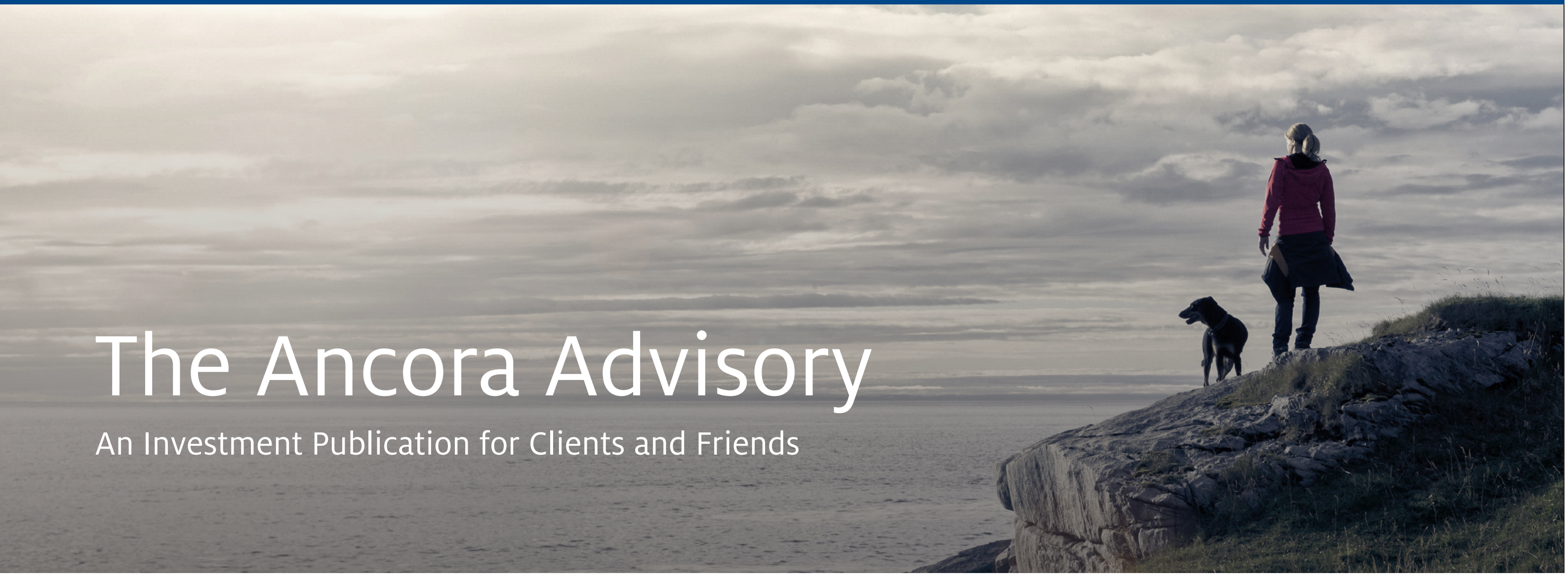


# The Ancora Advisory

An Investment Publication for Clients and Friends

*Ancora Holdings Inc. consists of three business units; Family Wealth, Asset Management and Retirement Plans. With top-tier portfolio managers, unique investment strategies and an entrepreneurial spirit, Ancora delivers tailored solutions so you can achieve more … on your terms.*

## An Investor-Focused Thanksgiving List

John Micklitsch, CFA CAIA
Chief Investment Officer

With Thanksgiving approaching, it seems appropriate to take some time to consider all of the things for which we are thankful. Any such list must start with a deep sense of gratitude to Ancora's clients who entrust us with their hard-earned assets to manage. We are here because of your trust and for that we are grateful. We are also thankful to those who have referred friends, business associates, family members, companies, institutions or other organizations our way with the understanding that we will embrace their unique circumstances and needs with the full resources that we, as a 70+ employee firm, can bring to the table.

Extending the holiday spirit into the world of investments, we have comprised a list of things we are thankful for that help us in our day-to-day work on behalf of clients. Some of the items on the list are more granular than others, but collectively they touch on the qualities that make the financial markets such a powerful medium for creating long-term wealth. So here goes.

1. We are thankful for capitalism itself. It may not be a perfect system, but it remains the best system in the history of mankind for improving the standard of living for so many. Think of the societal track record of the alternatives – they are not pretty. For anyone who is unsure of capitalism, they are welcome to move to North Korea, as the saying goes.

2. We are thankful for the rule of law that protects personal property rights and creates the very foundation upon which one can own shares in a business (public or private). In addition, it preserves the incentive to innovate, which ensures all stakeholders of a company benefit.

3. We are thankful for Warren Buffet who, at age 89 from his quiet office in Omaha, Nebraska, continues to serve as a voice of sensibility and reason for investors. Recall that it was Warren who penned a New York Times Op-Ed in October of 2008, near the darkest days of the 2008-2009 financial crisis, famously titled, Buy American. I Am. Warren will not be around forever,

something not be taken for granted, but the example he and his partner Charlie Munger have set for capital stewardship, hopefully will be.

4. We are thankful to Gary Brinson, Randolph Hood and Gilbert Beebower who together authored the defining paper on asset allocation back in 1986 titled Determinants of Portfolio Performance. This piece outlined that most of the return variability, and therefore risk, in a portfolio is determined by asset allocation which, in layman's terms, refers to how much you have in various asset classes such as stocks, bonds and alternatives. We are grateful because the paper helped establish the highly effective framework and process for allocating capital upon which portfolios are constructed and managed to this day.

5. Lastly, we are grateful to Luca Pacioli, an Italian mathematician who in 1494 in his book titled, Summa de Arithmetica Geometria, Proporzioni et Proporzionalita, which translates to a Guide to Arithmetic, Algebra, Geometry, Accounting and Weights and Measures, first cited the Rule of 72. For those of you not familiar with it, the Rule of 72 is a mathematical relationship that illustrates the miracle of compound interest. To calculate the length of time it takes for money to double, you simply divide the number 72 by the annualized rate of return you think you can earn. For example, if you thought you could earn 5% on your investments, it would take approximately 14 years for your money to double. 14 years compounding at 5% would be one double, 28 years compounding at 5% would be two doubles and so on. We can't tell you how many times we have used the Rule of 72 in helping people look at risk through a different light, and for that we thank Mr. Pacioli.

In closing, we would like to wish you all a safe and Happy Thanksgiving. We are thankful for the relationships we have with each of you. We are also thankful for the market framework that exists today and for the pioneers in investing and finance whose work, example and innovations assist us in helping you reach your unique goals and objectives. ◊

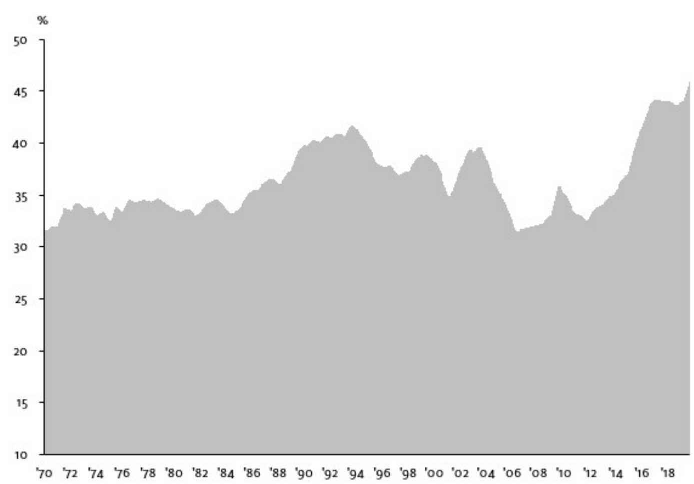
## The Potential Risks of Low Interest Rates, Debt and Free Beer

David Sowerby, CFA
Managing Director, Portfolio Manager

Rising debt levels, primarily for corporations, but also for the public sector, are a market risk to be seriously discussed. The public sector has been accumulating more debt, in the U.S. and elsewhere, as debt-to-GDP levels have risen across most developed countries. The implication is that the ever-increasing cost of servicing the debt becomes a black hole versus what potentially could be more productive uses of budgets and spending elsewhere.

Equally concerning is the rise in corporate debt. Among the multiple debt measures, (they all generallytell the same sobering story), is the rise in long-term debt-to-capital ratio for U.S. companies. The measure shown below is at its highest levels since the 2008 Great Financial Crisis. The debt concern is exacerbated in the context of cash burning companies such as privately held WeWork. However, equally concerning are debt levels for the lower end of investment grade companies (BBB) where leverage is at levels more in line with high yield borrowers than investment grade credits, historically speaking. In short, the mounting debt and longer-term market risk case centers on rising debt levels, too much leverage and world central banks flooding the system with too much money and creating low and in some cases, negative interest rates. The eventual outcome, albeit with uncertain timing, could be very problematic for the economy and the equity and credit markets.

**Large-Capitalization U.S. Stocks[1]**
**Long Term Debt-to-Capital Ratios**

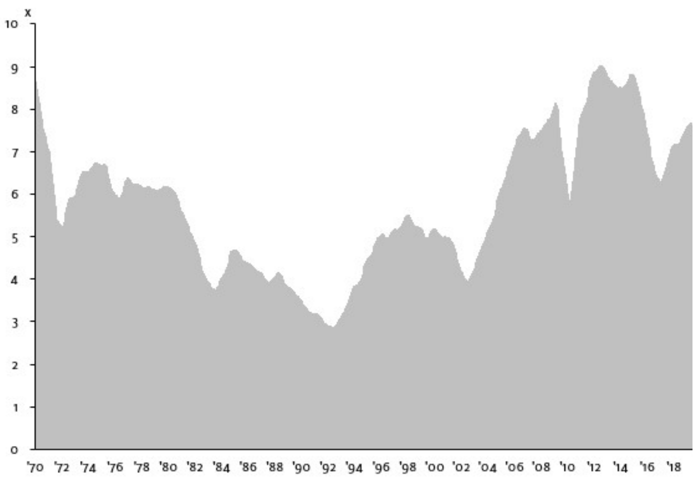



Source: Corporate Reports, Empirical Research Partners Analysis.
[1] Excludes financials and REITs, data smoothed on a trailing six-month basis, 1970 Through September 2019

Eleven years of extraordinary monetary stimulation has propelled financial assets measurably higher than the commensurate change in nominal GDP growth. Approximately $12.4 trillion in world interest rates are at negative yields, including mortgages in some countries and even some high yield debt. Money and credit are historically easy at very low, even negative borrowing costs, providing a potentially distorted environment for capital allocators and investors.

Up to this point, higher debt levels have been problematic primarily in more isolated cases rather than on a systemic basis. To be fair, in aggregate companies continue to generate sufficient cash flow to service their debt levels and an important debt servicing metric such as EBITDA margins for the S&P 500 remain at peak levels of 20%. Corporate debt ratios, such as their earnings before interest (EBIT-to-interest expense) remain very low, thanks to the low cost of borrowing. Indeed, interest paid on existing and new fixed rate debt has declined by 2 percentage points and the average rate is about 4%. In this environment, many companies have been sensible capital allocators, using their cash flow to not only service debt, but to increase dividends, buy back shares, spend on capital or look for acquisitions.

**Large-Capitalization U.S. Stocks[1]**
**EBIT-to-Interest Coverage Ratios**




Source: Corporate Reports, Empirical Research Partners Analysis.
[1] Excludes financials and REITs, data smoothed on a trailing six-month basis, 1970 Through September 2019

One area of potential concern, if debt service ratios weakened, would be private equity where buyouts are done at ever-higher multiples and financed with private credit funds, which use leverage to generate higher returns. Here we are closely monitoring the combination of deals done at high valuations, financed with higher debt levels, by players who too often were not in the game before or during the great financial crisis. For investors buying this debt we are reminded that yield does not necessarily equal total return and that higher potential return comes with higher risk.

For the time being, low interest rates have been a key force for a sustained business expansion and a rise in financial assets. What to be cognizant of, especially if this occurs in the later innings of a business cycle, is when the allure of low borrowing costs leads to excess use of debt and results in too much leverage. Low borrowing costs can help the eventual return on invested capital if borrowers act judiciously in their capital allocation decisions. We liken capital discipline, in a low interest rate world specifically, to the concept of free beer. When free, perhaps the first two or three beers would yield a good outcome. Increase that free beer count to maybe five or six, and the impact is likely to yield a different outcome. In the meantime, we will be even more vigilant on monitoring higher debts levels and the potential risk to markets and investor capital. ◊

## What is Going On in the Fixed Income Repo Market?

Kevin Gale
Managing Director, Fixed Income

By now, most investors have heard of the volatility that occurred in the repo market in September. What is the repo market? A repurchase agreement (or repo for short) is a form of short-term borrowing. It is the sale of a security, usually government related securities, for cash with a commitment to repurchase those securities at a predetermined price at a later date. The length of the repurchase agreement can vary, but overnight is the most common. The size of the repo market varies on a daily basis, but on average is $2 trillion per day.

Historically, the repo market has been a highly liquid, dependable and stable market for short-term borrowers. In September of 2019, cracks in the system surfaced as borrowing rates unexpectedly spiked. The underlying cause of this spike in rates has many factors, including significant issuance of short-term T-bills by the Treasury, corporate tax payments due in mid-September resulting in investors pulling billions of dollars of cash out of the market at once, scarcity of bank reserves and increased demand for financing.

The spike in rates in September has since been mitigated, in part with help from the Fed. The Fed conducted open market operations to help increase the supply of reserves and began to repurchase T-bills, injecting additional cash into the market. The Fed has now committed to purchase $60 billion of T-bills per month at least through the second quarter of 2020. Combined, these actions have helped stabilize the repo market for the time being.

Will these actions by the Fed prevent the unexpected spike in repo rates from happening again? We believe we could see additional volatility in the repo market going forward. The unintended consequences of increased regulations on banks has prevented them from their traditional role of stepping in to help calm the market, leaving nearly all the responsibility on the Fed to do this. In addition, as the U.S. (both the government and corporations) continue to increase their reliance on debt financing, the supply and demand imbalance for borrowing needs can quickly rise, leading to higher volatility in rates.

How does this impact your portfolio? Individual investors do not directly invest in the repo market. However, mutual funds such as money market funds and larger institutional investors participate in the repo market on a regular basis. From a credit perspective, we do not believe loss of principle is likely. We believe that any volatility in the repo market will be temporary and would create opportunities for short-term fixed income investors. Opportunities could arise by a sudden spike in short-term commercial paper rates and yields on ultra-short bonds unexpectedly spiking. We will continue to monitor the situation closely. ◊

## Retirement Plans Q&A: New Developments in Multiple Employer 401(k) Plans

With new developments emerging in the Multiple Employer 401(k) Plan marketplace, we sat down with John Bartels, Howard Essner, JD and Bill Koenig, JD from Ancora's Retirement Plans division for an update.

**Q: We've heard a lot about Multiple Employer Plans in the news lately. In a nutshell, what is a MEP?**

A: A Multiple Employer Plan ("MEP") is a type of retirement plan that is adopted by two or more employers that are unrelated to each other for income tax purposes. A MEP is maintained by the adopting employers to pool investments and share administrative costs while offering separate accounts for each adopting employer.

**Q: Why are we hearing about MEPs more recently?**

A: Recently introduced regulations could help small businesses provide their employees with a retirement plan. In short, these rules make it easier for non-related employers to band together and enjoy the economies of scale seen by larger plans and reduces the liabilities of each participating employer in terms of plan testing.

Over this past summer, the U.S. House of Representatives passed the SECURE Act, which, among other provisions, would make Open MEPs qualify as employer-sponsored plans under ERISA, just as Closed MEPs always have. Although the SECURE Act has not yet passed the Senate, these positive trends have increased interest in MEPs in the retirement plan community.

**Q: Why might a MEP be of interest to a 401(k) plan sponsor?**

A: A MEP fills the gap for small businesses who may not otherwise be able to offer a retirement plan due to the workload, costs or fiduciary liability. Benefits of a MEP include:

- The ability to entice top-level talent and retain staff with a retirement benefit
- Economies of scale to spread costs among participating employers
- Flexible plan design elements for each employer
- Professionally administered plan reduces fiduciary responsibility for the employer and streamlines reporting & disclosure requirements
- Reduced fiduciary responsibility with investment selection and monitoring by an experienced investment manager

- More time to focus on your business needs
- Education services for your employees

### Q: Are MEPs a new concept?

A: No, MEPs have been around even before laws that governed their structure existed.

“Closed” MEPs, available only to employers with some form of qualifying relation to one another, have perhaps been the most common or recognizable MEP structure. In contrast, we are focused on “Open” MEPs, where the participating employers are not related in any way. While Open MEPs are not new, recent legislation has made them more attractive and accessible to employers than they were previously.

### Q: What is Ancora doing in this space?

A: Because of the positive legislative and regulatory trends, Ancora recently decided to move forward in creating the Ancora MEP, an Open MEP effective December 2, 2019. Ancora has contracted with Newport Group for the administration of the plan. Newport Group is one of the country’s largest independent retirement plan administrators and recordkeepers and has significant experience in the MEP market.

There are three key parties to the Ancora MEP. First, Ancora acts as the MEP Sponsor. Second, Ancora’s Retirement Plans division acts as an ERISA 3(38) fiduciary for the investment menu, meaning that we take full discretionary authority as a fiduciary for the MEP investment options. Third, Newport Group acts as an ERISA 3(16) fiduciary for administration of the plan, meaning it takes full fiduciary responsibility for the operations of the plan.

With this structure, other companies can adopt the Ancora MEP for their 401(k) needs to reduce their fiduciary liability, get access to a well-designed fund menu, design certain aspects of their plan and get the benefit of the economies of scale of participating in a plan with significant assets.

### Q: Is a MEP right for every company?

A: A MEP may be more beneficial for smaller employers with roughly less than 200 employees and less than $7M in plan assets, as an example.

A company might choose not to adopt a MEP if they are satisfied with their current service providers and fee structure or have the desire to offer certain investment choices not included in the standard fund menu of the Ancora MEP.

For plans that are perhaps too large to adopt the MEP, Ancora may be able to offer a customized solution that includes similar full fiduciary protection as found in the Ancora MEP, in a more cost-effective manner on a stand-alone basis.

### Q: Is the MEP Ancora’s only retirement plan solution?

A: No, the Ancora MEP is just one of our service offerings. We act as the fiduciary investment advisor for more than 130 employer sponsored retirement plans with a variety of plan types.

### Q: If a current 401(k) plan sponsor wanted more information on MEPs, how should they proceed?

A: Any interested plan sponsor can contact their Ancora relationship manager, John Bartels, Howard Essner, JD or Bill Koenig, JD at Ancora. ◊

As always, don't hesitate to contact your Ancora advisor or relationship team if you have any questions or would like to learn more about these topics. Visit our website at www.ancora.net to read past newsletters and find other news and insights from the investment professionals at Ancora.