MAIN MANAGEMENT, LLC

Q1 2020 MARKET RECAP

APR 8, 2020

RECESSION BY PROCLAMATION

This is the first time that the US has had a recession by proclamation. Usually, recessions occur at the end of business cycles with inflation from supply constraints (OPEC embargoes in the '70's), or demand collapses due to levered consumers and levered banks (2008 with housing and the consumer).

Let's look at the four legs of the stool (Price, Fed, Fiscal, and Virus), then at signs of a bottoming process, and finally what may take us out of this recession by proclamation.

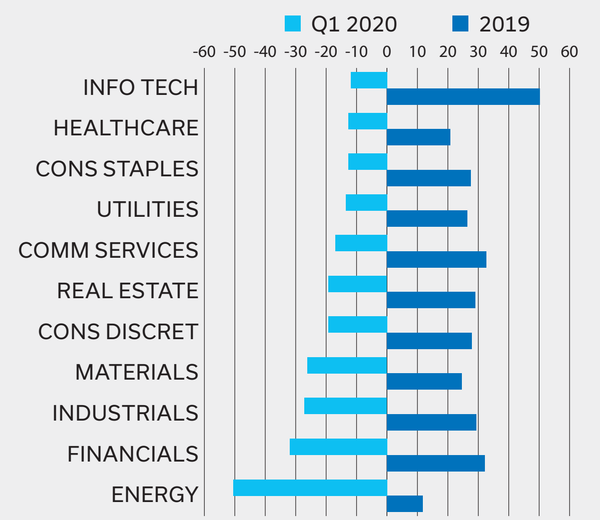
1. **Price**. This bear market was the quickest by price decline ever. Since WWII, there have been 13 bear markets where the first 22 days averaged a 5% price decline. This market was down 35%, or 7x the average.
2. **The Federal Reserve**. The response was rapid and large in scale. The Fed cut rates to zero, introduced facilities to backstop commercial paper, money market accounts, etc., and implemented a fourth round of quantitative easing (QE4) with a run rate of $17.5 trillion versus the former QE3 run rate of $500 billion. The response came just over one month after the peak price, while in 2008 it took over 12 months for a response.
3. **The Fiscal Stimulus**. $2.2 trillion versus 2009 of $850 billion, and it also came just over one month after peak prices versus 16 months in 2009. In addition, most of the $2.2 trillion is expected to impact the economy over the next 9 months while in 2009 some of it took up to 2 years to reach the economy.
4. **The Virus**. Like weather and economists, virus modeling is only as good as the data that is utilized for the model. The data and models are also constantly being updated. The early models (Niall Ferguson, Imperial Model, and Murray Model) had very large death numbers (US at over 2 million, UK at over 500,000). But, as shelter-in-place, social distancing, cocktails of hydroxychloroquine and Z-Paks, and better testing have been introduced, these early models' expectations of fatalities have collapsed. The US is now modeled at 150,000 deaths and the UK at 20,000. The personnel and equipment shortages are being addressed by the private markets: NY is offering $100/hour for nurses, or 4 times the rates in other parts of the country (Source: Reuters), and the private sector is reallocating manufacturing for masks and ventilators. The Chinese built a new 1,000 bed hospital in 12 days, while NYC converted the Javits Center in 4 days to a 1,200 bed hospital and can expand to a 2,900 bed hospital. (Source: Department of Defense)

PRICE AND PROOF

It is important to remember that Price and Proof rarely happen at the same time.

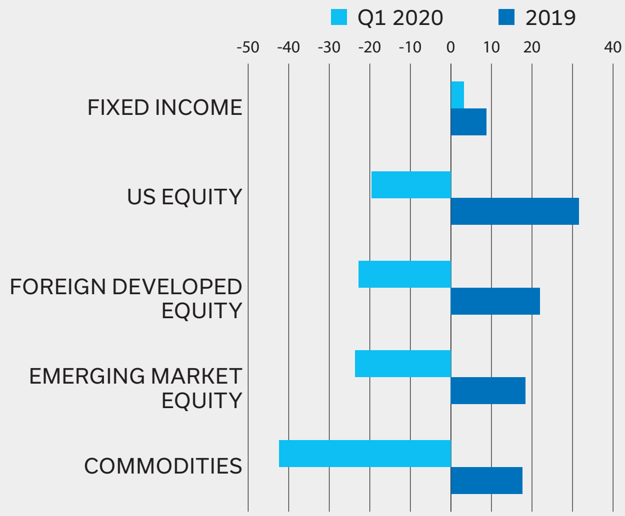
1. The University of Michigan Consumer Confidence Survey plunged 11.9 points for the month of March. This was the 4th largest drop ever. The biggest 3 drops were: 1980 during the recession, 2005 for Hurricane Katrina, and 2008 for the Great Recession. Twelve months later, the equity markets were up 28% on average.
2. The 60/40 equity/fixed income benchmark was down 20% from peak to trough, only the 4th time in 50 years to happen, (8/1974, 9/2002, 1/2009). The average 12 month forward return was almost 16%.
3. Global interest rates were at 2.5% when equity prices bottomed in 2009. Today that rate is below 1%, and the consumers will get a tax break once they start driving again with oil at $20/bbl (although this is not good for the 5% of Americans employed by the oil and gas industry).

Sector Returns, % return
As of 3/31/20



Source: Morningstar Direct

Asset Class Returns, % return
As of 3/31/20



Source: Morningstar Direct

4. Volatility hit 84 when the S&P 500 hit 2,300, higher than its pinnacle in 2008. High Yield credit spreads are at over 1000bps (as of the end of March) and these spread levels are where the average recession peaks (1116bps is the current peak). Average recession high grade fixed income spreads are 235bps (326bps is the current peak). The average recession equity price decline is -26% (down 35% at 2,200) and the average 5-Year US Treasury yield decline is 265bps (261bps is the current peak).

5. We saw forced liquidation across systematic investors, passive investors, active investors, active investors with leverage, and retail investors.

6. Finally, after a 30% peak to trough decline (to around 2,400 on the S&P 500), the historic forward 3 year annualized return is +11% and the 10 year annualized return is +9%.

7. Small cap companies appear cheap. 55% of them are trading below book value versus at the 2009 bottom when "only" 50% were.

WHAT MAY LEAD US OUT OF THIS RECESSION BY PROCLAMATION?

1. China, which has been 40% of global incremental growth, led us into this with the 1st reported virus cases. After their lock down in January, cases peaked 3 weeks later, and 2 months later they began a soft re-opening of their economy. For March their PMI for large businesses was 52 (above 50 is expansionary, and above the 42 estimate; Source: TradingEconomics.com) and the March Markit PMI was 50.1 for small- and mid-size businesses (estimate was 45.5). Also, their small- and mid-size business capacity utilization rate is 76%.

2. Taiwan's March PMI is also above 50, at 50.1, as is Australia's at 53.7.

3. Coordinated, global shelter-in-place, coordinated global central banks (rates below 1%), and coordinated global fiscal response (almost $4.5 trillion between the US, Europe, UK, and Japan).

4. Global manufacturing and supply chains will likely change post virus. Today, China is 28% of global manufacturing, the US is 16%, and Mexico is 1%. The latter two could see share shifts in their favor.

Please let us know if we can answer any questions that you may have.

Sincerely,

Kim David Arthur
CEO and Portfolio Manager