MAIN
MANAGEMENT, LLC

Q3 2018 MARKET RECAP

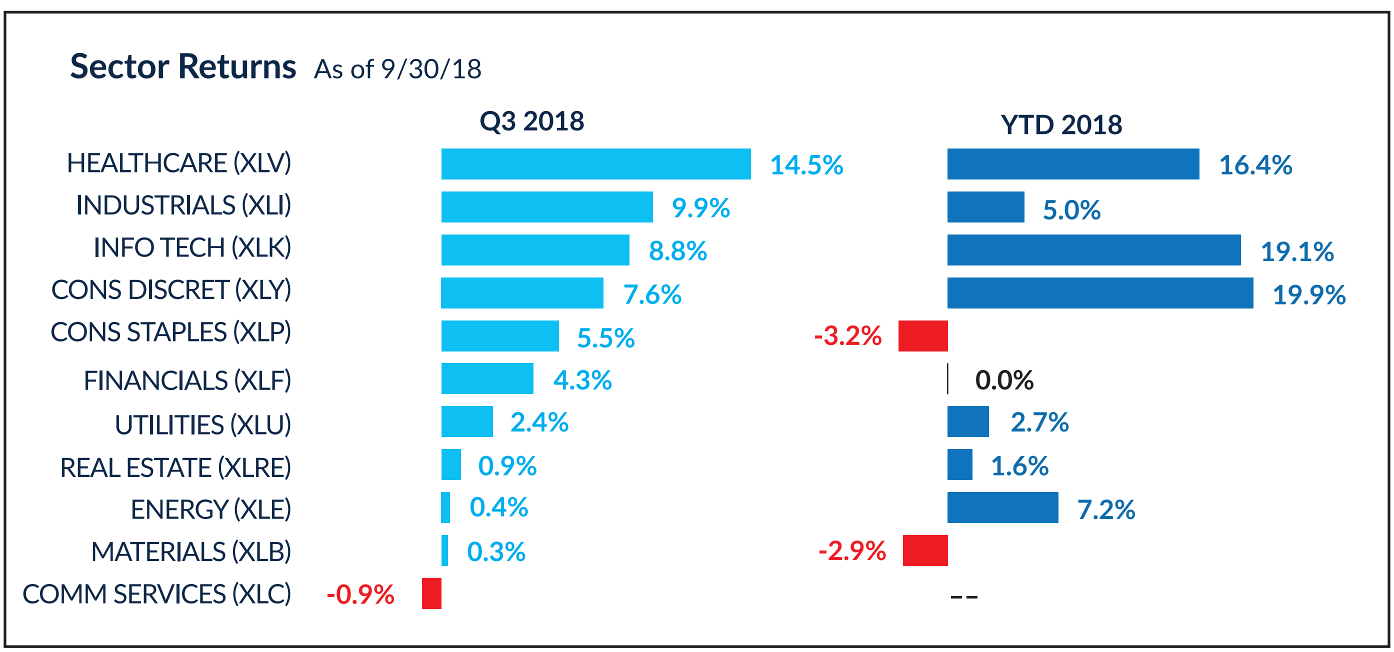
OCTOBER 5, 2018

U.S. ECONOMY TAKES THE LEAD

The third quarter of 2018 brought further conviction that the U.S. economy continues to lead the rest of the world later into the economic cycle. Q2 GDP data for the U.S. was quite strong, coming in at 4.2%. Much of what we saw during the second quarter continued, with inflation, as measured by Core Personal Consumption Expenditures, hitting the Fed's 2% target for the first time since 2012. The labor market remains extraordinarily tight as the economy has added an average of 207,000 jobs per month through August, keeping the unemployment level below 4%. Wage growth picked up as well, rising 2.9% in August from the prior year, the strongest gain since 2009. Against this backdrop, the Federal Open Market Committee raised rates once more in September and the market is forecasting a fourth hike in December ahead of 3 additional hikes in 2019. As the Fed has tightened, rates have risen across the board as well and the strength of the data has resulted in very elevated consumer confidence readings. The U.S. continues to move deeper in the economic cycle, as evidenced by traditional early-cycle industries like autos and home builders having trouble and late-cycle commodity inflation become more of a factor.

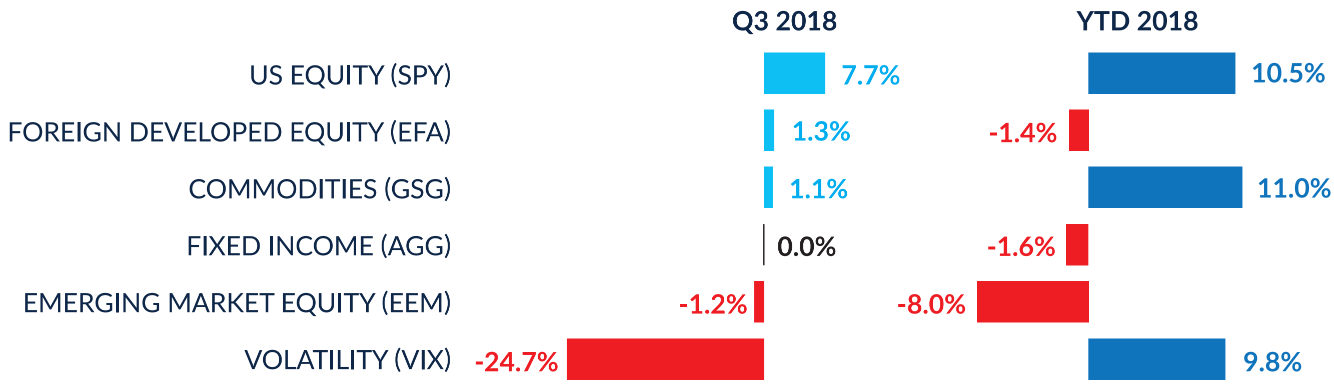
...WHILE GLOBAL MARKETS LAG BEHIND

As in the second quarter, things remain uncertain internationally. Global equities underperformed the U.S., but Emerging Markets were seen as particularly vulnerable as trade war rhetoric dominated the headlines throughout the summer. The U.S. dollar was basically flat during the quarter, but overall remains quite strong relative to international currencies and continues to raise concerns about trade competitiveness and debt servicing costs. Manufacturing PMI numbers continued to cool but still remain in expansion territory for the majority of countries. However, recent agreements with Canada, Mexico, Europe, and Japan have eased fears, while China remains uncertain. It has long been said that as China goes, so do the rest of the Emerging Markets, and this seemed to be the case in Q3 as trade talks with China shaped investor sentiment around the broader EM space. Half of China's exports to the U.S. are now subject to tariffs. Currently, there is a 10% tariff on $200 billion of goods coming in from China, but that level is poised to increase to 25% on January 1, 2019 should an agreement not be reached. There are further threats of imposing tariffs on all Chinese goods. Still, only 2.6% of worldwide



601 California St., Suite 620 | San Francisco, CA 94108 | (415) 217-5800 | info@mainmgt.com | www.mainmgt.com

Asset Class Returns As of 9/30/18



trade is subject to tariffs. Even if those that have been proposed or announced are enacted, it would only affect 1% of global GDP. While these actual numbers might not seem like much, the sentiment can still move swiftly and forcibly. In the meantime, China is doing all it can to spur its economy, which should help Emerging Markets as a whole if it works. As for developed markets, things are a bit less uncertain as the economies continue to progress, albeit slowly. The ECB remains on its path to exit from quantitative easing over the coming quarters and will likely not raise rates until mid-2019.

As we move into the fourth and final quarter of 2018, the market environment continues to demand constant attention. In the U.S., both the FOMC and the White House are in focus, but will likely take a back seat to the mid-term elections in November. The newly created Communication Services sector (replacing Telecommunication Services) shifted some big names around in the S&P 500, but the changes were telegraphed months ahead of time and were handled well by the markets. However, the changes resulted in the traditionally defensive Telecommunication Services sector becoming a cyclical one with the change to Communication Services, leaving only Healthcare, Consumer Staples, and Utilities as the remaining truly defensive sectors. Domestically, earnings estimates remain strong, with forecasts calling for 28% growth in Q3 and 27% growth for the full year of 2018. Globally, Emerging Markets, and China in particular, will be in the spotlight as trade talks progress and China tries to turn around. The global economy remains strong but as the expansion continues to age, we are seeing more and more dispersion among sectors and countries, highlighting the need for vigilance and the ability to move when opportunities arise.

Sincerely,

Kim David Arthur
CEO and Portfolio Manager