ANCORA®

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The Ancora Advisory

An Investment Publication for Clients and Friends

Ancora consists of four primary business units; Family Wealth, Asset Management, Retirement Plans and Insurance Solutions. With experienced portfolio managers, distinctive investment strategies, and robust wealth and risk management, we are driven by an entrepreneurial spirit. Ancora delivers tailored solutions so you can achieve more ... on your terms.

Looking Beyond the 60/40

John Micklitsch, CFA, CAIA
Chief Investment Officer

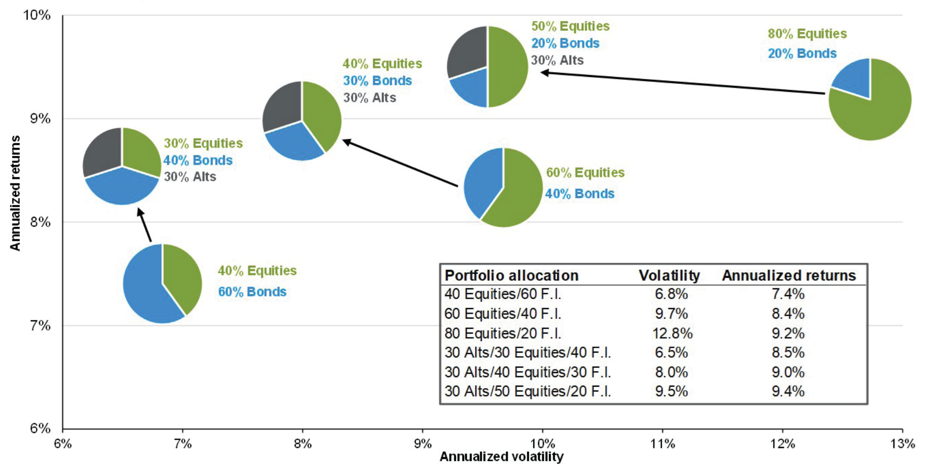
The 60% stock 40% bond portfolio has been an industry standard for the better part of the last four decades, for valid reasons. For starters, interest rates spent much of that period in decline which created a total return tailwind for bonds (yield + price appreciation from falling rates). In addition, 30-40 years ago, benign federal budget deficits and then the rapid adoption of emerging technologies like the Internet and cloud services combined with global outsourcing kept inflation low. Lastly, during much of this time period, investment alternatives beyond stocks and bonds, such as hedge funds, managed futures, private real estate, private equity and private credit, were available to only the largest investors and institutional asset owners. All these conditions contributed to the popularity of the 60/40 portfolio.

But what has changed and how can investors think about portfolio construction for the next 30-40 years as a result? We believe investors of many sizes can now consider the potential benefit of a portfolio built on a three-legged stool approach, consisting of stocks, bonds and alternatives, alongside the traditional two-legged approach, and here is why.

Although interest rates have risen recently, they are still far below the 12-15% level of the late 1970s and early 80s that ushered in the longest sustained bull market in bond market history. So, while future expected fixed income returns have risen recently due to the higher rate environment, we are far from the rate backdrop that in part drove returns from the 60/40 portfolio to widespread adoption. Moreover, systemic deficits are likely to keep interest rates higher for longer as we attempt to fund $2 trillion deficits for as far as the eye can see, which would deny bonds the tailwind of appreciation from sustained falling rates. Additionally, de-globalization is considered to be inflationary rather than deflationary, which reduces another tailwind. Lastly, the computing power and databases that boosted the economy's overall productivity over the last three decades have made it far easier for alternative investment managers to efficiently administer funds at lower minimums for new investors. All of which has ushered in an era that will be known, in our view, as the democratization of alternatives for everyday investors. This brings us to the question of whether alternatives in a portfolio are worth it.

We believe the answer is yes. This chart from J.P. Morgan illustrates the potential impact of adding alternatives to a two-asset class portfolio. In every circumstance, the expected outcome moves up (higher return) and to the left (lower risk). Oftentimes, portfolio improvements are measured in inches, these look more like yards.

Portfolio Diversification



Source: Bloomberg, Burgiss, FactSet, HRFI, NCREIF, Standard & Poor's, J.P. Morgan Asset Management.

Even recent experience in 2022 shows us the benefit of the third leg of the stool approach. In 2022, both stocks and bonds were down double-digits, yet it was alternatives that in many instances served as a lifeline during the year. In fact, correlations between stocks and bonds have risen in recent years, reducing their diversification benefit to each other, and could remain elevated as the Federal Reserve remains an enormous element of the stock and bond market backdrop.

To be clear, there are environments where alternatives will act as a drag on a portfolio's performance. Strong equity bull markets, for example, would be an environment where certain alternatives, particularly those that hedge, could lag. In addition, there are often additional liquidity, administrative and tax considerations with alternative investments.

All things considered, the carefully researched use of alternatives, in our opinion, may have a positive overall effect on a portfolio, broaden opportunity sets and add diversification when evaluated across full market cycles. All of these factors combined with increased accessibility and a seemingly perpetual state of global uncertainty, make us believe alternatives will be an increasingly important part of the investor tool kit for many decades to come. ◊

What's a Trillion Dollars of Interest Expense Among Friends?

Kevin Gale
Managing Director, Head of Fixed Income

In February 2023, the Congressional Budget Office (CBO) released its updated budget and economic projections. In some respects, most just glanced over these projections and moved on, but if you dig deeper into the data there are some real eye-opening numbers regarding the projected debt and interest expense of the United States.

In 2022, interest expense on the outstanding debt of the United States rose by 35% to $475 billion. Mostly, the increase was due to a rise in interest rates throughout 2022. 2023 has not been any more kind with interest rates rising to the highest levels in nearly 20 years, which will put even more pressure on the annual interest expense for the U.S. as lower cost debt is refinanced.

The CBO had projected annual interest expense would rise to $640 billion in 2023 and $739 billion in 2024. As of the end of October 2023, the annual interest expense on U.S. debt is running at a rate of about $800 billion, significantly higher than the CBO projected earlier this year. The increase is due to higher interest rates and a significant increase in outstanding debt. From 2020-2023, outstanding debt increased by $9.5 trillion to $33.8 trillion due to significant deficits to fund pandemic relief and other government programs.

The average interest rate the Federal Government is paying on debt is trending upwards. At the end of the second quarter 2020, the average interest on outstanding debt was 1.945%, according to the St. Louis Federal Reserve. That has since risen to 2.813% as of the end of the third quarter of this year. To put into perspective how rising interest expense is becoming a burden on the U.S. Government, it is now the fourth largest expense item for the Federal Government behind only Social Security, Medicare and Defense spending. The CBO projects that by 2033, annual interest expense will exceed $1.4 trillion and become the third largest expense, exceeded only by Social Security and Medicare.

Clearly, the United States has a debt problem. Difficult decisions in Washington must be made, which could include decreases in entitlement programs and/or increasing taxes. Rising rates and large fiscal deficits will continue to haunt the U.S. Treasury market, resulting in higher volatility in interest rates. Despite these issues, U.S. Treasuries remain the bellwether fixed income securities across the globe, which is unlikely to change. Maintaining an allocation to bonds, and in many cases alternatives, in portfolios can lead to lower overall portfolio volatility in the long-term. With interest rates remaining near multi-decade highs, fixed income holdings, including U.S. Treasuries, are poised to contribute more materially to portfolio returns than they have in the recent past. Contact your Ancora team to discuss the positioning of your fixed income portfolio in light of this environment. ◊

Microcap Q&A: Small but Mighty Stocks

Michael Santelli, CFA
Director, Portfolio Manager

Matt Scullen, CFA
Vice President, Portfolio Manager

Microcap stock investing requires unique skills and can offer many potential benefits to a portfolio. We sat down with Michael Santelli and Matt Scullen, co-portfolio managers of Ancora's strategy that focuses on microcap stocks, to discuss the outlook for the asset class and how they go about creating value for investors.

Q: For starters, can you define microcap investing for our readers?

A: While there is no official definition, the simplest explanation is that investing in microcap stocks means investing in the smallest companies of the total stock market. The Center for Research in Security Prices (CRSP) defines the microcap segment of the market as the bottom 2% of investable market capitalization. Our team's definition is similar. Despite the small size of the market, opportunities in the microcap range abound. While the S&P 500 is limited to approximately 500 companies, there are roughly 1,500 to 2,000 microcap companies at any given time in the investable universe.

Q: What role do you believe microcap stocks can play in a portfolio?

A: We believe microcap stocks can enhance returns in a portfolio. In particular, microcap value, as measured by low price to earnings or price to book value, is the best performing segment of the market going back decades. We have seen that an allocation to microcap stocks may have diversification benefits, as microcap stocks have a lower correlation to large cap stocks. This could enhance the return to a greater degree than risk is increased. Individually, microcap stocks are more volatile than their larger capitalization peers, so our research indicates that the sweet spot is allocating approximately 10% of an equity portfolio to microcap. This may improve the return/risk ratio, but going past 15% will begin to increase the risk relative to return.

Q: What unique analytical skills do you believe investors need to be successful in the microcap range?

A: The analysis of a microcap company and a large cap company follows the same general process, though there are a few important differences. For starters, the management teams of microcap companies can be more important to the success of the company. From an analytical perspective, this means understanding incentives and evaluating management decisions becomes critical. Fortunately, investors in microcap companies typically are granted a great deal of access to the top executives. Additionally, financial strength is generally more important to examine for microcap companies. The sales of microcap companies can be more volatile than large companies and they may have a higher percentage of fixed costs, which can stress profitability during economic slowdowns. We like to see low debt and sufficient cash so there is no question of survivability in the companies we invest in. Finally, and perhaps most importantly, there is minimal coverage in this area by Wall Street firms, so you can't rely on outside research. In our view, this is a source of advantage for diligent microcap investors as thorough research can lead to significant rewards due to the low attention

from Wall Street and larger investors.

Q: Some have drawn comparisons between investing in microcap stocks and private equity investing. What is the basis for that comparison?
A: We believe the comparison is fair against the segment of private equity known as growth equity. The basis of this goes back to the opportunity for enhanced risk-adjusted returns. Both private equity and microcap can accomplish this. Each strategy invests in smaller companies with opportunities to grow. Both private equity and microcap offer diversification benefits to a portfolio, though microcap does offer some benefits that private equity cannot, such as daily liquidity whereas private equity typically requires a long-term lockup of capital. Private equity generally has higher and more complex fee structures than microcap strategies and will often use a high degree of leverage to boost their returns while microcap strategies are capable of achieving similar returns with far less leverage. Lastly, gaining access to the top performers in private equity can be very difficult. Most microcap strategies can be easily accessed through mutual funds or separately managed accounts.

Q: What misconceptions do you believe exist regarding investing in microcap stocks?
A: One of the biggest misconceptions is that microcap stocks are penny stocks, which has a negative connotation. The companies we invest in rarely trade below a dollar and typically trade on a reputable exchange like NASDAQ or NYSE. All the companies we invest in file with the SEC and are audited by a credible accounting firm, just like S&P 500 companies.

Q: What is your view on the active vs. passive investing debate when it comes to microcaps?
A: We are strong proponents of active investing, and there are several reasons for this. As mentioned, microcap stocks have less coverage from Wall Street and are often overlooked by large investors. We refer to this coverage problem as "institutional constraints" and we believe it can create wider mispricing in microcap companies as fundamental changes can go unnoticed. This means there are opportunities for investors who can spot the mispricing. There is a big universe of microcap companies, many of which can be lower quality, meaning less profitable or highly indebted. We think the number of stocks in the universe combined with the need to be highly critical of lesser-quality companies makes passive investing in instruments that mimic the index a poor choice. Active managers can filter for high quality companies with growing cash flows over time while passive options are stuck with a lot of low quality, speculative holdings. Index-tracking ETFs are known for low fees because they are passive and offer zero opportunity to outperform. You might pay three basis points expense to invest in an S&P 500 Index ETF, but the Russell Microcap Index ETF from iShares is much more expensive to access at 60 basis points. We believe those dollars would be better spent allocating to an active microcap strategy.

Q: In closing, what is your outlook for the asset class considering valuations and the economy?
A: We think the next five to ten years look bright for microcap equities. Today, after over a decade of underperformance versus large caps, small cap equities trade at one of the lowest valuations on record relative to large cap equities. The last time we saw relative valuations of small versus large like we have today was around 2000. Small cap equities went on to significantly outperform large cap equities during that cycle. With very attractive valuations and potential for higher economic growth in the future, we believe this is a great set up for microcap equities. ◊

The Impact of Generational Wealth Transfer

Stephen Forlani, JD
Vice President, Financial Planning

As the baby boomer generation ages into and out of retirement, the "Great Wealth Transfer" has become a hot button topic in the world of finance and economics. Baby boomers, or those born between 1946 to 1964, are estimated to hold about half the nation's household wealth and are expected to hand down the vast majority of that wealth to their primarily millennial children over the next two decades. This transfer will represent a significant change in circumstance for many in that millennial cohort, a group that has been troubled by two recessions, burdensome student debt and increasingly unaffordable home prices. What steps should be taken to prepare the next generation for such an adjustment?

Keep it in perspective

Though the sum total expected to be handed down is undeniably vast, many experts are skeptical about how much accumulated wealth will actually be inherited by the younger generations. The transfer has already begun in some cases through the use of inter vivos gifting, as retirees make gifts to their children while they are still living. High-net-worth individuals can make use of the annual gifting exclusion to avoid estate and gift tax on such gifts, while most others can give freely during life without jeopardizing their lifetime exemption from estate taxes. However, many baby boomers are entering retirement with debt of their own while facing longer life expectancy and the associated health care costs that come with it. Growing talk of an impending crisis of Medicare and Social Security can only exacerbate concerns over giving away too much.

Inheritors must also consider the tax ramifications associated with an inheritance. An obvious example is a child inheriting an IRA from a parent. The SECURE Act eliminated the stretch IRA option for most child inheritors, instead requiring that the entire account value be liquidated within 10 years following the death of the decedent. Withdrawals are treated as ordinary income to the IRA beneficiary in the year of withdrawal. Children inheriting an IRA from a parent are frequently at or near the peak of their earning capacity and therefore subject to taxation in the highest brackets during this 10-year liquidation period. The problem is worsened if the account being passed down has accumulated a particularly large tax-deferred balance. The after-tax value of an inherited IRA may therefore be quite a bit less than what it appears. In light of this, advisers should consider several action items when helping potential inheritors plan for their financial futures.

Encourage the asking of questions and better financial education

There is perhaps no better advice for families seeking to plan for wealth transfer than to establish clear and open lines of communication. Assets may be inherited in a variety of ways, whether via will, trust distribution, beneficiary designation or other. The questions of asset titling and how assets will pass down are of particular importance. Inheritors should be encouraged to ask questions and better educate themselves on these topics.

Furthermore, each situation is unique and requires its own special evaluation of the circumstances involved. The trust beneficiary of a large estate may need education on how and when they will receive distributions, how trust principal will be invested or how the trust will evolve over time. A beneficiary inheriting an IRA from a parent will need to devise a plan for distributing the money within the 10-year liquidation period in the most tax-efficient manner possible. Open discussion can lead to greater implementation of wealth preservation strategies, including annual lifetime gifting, income tax planning or estate tax planning through the use of irrevocable trusts or life insurance. The more an inheritor knows about what to expect, the better they can incorporate that expectation into their own financial planning.

Develop a plan and help to establish good financial habits

Arguably the most important thing for the next generation is to have a financial plan of their own, develop good habits as it relates to saving and spending and to understand how a future inheritance might impact their own planning. Take the example of those millennials who have been burdened by inconsistent market performance, student debt and rising costs. Advisers should help structure a plan for how to prioritize efficient savings and pay off high-interest debt, in the context of trying to allow for aspirational goals such as travel. In most cases, relying on a future inheritance is a dangerous concept in financial planning, and proper counsel from the adviser should steer a potential inheritor toward the best use of such a windfall, if it does come into play.

Put it into practice

The wealth planning team at Ancora works with clients and their children to develop holistic financial plans designed to optimize wealth transfer strategies. We strive to put an emphasis on educating the next generation about efficient transfer of assets, and our big-picture approach brings the full estate plan into focus. Direct access to resources such as our in-house life insurance team provides us with the ability to make what we believe to be the best strategic recommendations for each individual household. Please reach out to your Ancora team to discuss financial planning or preparing for a wealth transfer scenario. ◊

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.

Market Data Center

As of 11/30/2023

Stocks	1 month	3 months	6 months	YTD	1 year	3 years	Dividend Yield	NTM P/E	P/B
S&P 500	9.1%	1.7%	10.0%	20.6%	13.5%	31.1%	1.43%	18.7x	4.1x
Dow Jones	9.1%	4.0%	10.3%	10.5%	5.9%	27.6%	1.87%	16.8x	4.4x
Russell 2000	9.2%	-4.3%	4.2%	4.2%	-2.6%	3.2%	1.56%	19.6x	1.7x
Russell 1000 Growth	11.0%	3.4%	12.9%	36.4%	25.9%	28.1%	0.69%	25.7x	10.9x
Russell 1000 Value	7.6%	-0.3%	7.1%	5.4%	1.2%	25.7%	2.13%	14.2x	2.3x
MSCI EAFE	8.2%	1.2%	4.3%	12.3%	10.2%	12.3%	2.18%	12.8x	1.7x
MSCI EM	7.8%	1.0%	4.4%	5.2%	2.4%	-13.2%	2.26%	11.5x	1.5x
NASDAQ 100	10.8%	3.0%	12.0%	46.6%	33.3%	31.7%	0.56%	24.2x	6.8x

Fixed Income	Yield	1 month	3 months	YTD	1 year	3 years
U.S. Aggregate	5.05%	4.6%	0.3%	1.9%	1.0%	-12.6%
U.S. Corporates	5.71%	7.5%	1.2%	4.3%	2.6%	-15.5%
Municipal Bonds	4.03%	5.7%	1.7%	3.2%	2.9%	-2.7%
High Yield Bonds	8.56%	4.9%	2.1%	7.9%	5.9%	1.4%

Key Rates	11/30/2023	10/31/2023	8/31/2023	5/31/2023	11/30/2022	11/30/2020
2 yr Treasury	4.71%	5.06%	4.84%	4.39%	4.38%	0.14%
10 yr Treasury	4.36%	4.90%	4.09%	3.64%	3.70%	0.84%
30 yr Treasury	4.51%	5.06%	4.21%	3.86%	3.82%	1.58%
30 yr Mortgage	7.57%	8.06%	7.53%	7.08%	6.67%	2.94%
Prime Rate	8.50%	8.50%	8.50%	8.25%	7.00%	3.25%

Commodities	Level	1 month	YTD
Oil (WTI)	75.96	-6.2%	-5.4%
Gasoline	2.13	0.0%	-17.3%
Natural Gas	2.80	-26.5%	-31.7%
Propane	0.64	-6.6%	-17.7%
Ethanol	1.85	-9.5%	-15.9%
Gold	2,057	3.2%	12.6%
Silver	25.66	11.8%	6.7%
Copper	3.83	5.1%	0.6%
Steel	1,044	19.9%	40.3%
Corn	4.83	0.8%	-28.9%
Soybeans	13.33	4.2%	-11.0%

Data Reflects Most Recently Available As of 11/30/2023

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