Q4 2020 MARKET RECAP

JAN 12, 2021

The U.S. GDP output gap has closed down to -3.5%, back above the output gaps that occurred in the troughs of the 1982, 1990, and 2009 recessions. The average S&P 500 forward 12-month return starting the quarter after those troughs (which is the period in which we are now) is +10.6%. Q4 2020 GDP is currently forecasted to be up 4.6% on Wall Street while we are looking for a figure closer to 5%. Notably, the Atlanta Fed GDPNow forecast for Q4 is around 9% (as of 12/30/20). Our Q1 2021 estimate is also around 5% on the back of the $900 billion stimulus bill that was passed recently, while the Street is down at 2.8%. For the full year 2020, GDP is forecasted to come in at -3.5%, which is a considerable improvement from the -12.8% estimate at the end of Q2. The National Bureau of Economic Research has yet to declare that the recession that begin in March is over, but we continue to anticipate that this recession will be the shortest on record when the NBER looks at the data.

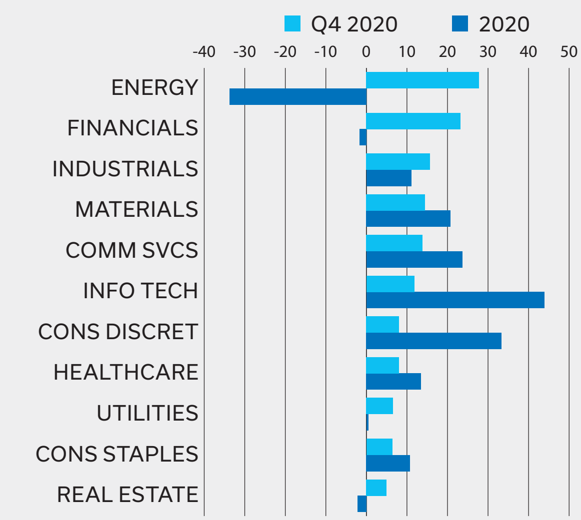
THREE MAJOR RESOLUTIONS

After strong Q3 gains, the S&P 500 continued on to new highs in Q4, positing a +12.15% gain. It was risk-on globally, with the MSCI All Country World ex-USA Index beating the S&P 500 for the first time since Q4 2018 and the Bloomberg Barclays US Aggregate Bond Index was up less than 1%. Multiples on the S&P 500 expanded slightly due to the price performance but were kept in check by the improving earnings (Q3 2020 Next Twelve Months (NTM) P/E: 21.5x, Q4 2020 NTM P/E: 22.3x) The strong market performance was primarily driven by the resolution of the three key issues we were looking at coming into the quarter. The uncertainty around the outcome of the presidential election has been put to bed, with Democratic nominee Joe Biden winning the presidency. The Democrats control the House by 4 seats and the Senate is split 50 / 50. Ever since Woodrow Wilson, Democratic presidents have come into the White House with a unified House and Senate and the average annual market return has been +11.3% (CFRA).

Another big question that was resolved was the creation of multiple vaccines. A handful of companies in the US and other nations applied for and received emergency use authorizations from regulatory bodies and people across the world are currently being vaccinated. Technology took 1st place as the mRNA method got the first 2 approvals (with forecasted cumulative 2021 doses of 1.8b – 2.3b). The news of the vaccines was welcomed by markets and played a big role in lifting them to new highs. Hopefully this means that the light at the end of the tunnel is drawing closer. Peter Thiel, disruptive tech mogul, offered the idea that the pandemic finally ushered in the 21st century (only 20 years late) and the end of the old economy. AstraZeneca, whose vaccine was approved in the UK, will be providing 2 billion doses in 2021. Johnson & Johnson is next in line for approval, currently in phase 3 trials for their single shot vaccine, and has said they have the capacity for 1 billion doses in 2021. Forecasts in the US are calling for vaccination of half of Americans by April and 70% of people in developed markets across the globe by fall 2021 (Goldman Sachs). This development would likely allow for a full-blown economic reopening and may release much of the pent-up demand and discretionary spending that has been stifled by the lockdowns.

The third issue that we were looking for a resolution around heading into Q4 was further economic stimulus, and that too came to fruition. The legislature recently passed a $900 billion stimulus bill which includes unemployment benefits and another round of direct payments to individuals. Goldman Sachs is expecting $750b and Jefferies expecting $1 trillion of further stimulus.

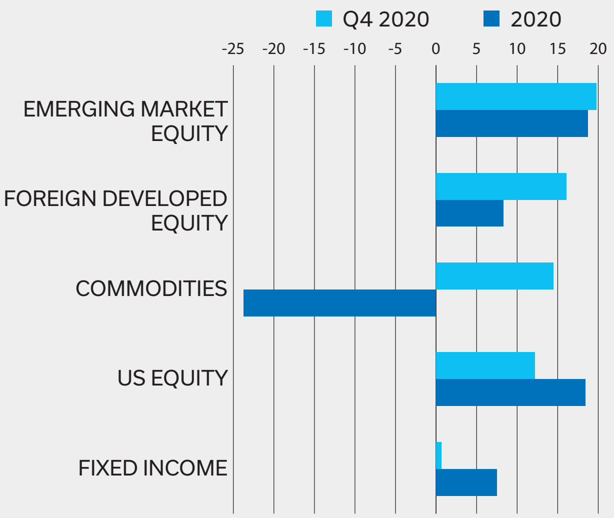
Sector Returns, % return
As of 12/31/20



Source: Morningstar Direct

MAIN
MANAGEMENT, LLC

Asset Class Returns, % return
As of 12/31/20



Source: Morningstar Direct

WHAT'S NEXT?

So where has the resolution of these issues gotten us and where do we go from here? As we mentioned above, Q3 US GDP saw an historic gain. If Q4 GDP comes in near its estimates, that would be another very strong reading. Manufacturing PMI figures both in the US and abroad have risen markedly from their springtime lows and in many cases have posted multi-year highs. Global trade has picked back up. The digitization of the economy continues to be front and center as people are working and shopping from home and companies have responded to the new set of demands that consumers are placing on them. While the vaccine rollout should continue to move forward and push the re-opening process along as 2021 progresses, it is also highly likely that certain areas of the economy and consumer behavior have been forever altered as a result of this pandemic. The stimulus bill should provide some relief to Americans and the economy as a whole as we near the end of the pandemic. That would provide a welcome boost to those relying on unemployment to get them through these trying times. However, it must also be noted that the consumer appears to be in good shape, with retail sales at historically high levels and the direct payments coming which will result in more disposable income in their pocket.

For the S&P 500, our year-end 2021 price target is 4,000 with a 20x forward multiple on earnings of $200 for 2022. The average decline in any given year is roughly 12% from peak to trough. We saw 3 drawdowns in 2020 and are forecasting one drawdown more in line with history in 2021. Overall, across our strategies, we are invested with a barbell approach between growth and value, and within the growth space, we are focusing on achieving that growth at a reasonable price. Our overweights stand to benefit from a number of line items. Internationally, China has 2021 GDP growth forecasted to be 8.2% and foreign ownership which is less than half of the US. Domestically, Financials stand to benefit from the greenlighted stock buybacks as well as declining defaults. Small cap technology has a price-to-earnings growth ratio of roughly 1x versus large cap tech at 1.8x. Our newly launched Thematic strategy focuses on the future and disruptive technologies with large addressable markets. To put that in perspective, we often point to Bitcoin, which we do not hold, but which has an investor base of roughly 1 million people versus equities at 1 billion people. Our BuyWrite call writing strategy stands to benefit from the elevated volatility environment.

We hope that you and your loved ones are healthy and safe and please let us know if we can answer any questions that you may have.

Sincerely,

Kim David Arthur
CEO and Portfolio Manager