equity Markets

The U.S. equity markets were positive for the first quarter.[v] Large cap stocks continued to outperform in the first quarter outpacing both mid and small cap stocks.[vi] The chart of the S&P 500 has gone parabolic in the last two years driven by the run up in mega cap technology stocks. Almost the entire return of the S&P 500 has been generated by the top 10 stocks in the benchmark. As a result, the valuation of the top 10 stocks is nearly at a record level, while the remaining benchmark holdings have valuations that are relatively tame. In fact, the Financial Times reported that US small cap stocks have suffered their worst run of performance relative to large cap in more than 20 years, highlighting the degree to which investors have chased mega cap technology stocks.[vii] Small cap stocks have lagged large cap stocks for the majority of the time since 2016. For the most part small cap has traded at a multiple close to the S&P 500, however it is now trading at a near-record discount. This is reminiscent of what was seen in 1999 and 2000 - after which small cap stocks had strong performance for a decade.

Growth outperformed value for the quarter with communication services and technology leading the way. Large investment into and around AI has been driving some traditional growth sectors. Energy and financials, both value sectors, were also top performers for the quarter. Oil prices moved from $71/barrel in December 2023 to over $81/barrel in March.[viii] Longer dated bond interest rates increased and the financial sectors benefitted. That same interest rate move impacted the bond proxy sectors such as Utilities and REITs, which were the worst performing sectors for the quarter.

## U.S. Fixed Income

The U.S. fixed income market had mixed performance over the quarter. Longer dated interest rates have been fluctuating. In general interest rates have trended higher since the beginning of the year with the 10-year Treasury yield settling around 4.2%, up from 3.9% in December 2023.[ix] The S&P U.S. Aggregate Bond Index is down year-to-date 1.63% with longer dated Treasury bonds down more than 5%.[x] There are parts of the bond market that are positive given the higher coupons, such as leveraged loans and high yield. If credit quality holds up, these bonds should perform well.

In previous commentaries we mentioned concern over the debt maturity wall coming due. Given the amount of capital available, many companies have been refinancing their debt at a rapid pace to extend maturities and avoid any near-term issues.[xi] While higher interest rates may be a problem for these companies at some point, they have been able to avoid major catastrophe and any big blow ups for now.

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

Many have been monitoring closely when the Federal Reserve will decide to cut interest rates. At the last Federal Reserve meeting, the committee kept the Fed Funds rate unchanged at the 5.25% to 5.50% range. However, Chairman Powell indicated that the committee is still targeting three 25 basis point interest rate cuts in 2024.[xii] The driving force behind the Fed's actions has been the combination of a resilient economy and sticky inflation. The latest inflation numbers for February show the Consumer Price Index (CPI) increased by 3.2% and Personal Consumption Expenditures (PCE), which is a different way of measuring inflation, increased by 2.8%.[xiii] Both wages and rents continue to increase. These inflation levels are above the 2% level targeted by the Fed.[xiv] The Fed is in an interesting position - they worry about cutting interest rates too soon and having inflation increase again while simultaneously worrying about cutting too late and pushing the economy into a recession. We believe that the Fed will be forced to cut interest rates to support the lower-end consumer. The lower-end consumer tends to borrow the most and whom higher interest rates are having the largest impact. Also, the government has a record level of debt and interest costs have ballooned as interest rates have remained higher.

The U.S. economy has been holding up reasonably well. Fourth quarter GDP grew at 3.2%[xv], unemployment remained low at 3.9%[xvi], retail sales remain positive[xvii] and the Purchasing Managers Index (PMI)[xviii], which measures manufacturing activity, is now in expansion mode. We are also hearing from retailers on earnings calls that the lower-end consumer is focused on essential goods like groceries and health care and not spending on discretionary items.

Housing data remains soft, and inventory remains low. New and existing home sales continue to be lower than average because of higher mortgage rates and the unwillingness of sellers to move.[xix] New York Times reported that there is a shortage of approximately 4 million homes in the U.S.[xx]

## Performance Overview

The Anchor Capital Value Opportunities Portfolio outperformed the Russell 3000 Value index for the quarter. On a relative basis, the Portfolio benefitted the most from security selection in the Technology and Energy sectors as well as an underweight allocation to the Real Estate sector. Security selection in Consumer discretionary, an underweighting in Financials and an overweighting in Consumer Staples were the greatest detractors from performance.

### Quarterly Attribution Highlights[xxi]

| Sector - Top 3 Contributors | Sector - Bottom 3 Detractors |
|---|---|
| Industrials | Real Estate |
| Financials | Utilities |
| Energy | Consumer Discretionary |

| Security - Top 5 Contributors | Avg. Weight % | Contribution % | Security - Bottom 5 Detractors | Avg. Weight % | Contribution % |
|---|---|---|---|---|---|
| Marathon Petroleum Corp. (MPC) | 2.00% | 0.67% | Crown Holdings, Inc. (CCK) | 0.55% | -0.23% |
| JPMorgan Chase & Co. (JPM) | 3.33% | 0.59% | American Tower Corporation (AMT) | 1.06% | -0.11% |
| Progressive Corporation (PGR) | 1.96% | 0.55% | NV5 Global Inc (NVEE) | 0.08% | -0.11% |
| Boston Scientific Corp. (BSX) | 2.31% | 0.42% | UnitedHealth Group Inc. (UNH) | 1.72% | -0.10% |
| McKesson Corporation (MCK) | 2.41% | 0.38% | McDonald's Corporation (MCD) | 2.01% | -0.09% |

### Quarterly Transactions

| Purchased | Sold |
|---|---|
| TD Synnex Corp (SNX) | NV5 Global Inc (NVEE) |
| Fidelity National Information Servcs Inc (FIS) | Apple Inc (AAPL) |
| CRH PLC (CRH) | Waters Corp (WAT) |
| Ferguson PLC (FERG) | Crown Holdings, Inc. (CCK) |
| CNH Industrial NV (CNHI) | |
| Advance Auto Parts, Inc. (AAP) | |

### Purchases

TD Synnex Corp (SNX) is the largest IT distributor in North America and Europe, and top 5 in Asia and Latin America. The company distributes technology products to thousands of value-added resellers. SNX has a goal to grow over 5% a year and grow net income over 10% per year. The company plans to have a 2% medium term dividend yield. The company generates strong free cash flow with over 50% of EBITDA converting, and greater free cash flows in recessions or when sales are down. As the PC cycle is bottoming, SNX should benefit as sales pick up. Further the company will benefit off continued growth in cloud, data, security, software, and services. on average, we believe the company can grow earnings per share over the long run at mid to high single digits. We believe it is a clear take-out candidate as their competitors are almost all owned by private equity. Further, Tech Data which merged into SNX received offers from Apollo and Berkshire Hathaway in the past. We believe the company has a long runway to grow thanks to secular tailwinds of IT spending. Further the valuation is below what private equity has paid for businesses in the space and one of the lowest valuations of any tech business. We believe the shares should re-rate over time to a slightly higher multiple with strong earnings growth as well.

Fidelity National Information Servcs Inc (FIS) offers a wide range of financial products and services to merchants, banks, and financial service companies. The stock was down over 60% in the last 3 years following its $43B mega-merger with WorldPay, a merchant acquirer. However, the company has since sold 55% of its stake in Worldpay, which will it to de-lever its balance sheet and re-focus on its two high quality business segments. The RemainCo will be led by a new management team and Worldpay is bringing back its old CEO who created enormous value during his time there before selling it in 2019. Both businesses in the FIS RemainCo are leaders in their respective industries with longstanding incumbency. They provide mission critical software with 3-5 year contracts and hefty termination fees. The products are extremely sticky given the time, cost, and effort it would take to rip them out. Nearly 80% of combined revenue is recurring and is expected to grow 3-5% per year from pricing, banks and financial institutions modernizing, the cross-selling of additional features, and client & transaction growth. We purchased the stock at depressed valuation and should re-rate closer to peers and its historical valuation pre-Worldpay.

CRH PLC (CRH) is the largest construction materials, building products, and infrastructure services company in North America & Europe. Over the last decade, the company has completed a complete portfolio restructuring, shifting its business mix to the U.S. and becoming a fully integrated building solutions provider. We believe CRH is well positioned to benefit from of a golden age of construction in the U.S. due to tailwinds from infrastructure bills as well as onshoring/mega projects. Additionally, the company is very return focused and expects to have ~$35 billion of incremental capital to deploy at attractive rates over the next five years. Given its size, the company is still relatively unknown by many U.S. investors, which allowed us to purchase shares at a wide valuation discount to peers. The company moved its primary listing to the NYSE last September and has transitioned to U.S. GAAP accounting and financial reporting standards. These steps will allow CRH to get added to U.S. indices, which should increase U.S. investor awareness of the company and ultimately lead to a narrowing of the valuation gap between itself and peers as the investment community comes to appreciate its business quality and positive outlook.

Ferguson PLC (FERG) is a $37B distributor of plumbing supplies, water heaters, pipes, valves and fittings, kitchen and bathroom fixtures, appliances, HVAC units, fire sprinkler systems, and others supplies. The company just completed a decade long restructuring of its business, exiting lower return international businesses and focusing entirely on North America. Its markets, estimated at over $350B in total, are highly fragmented and over 75% of FERG's revenues come from markets where they are the #1 or #2 player. The company targets the trade customer and wins on relationships, breadth of products, product availability, branch density, technology, and superior service. It has consistently gained market share over the years, outgrowing its markets by 300-400bps organically each year. It also has a long runway to acquire smaller independent players at accretive valuations. On average, we believe the company can grow sales 7-12% per year and EPS in the low- to mid-teens. Ferguson is still relatively unknown by many U.S. investors as it was re-listed from the London Stock Exchange to the New York Stock Exchange just last year. This allowed us to pay what we believe will prove to be an attractive price for a company with a long runway for growth that pays a healthy dividend and has a strong balance sheet.

**CNH Industrial NV (CNHI)** is the second largest global agriculture equipment manufacturer with commercial presence in 170 countries. The company operates in an attractive oligopolistic market. It is in the middle of deep transformation led by a well-regarded new management team and a thoughtful large investor (Exor). They have been executing a multi-year plan to simply the business by spinning off its trucking business to make it a pure play ag and construction equipment business, moving to a single listing on the NYSE, increasing investment in tech including precision ag, and improving margins. The Ag downcycle is still early but we believe much of this is priced into CNH's stock at under 8x P/E and peers trading much higher. Additionally, a 3.3% dividend yield is attractive and at all-time high levels.

**Advance Auto Parts, Inc. (AAP)** is the third largest auto parts aftermarket retailer in the US by revenue after AutoZone and O'Reilly. The company operates over 5,000 stores. The company's stock started to fall deeply in May 2023 falling nearly 60% due to past management execution issues on the supply chain, in store experience, and lack of parts. Further the company had large amounts of debt which caused them to nearly trip their covenants. Recently they have brought in new high quality management. The new CEO comes from Home Depot having run HD Supply. The new CFO was head of transformation at Lowe's. New management started with announcing the sale of a large asset in Worldpac as well as their Canadian business CarQuest. All in they will de-lever and potentially have no net debt post the sales. The company also has announced clear steps to fix the distribution issues and focus on in store performance. The shares trade at a depressed valuation relative to normalized earnings. We believe that as the company goes back to the earnings profile it had pre the issues, the stock should re-rate significantly based on its past multiple range. Further the underlying business is countercyclical, defensive, and has a long growth runway with the right management, which we believe there currently is. Lastly, activists have come in and brought 3 new board members with auto part retailing experience or distribution experience, which is exactly what was needed on the board. We believe long term the business should see strong earnings growth as earnings go back to historic levels. With earnings at those levels, and the multiple it received in the past, there is strong upside to shares from here from a value framework.

### Sales

**NV5 Global Inc (NVEE)** is a leading provider of professional and technical engineering services to public and private sector clients. The company offers quality assurance, surveying, mapping, permit planning, program management, geospatial services, and compliance certifications. About 70% of the business comes from the public sector. The CEO Dickerson Wright built a similar business and sold it in 2002. The company has grown strongly through organic growth and acquisitions at 5x to 8x EBITDA. There is a long runway of acquisitions at their size goals as there are 144,000 engineering firms in the US. The company was fully valued and we thus decided to sell the business based on it.

**Apple Inc (AAPL)** shares traded at the NTM PE of 29x, ~15-20% above price target and exit multiple of 25x. In FY2024, AAPL is expected to grow revenues less than 2% as product growth, including iPhones, is expected to decline 2% while services are expected to grow 10%. Apple faces negative demand dynamics in China which account for ~20% of sales. We saw no compelling reasons to continue holding the stock's negative risk/reward profile.

**Waters Corp (WAT)** is a leading global manufacturer of liquid chromatography, mass spectrometry, and thermal analysis instruments for pharma, biotech, academics, and the government. They play in rational spaces where the top 3 to 4 players control the space. The company has a strong service component which allows it to have high 50s gross margins and high 20s operating margins. The company has a return on invested capital in the mid-teens with far above market return on assets. With that said, the company has run up and sells at a full valuation. We thus decided to sell based on the full valuation.

**Crown Holdings, Inc. (CCK)** is the second largest global aluminum can manufacturer. It makes aluminum cans for all kinds of beverages. It also makes can for food products and has a transit supplies business. The company has been struggling with input costs and slowing sales due to lower volumes. We sold the position to reinvest the proceeds into a holding with better upside.

### Anchor's Positioning

Since the beginning of the year, Anchor has been finding interesting investment ideas. In our search for value, we are looking for companies that might be out of favor, underappreciated or undiscovered by the market. We have been able to find these stocks across several different sectors.

We have also been reinforcing some positions that we believe have the ability upside potential while reducing or selling stocks where the valuation has become stretched. We brought cash down in portfolios during the quarter to take advantage of these new opportunities, which has helped in an environment where the market and most areas have performed well. However, we have been mindful to keep our portfolio risk down, so that we protect better.

### Outlook

We are encouraged about the new stocks that we have added to the portfolios and believe that the economy is relatively stable. Markets have run a lot since the beginning of the year, particular in AI related stocks. With valuations above historical averages we could see a pull back, which is why remain more defensively positioned.

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[i] https://www.reuters.com/markets/us/fed-policymakers-stick-three-rate-cut-view-24-barely-2024-03-20/
[ii] https://www.wsj.com/finance/investing/the-8-8-trillion-cash-pile-that-has-stock-market-bulls-salivating-0a1b4a8c
[iii] https://www.alphaspread.com/security/nasdaq/nvda/earnings-calls/q4-2024
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[vi] Ibid
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[xiii] Ibid.
[xiv] Ibid.
[xv] https://www.usnews.com/news/economy/articles/2024-02-28/fourth-quarter-gdp-revised-slightly-downward
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[xxi] FactSet financial data & analytics; Attribution

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.