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Ancora Advisors is a client focused investment advisory firm that operates with the highest level of integrity and honesty in all aspects of our business. This is accomplished through a culture of entrepreneurial spirit that encourages teamwork, excellence, accessibility, humility and accountability. We invite you to learn more about Ancora and what our years of market experience can do for you.

LATEST ARTICLES

THE EVOLUTION OF ASSET ALLOCATION

John Micklitsch, CFA, CAIA
Chief Investment Officer

In April of this year, Morningstar Inc., the influential investment research firm and creator of the widely followed investment style box, announced that it was time to think beyond the traditional style matrix approach to portfolio construction and wealth management. Speaking at an industry conference, Scott Burns, Morningstar's head of asset management stated, "The style box is a two-dimensional risk map. It's a really nice simplification." However, he noted, "The world has evolved beyond this two dimensional framework." As a refresher, the style box refers to the nine box equity cube constructed with the style labels Value/Blend/Growth across the top and the capitalization labels of Large/Mid/Small along the side. In terms of the lesser known fixed income cube, the horizontal part of the matrix is comprised of the interest rate sensitivity classifications Limited/Moderate/Extensive and vertically the credit quality classifications of High/Medium/Low.

The theory was, and still is for many investors and their advisors, that by simply checking multiple boxes across both the equity and fixed income style boxes, an investment portfolio was optimally constructed. However, during the 2008 crisis, the correlation of many of the style box components shot up close to 1.0 (perfectly correlated with each other). Investors realized that diversifying amongst large and small, growth and value and even U.S. versus international equities had its limitations. What has evolved from the lessons of the financial crisis, and the historically low interest rate environment that has followed, is the emergence of portfolio construction methods based less on the notion of style box completion and more on the basis of risk and liquidity "budgets." In addition, portfolios focused more on outcomes such as CPI+ or absolute return targets in the institutional world and more of a total return versus income mindset for individuals when it comes to retirement income planning.

To achieve these outcomes, portfolios are increasingly being constructed and being viewed as a collection of diversified return streams. Increasingly, these return streams are extending beyond traditional stock and bond risk premiums (returns associated with taking risk). In casting a wider net to include alternative risk premiums, such as long-short investing, advisors seek to provide clients with solutions that better mitigate risk across full market cycles while still generating sufficient returns to achieve targeted return goals. All of this comes, however, against a backdrop of unprecedented low, global interest rates and central bank policy which makes asset allocation decisions more difficult than ever.

Another reason the investing world is moving beyond style box investing is the regulatory fallout and central bank actions that followed the financial crisis. Regulation such as Dodd Frank has significantly curtailed certain bank activity such as proprietary trading. With big bank liquidity removed from certain trading related activities and central bank actions having huge impacts on investor sentiment, markets have gotten more volatile. Money managers have responded with products that are more tactical in nature and purposely unconstrained by historical benchmark limitations in order to take advantage of this increased volatility. Many of these more flexible or unconstrained strategies simply don't fit neatly into the old style box framework but can provide significant utility value to a portfolio.

The investor takeaway from all of this is that portfolio construction continues to evolve and investors and advisors should evolve with it. The good news is that collectively, investors of all sizes have never had access via innovative investment products to so many varied return streams from which to build portfolios. The bad news is the choice and product proliferation can be overwhelming. For example, investors can now invest internationally through active or passive strategies, broad based or country specific allocations and via exposure that is hedged or unhedged back to the U.S. dollar. It is reminiscent of the retail studies that show decision paralysis when consumers are presented with too many choices. However, as the famous saying goes "time waits for no man", so too could the saying go, "the market waits for no investor." And so despite the ever more complicated world investors must navigate to achieve their goals, investment decisions have to be made and returns must be generated or long-term goals will not be met.

At Ancora we work diligently on behalf of institutions and individuals to keep up to date on the latest portfolio construction methods so that we can build portfolios that blend the best of traditional asset management with the evolving world of asset allocation.

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FIXED INCOME Q&A June 2015

Jim Bernard, CFA

Managing Director, Fixed Income

Where do you think we are in the current interest rate cycle?

As we approach mid-year, the odds of a rate increase later this year (Sept-Dec) have fallen to just over 50/50. Our view is that we will see at least one increase this year of 25 basis points, assuming that GDP remains above a 2% annualized growth rate. We also continue to believe that barring a significant increase in GDP or inflation, increases in short rates will occur slowly over time with less than 100 basis points of increases in 2016 regardless of what happens later this year.

How do you put today's low interest rates into perspective?

With continued slow payroll increases, a large percentage of underemployed and low labor force participation rates, the FED continues to seek out avenues to improve economic growth in the current slow growth, low inflation environment in which we are living. With rates already so low and limited alternative growth stimulating programs available to the FED, maintaining a low rate environment to encourage borrowing seems like one of the few avenues available to improve economic growth.

What factors will influence the timing of the FED's decision on interest rates?

Besides the obvious projections of economic activity (GDP) and inflationary trends (the FED likes to look at the personal consumption expenditure (PCE) numbers), the FED also factors in underemployment, wage growth, and possibly the labor force participation rate when judging potential economic growth. While the mantra of FED policy is supposed to be limited to "promoting economic growth while maintaining a low inflationary environment", in recent years both the FED Chairmen and FED Governors have indicated their periodic concerns with valuations in the securities markets, potential bubbles in various markets, etc. While these later points may be of concern from time to time, we believe the FED should stick to the primary goal discussed above and not attempt to manage FED policy in regards to all risks of the economy and the various capital markets.

How and why do interest rates go negative?

Historically negative interest rates have occurred, although very infrequently. In general most investors believe accommodative FED policy is limited to dropping rates close to or near zero in an effort to maintain a low rate, growth oriented environment across the yield curve. However, in an extremely accommodative environment with massive amounts of buying by central bankers, supply/demand can result in short rates actually going negative. In other words, investors are actually paying a penalty to hold short-term deposits.

What impact, in your opinion, do historically low interest rates have on asset allocation decisions?

Asset allocation is and always will be a tradeoff between potential growth opportunities in certain asset classes (stocks, real estate, commodities, etc.) and income producing asset classes (bonds, income producing real estate, MLPs, etc.). In many sectors, valuations rely on income potential to assign acceptable valuations. Therefore, with historically low interest rates and very low credit spreads in recent years it has been difficult to allocate funds to many fixed income sectors. One of the problems for investors is that after nearly seven years of low interest rates, many formerly risk adverse investors have found themselves with minimal fixed income exposure for the reasons mentioned above. In some of these cases the investors' risk profiles and current asset allocation may have become imbalanced. We frequently attempt to remind clients that their risk profiles need to remain in line with their existing asset allocation regardless of how attractive the valuations in certain sectors may or may not be. While moving one's allocation to the low end of a targeted range may be very applicable in certain markets, eliminating an allocation to a sector because it appears overvalued hints of market timing and should be avoided unless the client's risk profile truly changes.

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THE RULE OF 21

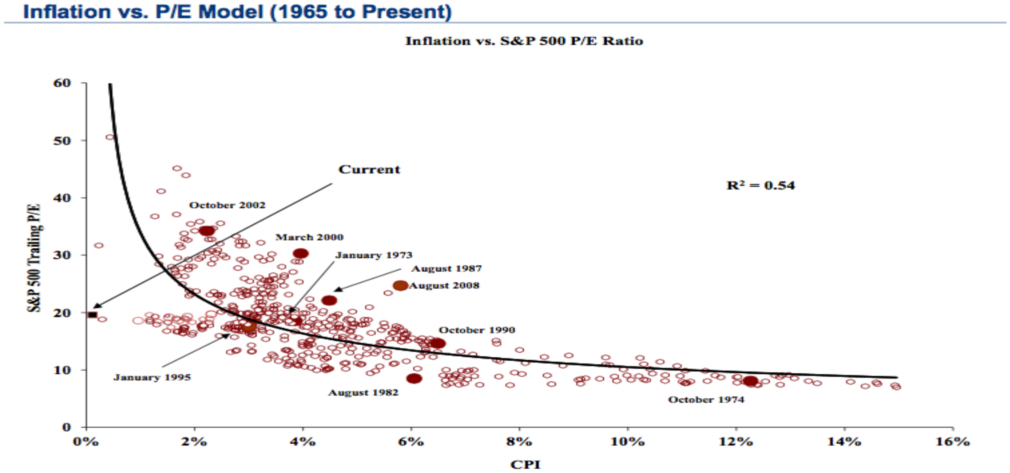
Matt Scullen, CFA

Vice President, Equities Analyst

We all hear it. "The market is overvalued." "The market is cheap." "The market is in a bubble." These are opinions echoed almost daily in the financial news and especially on TV. The reality is we live in a low inflation, low interest rate environment. What was true in yesteryear may not hold true today. Take for instance the often quoted P/E ratio so many look to as their barometer for fair value on the S&P 500. Most frequently very little context is given to this ratio other than its historical range and average. This is unfortunate because so much significant information gets missed.

As previously mentioned, inflation is low; the Core CPI increased 1.8% year over year excluding food and energy. Including food and energy, the headline CPI has actually declined year over year by 0.1% and the median consensus calls for 2015 Core CPI increase of 1.7% and 2% in 2016. With the boring information out of the way, now we can provide some *context* for investors.

Inflation vs. P/E Model (1965 to Present)



Source: BofA Merrill Lynch US Quantitative Strategy

This eye glazing chart demonstrates there is a fairly good relationship between the P/E ratio and inflation rates. Before this chart causes you a severe migraine, let me explain what you're looking at in simple terms. The relationship can be referred to as the "Rule of 21," which says that the sum of the P/E ratio and CPI inflation should equal 21. It's not a perfect relationship, but holds true generally.

What can we infer from this information for today's market? Given that the S&P is trading at a P/E ratio of 17.7x and the median headline CPI in 2015 is for 0.3%, this implies that the S&P 500 could actually experience P/E expansion of 3 points! Even using the Core CPI forecast would suggest further room for P/E expansion or at least a market multiple that is justifiable in the current, low inflationary environment.

The lesson is valuation is not black and white. Context is always important, as are economic expectations and it's especially important to consider a variety of valuation metrics which includes the P/E. The "Rule of 21" doesn't necessarily say the market is cheap, but it does provide important information to include in a holistic approach to valuation.

Sources: CPI Data from Factset, BLS, Chart from Episode I: High valuations Savita Subramanian, Equity & Quant Strategist, MLPF&S Equity and Quant Strategy | United States 26 May 2015

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MAY 29 – THE SAVINGS HOLIDAY

John Kane
Vice President, Private Client Advisor

Some things just make themselves too easy to pass up for being recognized as "National Holidays." May 29th is no different, and coincidently enough is now recognized, by the industry at least, as National 529 College Savings Day. In light of this newly minted "holiday," we thought this might be a good opportunity to bring to light a perplexingly underused investment tool; the 529 college savings plan. Recent studies have indicated that only about one out of three Americans are utilizing this tax effective vehicle, even though many states offer income tax deductions or credit, based on your contributions. Not only that but there are no income limitations and earnings are not taxed when the assets are used to pay for eligible college expenses.

The current refrain among college graduates is that many are coming out of school with no immediate job opportunities and are drowning in tuition debt. Similarly, parents of young children and even grandparents, have serious concerns about future tuition costs and their offspring becoming part of the difficult student debt cycle. As a frame of reference, between the 2014 and 2015 school year, the average published tuition and fee increase at four-year public universities was 2.9% for in-state students and 3.3% for out-of-state students. By comparison, private university tuition increased by 3.7%. At the current pace of increases it is not out of the question for a private college to cost upwards of $500,000 for four years including tuition, room and board, books, etc.

There is good news, however, you can start investing early and in most states you can contribute $300,000 or more per beneficiary via a tax advantaged 529 college savings plan. Like any competitive market, investors also have options in terms of which 529 plan they select. Investors are not limited to using their own state's vehicle. In fact, investors have the opportunity to shop the different state investment options, find one that they are most comfortable with and even work with their advisor to choose their own investment allocation.

Since there is no limit to the number of accounts a beneficiary can have, there are also options for grandparents, or others, to open accounts for grandchildren or children they know. For example, let's say a parent lives in Illinois but prefers the investment options of the Ohio 529 Plan. That parent can open two plans, one in Illinois, to take advantage of the state tax credit, and another in Ohio, to receive the benefits of Ohio's investment options and to diversify portfolios. Furthermore, most 529 plans have age-based investment options that automatically reallocate funds within the account to fit that child's "investment profile" as they approach eighteen, the typical enrollment age. The investment portfolio for a 1 year old would and should look drastically different from that of a seventeen year old looking to tap into these funds within the next year or two.

Whether giving a gift for a new born, trying to maximize tax credits, or maximizing gifting options for estate purposes, a 529 college savings plan is often an intelligent and cost effective way to help prepare for a child's future. The compounding effects of an eighteen year investment portfolio can help ease the college tuition burden for parents, grandparents and students, as they inch closer toward a diploma. Studies indicate that more people than ever plan to enroll in college, with lower unemployment rates and higher lifetime earning power accruing to those who attend; so why not help give a child a leg up and start investing today on their behalf?

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