MAIN
MANAGEMENT, LLC

Q1 2018 MARKET RECAP

APRIL 5, 2018

VOLATILITY SPIKED

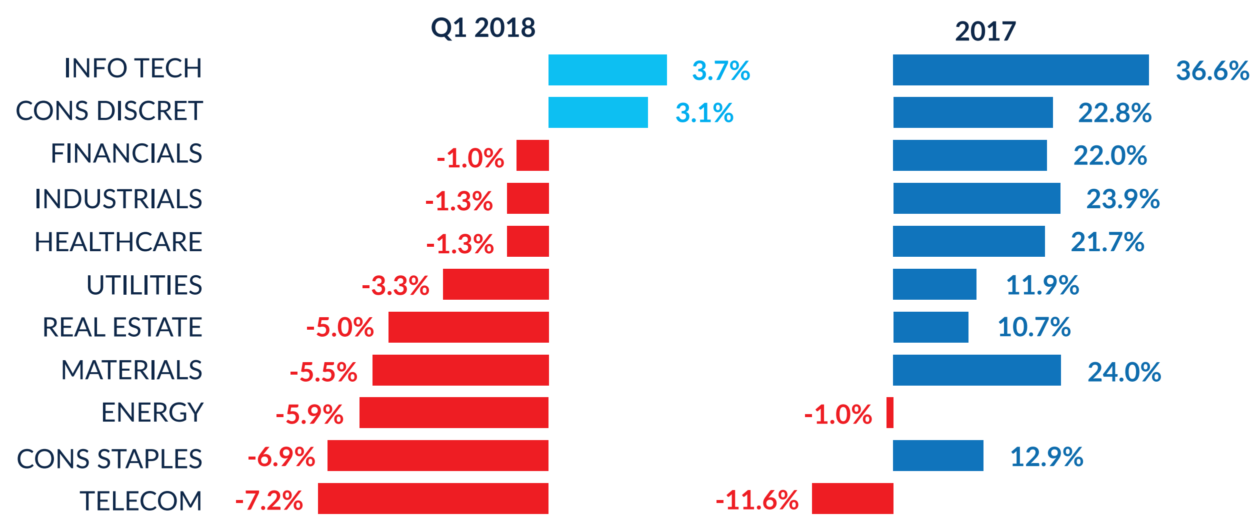
The first quarter of 2018 was anything but a continuation of the market behavior we saw in 2017. After historically low volatility and positive total returns for each of the 12 months in 2017, January continued the trend of higher markets with nearly historic lows in volatility. Then came February. Registering volatility levels below 15 for the month of January, the CBOE Volatility Index (VIX) spiked 116% on February 5, the highest daily move ever recorded. On that same day, the Dow Jones Industrial Average plunged 1,175 points, or -4.6%, its largest single-day point decline in history and the worst day performance-wise since August 2011. The volatility spike was so violent that it even resulted in the shutdown of a widely-traded inverse VIX product. This product was far from being the only one positioned for continued low volatility as many other products and managers had their portfolios positioned in a similar manner and suffered heavily from the sudden increase.

The natural questions that arise are: what caused this spike in volatility and why did we continue to see higher levels throughout the rest of the quarter? Will it remain this way? The short answer to the last question is almost certainly yes. The volatility levels we saw in 2017 were historically low and a return to a higher baseline would be typical in a period of higher rates. Higher volatility is also likely here to stay as fundamentals are starting to change for the first time in quite some time on a broader, macroeconomic level. A higher-than-expected inflation reading for January raised fears that inflation was returning. While February's inflation numbers eased those fears as the numbers retreated from January's reading, the direction of inflation is still in question. Additionally, the first quarter GDP estimates for the U.S. are indicating that growth has slowed and manufacturing PMI numbers around the world are cooling from extremely elevated levels. Combine that backdrop with the coordination of central banks around the world (whether intended or not) which are either outright tightening (like the U.S.) or at least no longer actively easing as the global economy is moving into the late stages of the economic cycle.

THE UNCERTAINTY INDEX

Returning to the VIX, it is important to remember that

Sector Returns As of 3/31/18



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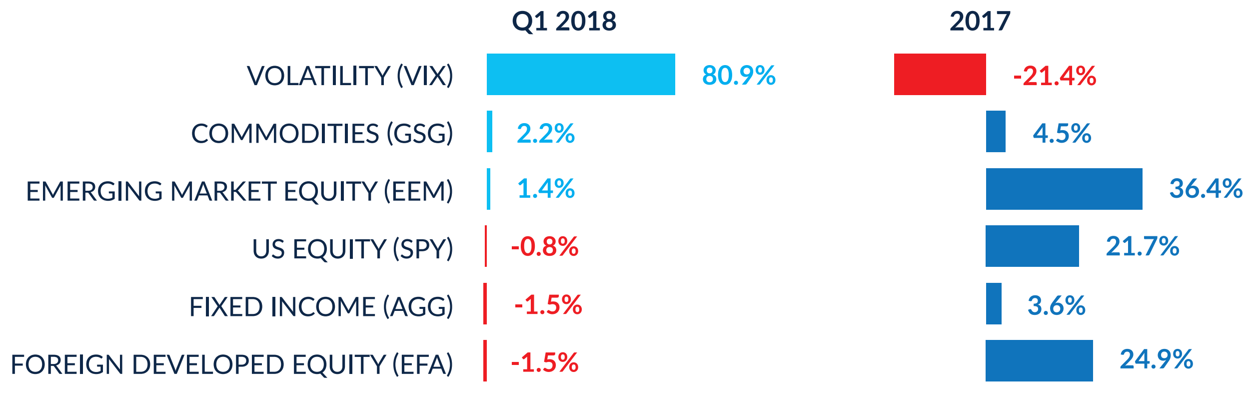
Asset Class Returns As of 3/31/18



while it is colloquially known as the "Fear Index," a more appropriate moniker might be the "Uncertainty Index." Its increase reflected what would be normal given the increased level of uncertainty that the recent economic data is introducing into the markets as it is starting to show cracks. Add to that the rhetoric coming from the White House on tariffs, resulting fears of a trade war, and uncertainty about how many more times the FOMC will hike interest rates this year (they have already hiked once as expected), and we're in a prime environment for increased volatility that did not show any signs of relenting towards the end of the quarter.

In fact, during the second-to-last week of March, the S&P 500 had its biggest weekly loss in more than two years on concerns surrounding trade and the possibility that higher borrowing rates could slow global growth. Interest rates around the globe seem to have bottomed while economic growth has perhaps softened in some areas. Unlike last year where the rising tide of positive economic data lifted all boats, different markets have responded very differently to the developments in the first quarter.

WHICH PART OF THE CYCLE ARE WE IN?

As we continue to move into 2018, we recognize that the market environment is more difficult. Sector and geographic selection is now much more important than it has been in the past few years. The White House and the FOMC will play a large role in the economy as their policies and directions become clearer. With the market pullbacks, valuations have retreated from their lofty levels of last quarter to levels that are more in-line with historic norms. We believe that the global economy remains strong but that we are likely moving into the later stages of the expansion. Earnings estimates for the first quarter of 2018 are calling for a 16% gain and an even more robust 18% for the full 2018 year. The economic data may be less consistently positive as different areas around the globe find themselves at different points in the economic cycle and as a result, it is important that we remain vigilant for opportunities as they present themselves.

Sincerely,

Kim David Arthur
CEO and Portfolio Manager