ANCHOR
Investment Management, LLC

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COMMENTARY 1st Quarter 2018

Market/Index	2015 Close	2016 Close	2017 Close	2017 Change	As of 03/29/18	2018 Change
DJIA	17,425.03	19,762.60	24,719.22	25.08%	**24,103.11**	**-2.49%**
NASDAQ	5,007.41	5,383.12	6,903.39	28.24%	**7,063.44**	**+2.32%**
S&P 500	2,043.94	2,238.83	2,673.61	19.42%	**2,640.87**	**-1.22%**
Prime Rate	3.50%	3.75%	4.50	0.75%	**4.75%**	**+0.25%**
10-year Treasury	2.27%	2.446%	2.40%	-0.046%	**2.74%**	**+0.34%**

The Return of a "Normal" Market…

By any measure, 2017 was an "abnormal" market. Optimism from a new administration, along with earnings increases and low volatility lulled the markets into complacency. The 1st Quarter of 2018 reminded us that we do live in the real world and markets do have cycles. The important thing to remember is that this is a cycle that allows the markets to "reset" and prepare for the next leg up. So let's figure out where we are…

Volatility. Market volatility is measured by the VIX® Index, which is calculated by estimating expected volatility for the S&P 500 index. As of the close of business on March 29, 2018 the VIX Index stood at 19.97, up from 9.77 on January 2, 2018. While it is a huge short term spike, for the past ten years the VIX index has averaged a daily closing price of 20.02, almost identical as to where it is now. We have returned to "average" volatility, which can be a good thing for long term investors.

Market Overview. In early February, the Labor Department said the cost of employing the average American worker rose 0.5% in the final three months of 2017 and was up 2.6% in the 12 months ending in December. That's the biggest 12-month gain for the employment cost index in almost three years and was a catalyst for the market downturn. The report led to speculation that the Federal Reserve would be more aggressive in raising interest rates to combat inflation and the markets reacted negatively to this information.

But let's think about this rationally. While we have had some short term volatility, this is a great sign for the economy for the long term. People are going back to work and earning higher wages, therefore they have more money to spend. Many analysts are revising their earnings estimates upward as they believe companies will start to earn more due to the increased purchasing power of the US consumer. According to Thompson Reuters, 77% of companies in the S&P 500 who had reported earnings had exceeded earnings expectations, an optimistic sign. The US economy continues to show strength and historically a strong economy is a buffer against any long-lasting downturns.

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Interest Rates. While a suspected spike in interest rates has been the catalyst for the recent market downturn, we have to measure how big those changes will be. As we spoke about last quarter, the Federal Reserve continues to be very transparent in its communications and has indicated that it is on track to raise rates three to four times this year, stating that the US economy has "substantial underlying economic momentum." The downside is that the increase in rates is beginning to affect borrowing costs for consumers and businesses alike. The upside is that higher interest rates will benefit those companies that are capable of raising prices on their services and products, such as banks.

The 10-year Treasury yield rose to 2.89% in February from 2.46% at the beginning of the year and now sits at 2.77%. What we don't want is a rapid spike in interest rates but we are blessed to have market conditions that will keep interest rates from rising too far too fast. The higher yield on U.S. debt is starting to attract additional foreign assets relative to lower yields from other developed countries. (Comparable 10 Year yields: Japan 0.025%, Germany 0.5%, France 0.74%, UK 1.36%) and should put a lid on how high interest rates can go.

What A Tariff On Steel & Aluminum Means. A report released on February 16th by the Department of Commerce prompted the President to enact tariffs on steel and aluminum imports entering the United States. The imposed tariffs, essentially a tax on steel imports of 25% and 10% on aluminum imports are in response to the findings of the Commerce Department report that said excess imports into the United States of steel and aluminum pose a threat of "weakening of our internal economy" and "threaten to impair the national security" of the country.

The United States is the world's largest importer of steel, with imports exceeding exports by nearly four times. Demand for steel and aluminum is driven by various industries including automotive, aerospace, consumer goods, and defense. Steel and aluminum are also indispensable materials used in building and expanding a country's infrastructure.

Ten US steel furnaces have closed since 2000, displacing over 52,000 U.S. steel workers. Meanwhile, international production of steel is up over 127% since 2000, employing tens of thousands of workers globally. China is by far the largest producer of steel worldwide, as well as the largest source of excess capacity, which is why China is a target for the new tariffs. China alone produces more steel in one month than the U.S. does in a year.

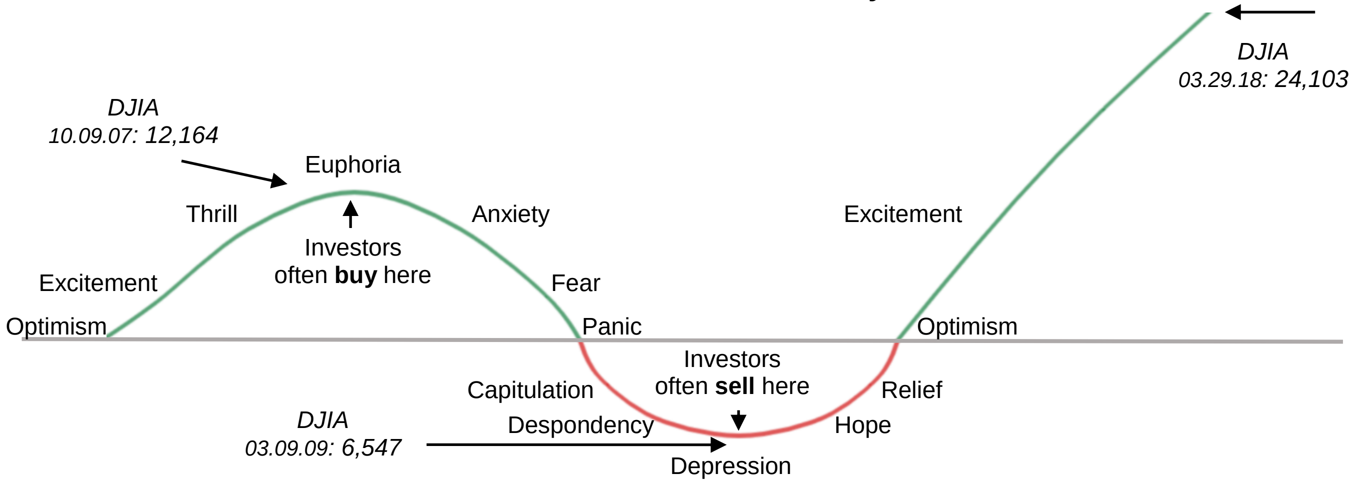
Several countries are being targeted for the newly imposed steel tariffs, notably Canada, Brazil, South Korea, and Mexico. The Section 232 report has determined that these countries have been selling steel into the U.S. market at below market prices, thus dumping steel onto the market. The dumping practices of these countries have led to unfair competition for U.S. steel firms, not allowing them to gain market share. Meanwhile, world steelmaking capacity has increased 127% since 2000, reaching 2.4 billion metric tons. Global excess capacity is 700 million tons, nearly 30% of this total.

Between 2013 and 2016, U.S. aluminum industry employment fell by 68%. Six smelters shut down, and only two of the five remaining smelters are operating at full capacity, despite an increase in U.S. demand for primary aluminum. There is only one remaining U.S. producer of high-quality aluminum alloy needed for military aerospace needs and maintaining and upgrading our infrastructure, which must be done for reasons of economic security, is a major use of aluminum.

Many consumers are worried about what the impact will be for American consumers and businesses. Economists believe that the initial effect on consumers will be slightly higher prices for aluminum can products and autos. The automotive and aerospace industries will initially be impacted until U.S. steel and aluminum producers come online to restore ample supply.

China will undoubtedly retaliate but many see the dynamics as short-term pain for long-term gain. It is important to know that this is not just about steel and aluminum. China does this with most commodities it produces, just ask any farmer about Chinese grain production. Every year the Chinese wait until US farmers have planted their fields and then they dump their excess capacity into the US market, but only for the crops we have planted. It is a very pointed way to run US farmers out of business and still keep prices high on other crops.

The 2007 – 2018 Investment Cycle



<u>Going Forward.</u> All of us at Anchor Investment Management are keenly aware of what's happening in the market, but we continue to take a long term perspective with regard to your investments. We have built your portfolio to accomplish your desired outcome, to weather these intermittent storms and have the ability to take advantage of buying opportunities. We appreciate your trust and confidence and look forward to serving your needs in the years to come.

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