MAIN MANAGEMENT, LLC

Q3 2020 MARKET RECAP

OCT 8, 2020

After posting its worst quarterly GDP decline on record in Q2, the United States stands poised to rebound with its best quarterly reading ever in Q3. Current forecasts are calling for a staggering jump of over 30%, which would go a long way to getting the economy back on track following Q2's -31.4% drop. It just remains to be seen when the National Bureau of Economic Research comes out and declares that the recession which began in March is over. We are anticipating that when all is said and done, this recession will be the shortest on record. The week of August 17 saw the S&P 500 surpass the all-time highs from February and a new bull market appeared well underway. Since 1933, bull markets last an average of 39 months and are up +128%. One result of the massive decline in GDP has been a historic opening of the output gap, or where the economy actually is compared to its potential. That gap is currently at -10%, meaning the economy is operating at 10% below its potential. For some perspective, the output gap in 2009 was -6% and in 1982 it was -7%. For the full year of 2020, GDP growth is forecasted to come in around -5.6% annualized for 2020, which is considerably worse than the -2% in 1982 and -4% in 2008. However, the 2020 forecast was estimated to be down -12.8% at the end of the 2nd quarter, so the outlook has markedly improved. The forward 12 months forecast for GDP growth is +10.6%, the second best since World War II.

PRICE

Following the record time bear market decline and subsequent 50% retracement in the S&P 500, the market continued higher in the 3rd quarter, but did pull back in the final month. Multiples have remained flat (Q2 2020 NTM P/E: 21.7x, Q3 2020 NTM P/E: 21.5x) as prices and earnings have risen, and corporate earnings as a whole are being consistently revised higher following their bottom in May. The election cycle is in full swing but volatility seems to be priced in through the inauguration. If the market sells off in October, historically, the incumbent loses and the market is flat for the balance of the year. If the market is up in October, the incumbent wins and the tape rallies 10% through the end of the year.

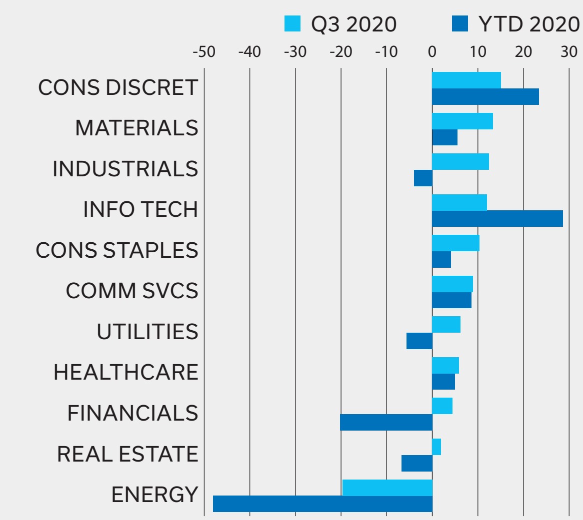
FEDERAL RESERVE

The Federal Reserve has maintained its commitment to doing whatever it takes to the economy by keeping rates low for the foreseeable future. The current environment, with low rates, low inflation, and massive monetary stimulus, remains set up for risk asset class bubbles, like potentially residential real estate and equities. Notably, the Fed changed its stance on inflation, stating that it would allow inflation to run above its 2% target in order to bring the average up to a 2% level, but with rates at zero and the economy on unsteady footing, it seems unlikely that inflation will make its presence felt in any meaningful way any time soon. Monetary policy typically has a year delay, so 2021 may see the benefits of the actions taken this year. The consumer appears to be holding up pretty well, at least by the Census Bureau's annual median income report, which showed that median household income rose by +6.8% from 2018 to 2019, the biggest annual increase ever!

STIMULUS

Despite the uncertainty around stimulus and the consumer, the manufacturing sector has come roaring back. After posting record lows in the throes of the pandemic, Manufacturing PMI figures have rebounded to multi-year highs, both in the US and around the world. The Service and Composite figures have been slightly less robust, but nonetheless, point to a remarkable turnaround since the spring.

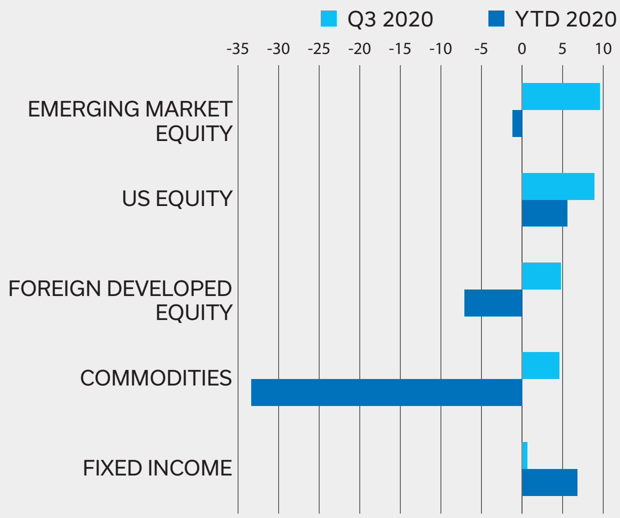
Sector Returns, % return
As of 9/30/20



Source: Morningstar Direct

Asset Class Returns, % return

As of 9/30/20



Source: Morningstar Direct

VIRUS

As for the virus, Operation Warp Speed has seen significant progress. For less than $10 billion, 5 companies directly involved in the venture are in phase 3 trails. In total, 11 companies are in phase 3 of their clinical vaccine trials. The Good Judgment Project Superforecaster prediction for vaccine availability between October 2020 and March 2021 has risen from below 20% in June to 50% in September, indicating clear optimism around the clinical trial process. In the US, cases and deaths are declining and the World Health Organization recently said the infection fatality ratio is 0.13%, or 99.87% of people survive versus 99.9% of people who get the flu.

MOVING ON

So where do we go from here? Heading into the final quarter of 2020, the three looming issues seem to be a further stimulus, a potential vaccine, and the presidential election. The economy has responded remarkably well to the stimulus provided thus far, and in particular the digital economy has taken off in ways few could have predicted. While the data is a few years old, the trend is clear. In 2017, the digital economy made up 6.9% of total U.S. GDP. From 1998 through 2017, the digital economy grew at an annualized rate of 9.9% versus 2.3% for the overall economy. From what we've seen, this trend has only strengthened in recent years, and especially in recent months. Progress on the vaccine continues and with so many companies working along parallel lines, we are hopeful for a breakthrough in the coming months. The election has the potential to move markets, but it is also important to remember that campaign promises prove hard to push through the legislature, especially a divided one. Since 1933, a Republican President with a split Congress has seen average annual returns of +13.4% while a Democratic President with a split Congress has seen average annual returns of +13.6%. For the market, our price range is between 3,100 and 3,600. We hope that you and your loved ones are healthy and safe and please let us know if we can answer and questions that you may have.

Sincerely,

Kim David Arthur
CEO and Portfolio Manager