MRP CAPITAL INVESTMENTS, LLC

3rd Quarter 2020 Client Newsletter

Capital Market Update

Inside this report:

In keeping with the theme of 2020, the 3rd quarter was a wild ride. The S&P 500 rallied about 14% in price during the first two months of the quarter and then pulled back about 10% during the month of September. To end the quarter, it settled up a little more than 4% for the year to date.

S&P 500 2020 Chart Supplied by BigCharts.com

But what is the most fascinating aspect of those data points is the continuing disparity between the returns of the indices. I can't remember a time when the returns of various benchmarks were so wildly different, as we discussed in the last newsletter. For example, the Dow Jones Industrial Average ended the 3rd quarter with a year to date price change of –2.08%, the S&P Global index was –1.01%, the small cap index was –17.6%, while a handful of tech stocks have propelled the NASDAQ well into positive territory.

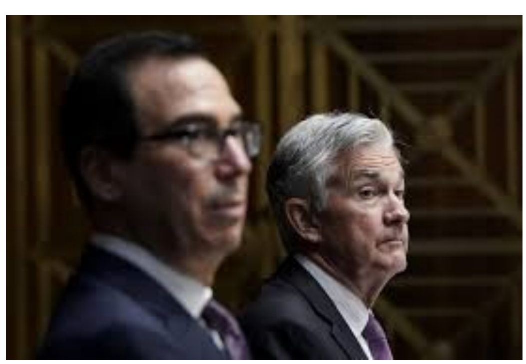
What will happen next in 2020? Frankly, not much would surprise us. But the election is close at hand and we've got a Supreme Court nomination in the confirmation process. Buckle up! It should be a wild ride.

The Election—Signal Through the Noise

With the U.S. Presidential election about a month away, it seems everyone is focused like a laser on it. The prevailing sentiment is that if Biden were to win, the stock market would crater. And if Trump wins, the market will rally. As we've stated in our previous reports, we disagree with that. We feel that regardless of who wins the markets will rally, although there should be a difference in which stocks boom. For instance if Biden were to win, we believe that international stocks will outperform U.S. stocks. If Trump wins, we believe the U.S. market will continue to outperform.

The basis of that opinion is built upon the fact that Trump has taken a path akin to a pseudo-Cold War with China and his "America First" policies. This has, undoubtedly, pushed investment dollars into U.S. assets. Biden is already on record saying that he will jump right back into the Paris Climate Accord. To us, this clearly illustrates that he will be more "internationally friendly" than President Trump and his tough negotiating tactics with other Sovereign nations.

But to be frank, we don't feel that focusing on the elections (Presidential and Congressional) is the most important data point to be concerned with. We truly believe that the Central Banks of the world are the most powerful market moving force right now. And, in our opinion, they will do whatever it takes to prop up asset prices. To understand why we have this opinion, all one has to do is look at the actions that they have taken since the 2008 Financial Crisis including the actions taken this year.



In essence, the Fed backstopped every market. And it worked in an almost seamless fashion with the Treasury. Their maneuvers flooded the market with liquidity to ensure that there was enough available capital for markets to function in as normal of a fashion as they possibly could. In fact, here is a list of some of the things they did to prop up the markets:

March 15th

-Fed Funds rate cut to zero

-A new round of quantitative easing announced

-Lowered the rate for banks to use the Discount Window by 150 basis points

-Lowered Bank Capital Requirements

-Coordinated international action to lower pricing on Dollar Liquidity Swaps

March 17th

-Backstopped the Commercial Paper markets

-Re-opened a collateralized loan facility for large broker-dealers

March 18th

-Backstopped Money Market funds

March 19th

-Extended Dollar swap agreements to Foreign banks

March 20th

-Changed frequency of Dollar swaps from weekly to daily for foreign banks

-Backstopped the municipal bond markets

March 23rd

-Backstopped mortgage-backed securities

-Established 3 new emergency lending facilities, which included backstopping corporate bonds

-Backstopped variable rate demand note and CD's

-Made changes to the bank Total Loss Absorbing Capacity to increase lending by banks

March 24th

-Delayed Implementation of the Foreign Banking maximum Overdraft Rule

-Scaled back their non-critical oversight operations

-Announced they would not take action against financial institutions with less than $5 billion in assets

March 26th

-Began buying Mortgage-Backed Securities

March 30th

-Eased Regulatory rules for banks

March 31st

-Postponed Bank Control Framework rules

-Established a new repurchase facility for Foreign banks

April 1st

-Losened Bank Capital Requirements

April 6th

-Relaxed Bank Capital Ratios

-Implemented 3 new emergency lending facilities, including PPP (Payment Protection Program) and Main Street Lending Program which allowed for purchase of $600 billion of debt from companies employing less than 10,000 workers

-Backstopped Municipal Bond markets

-Expanded the scope of previous emergency lending facilities by $850 billion

April 23rd

-Suspended credit limits of intraday lending

-Lending facilities extended to non-depository lenders

April 27th

-Expands Municipal Lending Facility by $500 billion

April 30th

-Expands Mainstreet Lending Program to companies with over 10,000 workers

May 5th

-Modified Liquidity Coverage Ratios for banks in the emergency lending facilities

May 15th

-Eased Bank Capital Requirements (again)

June 3rd

-Access to Municipal Liquidity program expanded

June 8th

-Drastically expanded Main Street Lending Facility raising Fed's participation to 95% of all loans

June 15th

-Expanded corporate bonds purchase program

June 17th

-Extends loan programs to non-profits

I hope that by listing the majority of the actions taken by the Fed in light of the Corona-virus outbreak, you can clearly see that the Fed, and Central Banks in general, will do WHATEVER IT TAKES to prop up the economy. And this is, in fact, the signal through all the noise that we see regarding the market on a daily basis.

Why would the Central Bankers do this?

We think the answer is obvious. We have a debt-based economy. If the collateral used to support those loans were to decline significantly, then no more loans could be made. But, perhaps more importantly, the loans already made wouldn't have enough assets to support them and they would be called in by the banks. And this would, without question, destroy our current economic system. With that in mind, we are very bullish on the idea that asset prices will be rising once we are through the election. But the day to day noise will cause an incredible amount of anxiety among investors. Given this, we need to keep our mind, and emotions, focused on the signal and not the noise.

A Time of Change

In this article, we want to discuss some of the current events taking place in the world right now. However, we do want to add in the fact that we are not voicing any personal opinions regarding these events in terms of whether we support, agree, or disagree with any of them. We simply believe that we are at the crossroads of major societal and global changes and these changes should have an impact on the capital markets. Hence, our need to discuss them.

The world's current political and financial systems are still anchored to the actions that took place during and soon after World War II. When the Allies won the war, with major contributions from the United States of America, U.S. dollars became the backbone of the world's financial system.

With this, the U.S. dollar is the world's reserve currency. To get a sense of how important the U.S. dollar is to the global economic system, simply review the last article and look at how the U.S. Treasury and Federal Reserve took quick action to supply the world with U.S. dollars and access to U.S. dollar based loans in the face of the Coronavirus scare. They did this because many loans on a global basis are denominated in U.S. dollars and without access to U.S. dollars these loans become difficult to service and repay. And, of course, the United States is the only country that can print and issue more dollars. Therefore, foreign nations and entities are dependent on access to U.S. dollars to continue to function and they are inherently dependent on the United States for their economic survival.

We think it is not too far fetched of an idea that sovereign nations being beholden to another sovereign nation for their survival isn't their ideal scenario as it usurps those entities independence, while keeping the United States in almost complete control of the global economic system.

In light of these facts, we believe you can find the source of many people's frustration with the current political strategies and tactics. For example, the Trump Administration seems very interested in pulling out of the "endless wars" around the world, which are focused in the Middle East. And we think you can dovetail these actions with the U.S.'s changing attitudes and level of support regarding many international organizations like the U.N, NATO, and the World Health Organization.

On one hand, it does make sense to not continue to risk American lives to fight wars in the Middle East. Furthermore, it makes sense to not be the main funding entity behind these international organizations if others aren't meeting their agreed upon level of support. Therefore, negotiating for better deals and/or pulling out of these entities if we don't get a better deal makes sense.

On the other hand, by ceasing to support these entities or pulling our troops out of volatile but important regions of the world the United States loses some of its influence over them and opens the door for other nations to take the lead within them. Currently, China seems to be the country that wants to step up its influence. We believe that this potential loss of global influence is why people like General Mattis and John Bolton have such issues with some of these maneuvers by the Trump Administration.

Again, we are not agreeing with one side or the other. We are simply noting that if the United States continues to withdraw from international organizations, it makes logical sense that the international influence of United States will lessen over time. The main risk to this potential declining global influence of the United States centers on how strong is the U.S. dollars hold on its current title of the world's reserve currency. If the dollar loses that status, many things will change and those changes will be substantial in terms of the global financial landscape.

To us, this concept of the U.S. dollar losing its standing as the world's reserve currency is the biggest risk to the United States. And, to be frank, it is the biggest risk to global economic equilibrium. In all honesty, it doesn't appear that this type of event will happen anytime soon. However, there is no question that many countries around the world are working on plans to unseat the dollar and replace it with, potentially, a basket of currencies, a new global currency, or, less likely, another currency currently in circulation.

As long as the dollar remains king of the currencies, the status quo and current level of balance will be maintained. This means that commodities around the world will still be priced in U.S. dollars. The currency of choice for international transactions will still be the greenback. It also means that the U.S. government will have an almost limitless ability to print money and have the world's financial markets be waiting and ready to receive and use those dollars. But if the dollar loses its status, there is the potential for the global demand for the dollar to wane. We think the most immediate ramification of this potential lack of demand for the dollar could be inflationary pressure on all goods transacted in dollars.

Nevertheless, as we discussed a few paragraphs ago, we don't see this happening anytime soon but if it would happen it would be a major event. Until then, almost nothing matters too much. In our opinion, Biden could win the Presidency and raise taxes substantially for businesses and individuals. However if the dollar remains revered globally, our economy should continue to function normally. Trump could win re-election and continue his tough negotiating tactics with foreign entities and, as long as everyone is beholden to the dollar, things should function normally and, in fact, quite well for the United States. But lose that world's reserve currency status and the game changes.

To us, these are the biggest issues currently on the table. Frankly, we haven't seen these issues discussed in the mainstream media. Instead, we see ANTIFA, BLM, Proud Boys, Coronavirus, trade wars, boycotts, riots, and peaceful protests. And those stories probably garner more eyeballs than discussions about the global currency markets. But we feel the currency markets lay the foundation for how society operates, moves, and evolves. So, we are keeping a close eye on them.

Non-Financial Events occurring this quarter

July 1 Russian amends its constitution to allow Putin to serve 2 more 6 year terms as President

July 2020 NASA launches its Mars 2020 mission

Supreme Court Justice Ruth Bader Ginsburg passed away on September 18th

September 4 Kosovo and Serbia normalize economic relations

September 15 Israel, Bahrain, and The United Arab Emirates signed an agreement to normalize diplomatic relations.

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