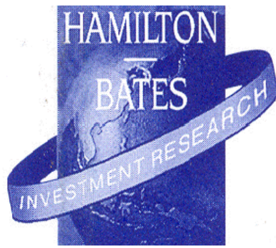

Hamilton-Bates
Market Update

March 6, 2014

March 6, 1899 – Friedrich Bayer & Co patent 'Aspirin', the brand name for acetylsalicylic acid. 'Aspirin' was originally made from a chemical found in the bark of willow trees. In its primitive form it was used for centuries in folk medicine, beginning in ancient Greece when Hippocrates used it to relieve pain and fever.

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Monday's decline over saber rattling in Ukraine was followed up relative calm, Vladimir Putin commented that military action would be a 'last resort'. This eased concerns and stocks had no problem rebounding. Not only did the S&P retake the breakout above the widely watched 1850 level , it has since moved on to a new all-time high at 1880. The next hurdle is tomorrow's February employment data. If all goes well, then 1900 here we come.

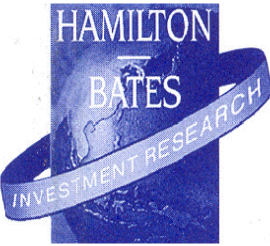
Earnings, Economics, and A Jobs Report
Over the past few months the employment situation looks to have weakened. Over the last two months the Government report on job creation weakened significantly while the competing ADP measure was just revised lower from November through January. Previously the ADP report has shown strength in the labor market. The prior results from ADP were at the time massive beats at the time, and have now become misses. Should the employment trends continue to weaken it won't bode well for earnings, but it could halt the tapering of QE. Another concern was the creation of just 1,000 manufacturing jobs according to ADP. The economy needs many more good-paying jobs than that. Current expectations are for a gain of roughly 150k gain in jobs in February from the Employment Report. We'll know tomorrow if the weakness in employment has become a trend.

On the positive side corporate earnings appear to have bounced. Aggregate earnings for S&P 500 companies increased by 10.6% year-over-year in Q4, the highest growth rate since 2012. Revenue gains were more subdued, but the improvement in results above the 8% gain of the prior quarter was welcome. Should economic growth shift into a higher gear this year, the fundamentals for a continuation of the equity bull market are still in place. Valuations are now elevated, so higher returns may be not be coming without continued earnings improvement.

Market Outlook and Investment Strategy
Global equities have reversed their losses from earlier this year with U.S. stocks moving to fresh highs. With the January decline and concerns over Ukraine, sentiment has come in from an over-enthusiastic levels at the beginning of the year. A survey of Fund Managers from Bank of America *Merrill Lynch* showed that only 45% of asset managers were overweight equities in February, down from 55% in January. Average cash balances stood at 5% of portfolios, the highest level since July 2012. The level of portfolio retrenchment by managers in January sets the market up for more gains over the next few weeks.

Managed portfolios remain invested with further upside expected in US equities and the riskier credit issues. We'd only look to add to holdings now on pullbacks that hold above the 1850 level on the S&P 500. The market looks like it will move higher for the first quarter, but we still have some concerns for 2014. One is the fact that the stock market has not experienced a significant correction (>10%) since fall 2011. For now the Fed seems to have things under control as they taper from elevated levels of QE. As long as the Fed keeps short term rates very low and we don't see a spike in long-term rates (dictated by the market) the bull will continue. A rapid rise in rates would be a negative for the economy, and pressure P/E ratios and stock market valuations.

The bulls hold sway with the S&P 500 over 1850.



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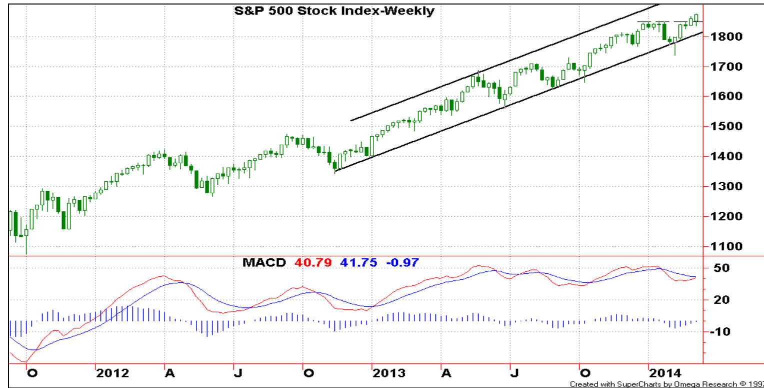
What We are Seeing in the Charts—The S&P 500 : Key Levels and Sectors to Watch

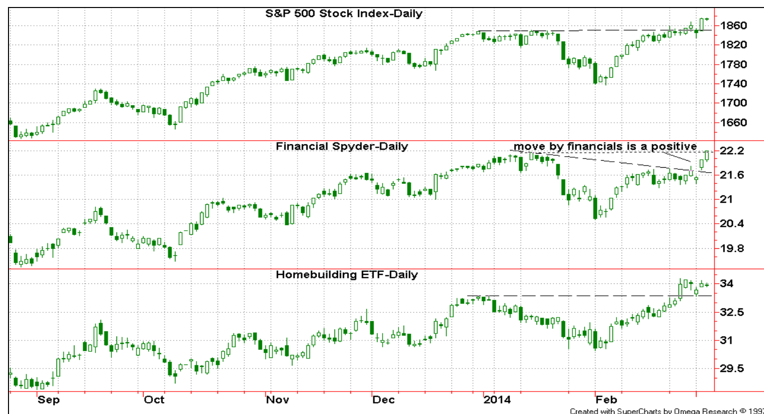
Near-Term S&P 500 (Top)
The move 1850 reasserted itself this week as the disruption over Ukraine was brief. A Friday close above 1850 would lock this level in as key support in our mind. Our view remains unchanged : if the S&P holds above 1850 (it has so far) we could see a move to the 1900's pretty quickly (we are nearing 1880 already).

Unless the S&P falls below 1830, the bulls have regained control.



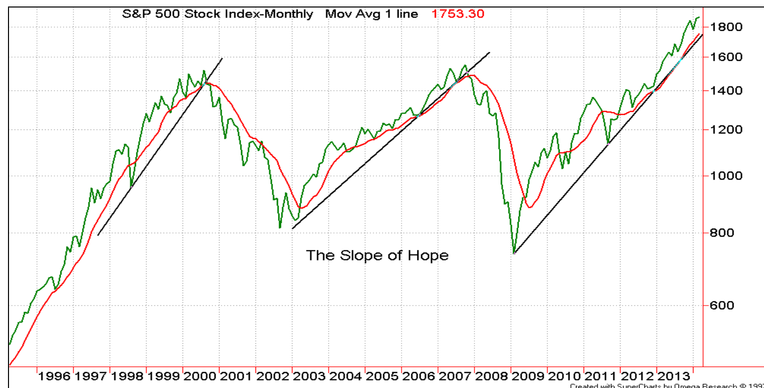
Key Sectors to Watch (Middle)
The S&P 500 has surpassed 1850 (top panel) and is at new highs. In the last Update we noted the lagging action in the Financial Sector (middle panel) which hadn't made a new high. That divergence has been cleared with the Financial ETF moving up sharply this week—a bullish sign. Homebuilders ETF (bottom panel), have taken a breather but still hold above the breakout level—also a positive.

Financials and Homebuilders are key sectors to watch for signs of both economic and market health.



Key Level for the Bull Mark (Bottom)
Since the mid-1990's there have been 3 bull markets punctuated with 2 severe bear markets. A key warning that something more than a 'normal correction' was unfolding came when the S&P finally broke a multi-year trend-line (3 solid lines) as well as falling below its 10-month average (in red). This happened early in 2000 and 2008 warning of a looming decline.

A drop below 1750 would be a major warning.



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