Q3 2021 MARKET RECAP

OCT 6, 2021

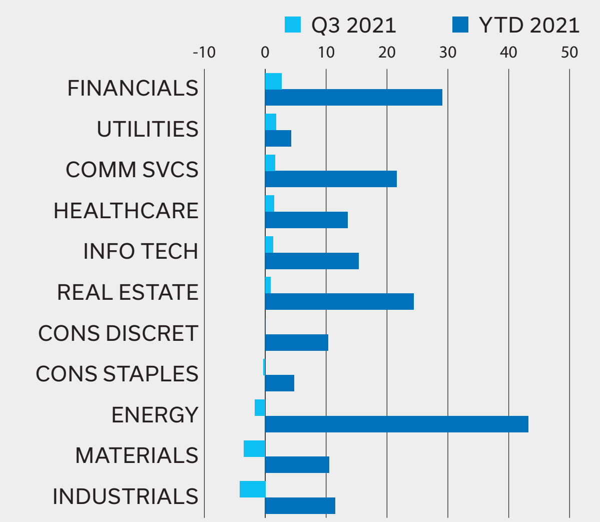
As Q2 2021 GDP figures were revised lower from 9-10% to a final reading of 6.7% during the third quarter, concerns around slowing growth are being voiced. However, it is important to remember that a GDP reading of above 6% (which we have now had for 2 consecutive quarters) is very strong relative to recent decades. The economy continues to recover and the output gap, the difference between the economy's actual output and its maximum potential output expressed as a percentage of GDP, is within 2%. It may fully close if we get the anticipated strength in Q3 and Q4 that forecasts are predicting, which could bring full year 2021 growth to above 6%. As the skewed year-over-year comparisons continue to abate, the headlines are now dominated primarily by inflation fears and by the Federal Reserve's response and the labor market. China regulatory issues have also taken up considerable space in the headlines as well, but the response outside of Chinese markets has been relatively muted.

There was some more dispersion among markets in the 3rd quarter than we saw in the 1st and 2nd quarters. The notable laggard was broad Emerging Markets which were dragged down by China as its regulatory crackdown on its internet and education sectors rattled investors around the world. However, the effects outside of the Chinese markets were relatively short-lived as investors realized that the knock-on effects around the globe appear to be fairly limited. The end result was that Emerging Markets as a whole were down -8.0% while Commodities led the way, posting a +5.2% return in Q3, bring them up to over 38% on the year. Fixed Income continues to trail on a YTD basis, down -1.6%. Growth stocks once again outperformed Value in Q3, returning +1.4%, while Value was down -0.6%. Historically, Growth has generally outperformed Value in periods of falling rates and seeing as rates were basically flat on the quarter, it may not be entirely surprising that Growth outperformed. If rates continue to move higher, as they did in the 2nd part of Q3, Value may outperform in Q4 2021. As we saw in Q2, Q3 once again saw Large Caps (Russell 1000) continue to outperform Small Caps (Russell 2000), with Large Caps up +0.2% and Small Caps down -4.4%.

INFLATION

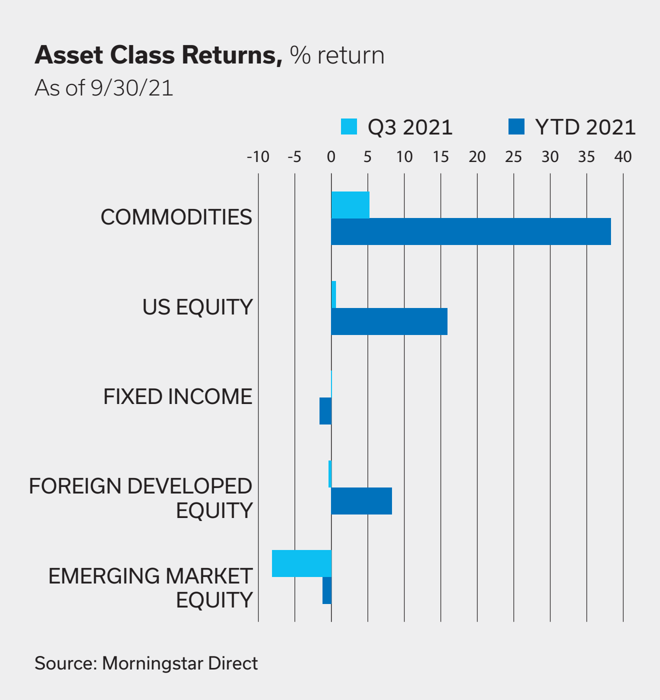
Inflation continues to be top of mind in the markets but the August figures showed some slowing from the strong June and July figures. As of August, Headline CPI is up 5.2% Y/Y, but did slow from June and July's 5.3% readings. However, Core PCE, which is the Fed's preferred inflation measure, posted a +3.62% Y/Y gain in August, the highest since May 1991. The Headline CPI deceleration in August was welcome and will hopefully continue as we head into the final quarter of 2021. We continue to believe that inflation is transitory and now more the result of bottlenecks in the global supply chain that are improving more slowly than anticipated. A look at the 2-year trailing average for the Core PCE figure shows it at 1.9%, below the Fed's 2% inflation target. As we've had years of below 2% inflation, it only makes sense that we need periods above 2% to bring the average to the Fed's desired level. The September FOMC meeting showed that inflationary views have largely remained the same but the path for rate hikes has perhaps moved up a bit. While the median dot plot figure indicates no rate hike until 2023, half of the 18 members do see one in 2022, which was a bit more aggressive/hawkish than markets had been expecting. The Fed announced its intent to taper asset purchases in the fourth quarter. While headlines may lead one to believe that rate hikes are not good for markets, it's important to remember that rate hikes typically come when the FOMC feels the economy is on solid footing, which is ultimately a good thing.

Sector Returns, % return
As of 9/30/21



Source: Morningstar Direct

MAIN MANAGEMENT, LLC



LABOR MARKET EXPECTATIONS

Labor markets continue to be another hot topic. While June and July saw robust readings of roughly 1 million jobs, August was unexpectedly weak at just 235,000 jobs added. Still, people are re-entering the labor force and the unemployment rate has continued to decline, dropping to 5.2% in August. Still, there is a clear mismatch between open jobs and available labor. There are roughly 10 million job openings (a record) and 8.4 million unemployed persons but the fact that companies are having difficulty filling a number of these positions shows that there is a disconnect between what employers are looking for from prospective employees and what is available. There are now 1.3 job openings per unemployed person, which is truly unprecedented. Additionally, it's worth noting that frictional unemployment is around 5 million, so the real number of "available" unemployed persons is probably closer to 3.4 million rather than 8.4 million. Still, the result of the labor mismatch is that wages continue to rise and could weigh on firms' profitability. For the most part, it continues to be the lower-wage earners, like those in the service industry, who are seeing the wage increases as firms are trying to entice them back to work while the higher-end earners have not seen the same upward pressure to their wages.

As for the virus, the Delta variant has caused a fair amount of concern but the continued improvement in vaccinations and additional immunity from prior infections means that a large percentage of the population has some protection against the virus. The result is that while cases and deaths did rise for several weeks, they now appear to be heading back down and we are hopeful that we have seen the final wave of COVID. Europe now leads the US in terms of vaccine doses administered per 100 people, with Canada and Japan also making up ground. Furthermore, we may soon see the approval of vaccines for children ages 5-11 years old, which would allow additional tens of millions of Americans to be vaccinated. Emerging markets continue to lag in terms of vaccinations but are generally seeing steady improvement.

As we move into the final quarter of 2021, we anticipate that above-trend GDP growth will continue and could bring the full year of 2021 to above 6%, which would be very strong historically. Interest rates, which were largely unchanged in Q3, remain historically low and may continue to provide a tailwind to the consumer and the economy. We anticipate that the re-opening will continue in earnest domestically and the holiday season will see robust consumer spending. Our 12-month price target for the S&P 500 is between 4,100 and 4,700. We still have yet to see a typical intra-year decline of 12% for the major averages from peak to trough, although one may recall that the NASDAQ declined roughly 10% in Q1. Multiples remain at fairly elevated levels but have already started to come in on improved earnings, which we feel is likely to continue.

Here at Main Management, we firmly believe that our investors should keep more of their returns. 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