Hamilton-Bates

Market Update

March 17, 2014

March 17, 461AD - Saint Patrick, Christian missionary, bishop and apostle of Ireland, dies at Saul, Downpatrick, Ireland. Made the patron saint of Ireland, he is said to have baptized hundreds of people on a single day, and to have used a three-leaf clover--the famous shamrock--to describe the Holy Trinity.

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There was an escalation in the threats and war of words with Russia. The passage of the Crimean referendum, accepted by Moscow and blasted as illegal by the West seems to be setting-up a showdown in coming weeks. Crimea will formally apply to join Russia this week. Sanctions were announced today but they were perceived as weak, perhaps there is little fight in the other western powers who cater to oligarch money. Soft sanctions were taken as a positive for stocks, and shorts covered. More serious sanctions aren't likely until after March 24, because Congress is on Spring Break—really.

Worries about Russia and China dominated the markets last week causing sellers to come off the sidelines, sending markets around the world lower. China and Russia plunged the most, down 5.5%. The US averages ended down a more moderate 2%. Interestingly on Friday the small-caps and more US centric mid-cap indexes were actually higher for the session. We could be seeing a rotation into domestic centric sectors and indexes.

Earnings, Economics, and A Jobs Report

With earnings season essentially over there is little in the way of positive catalysts for equities. Earnings data for the last quarter was slightly better than expected but economic data has weakened recently to counter the earnings news. Now we have entered into the period before the next earnings season so we will have a lack of visibility for a few weeks as far as earnings go. We need to see forecasts increase also because with P/E ratios still near multiyear highs equities can't continue to rely on multiple expansion for price appreciation. In 2013 the S&P 1500 gained 29%. The P/E ratio expanded 21%. Earnings only increased 8%. Without aggregate earnings growth it will be tough sledding for equities to appreciate substantially even with low interest rates.

Market Outlook and Investment Strategy

The S&P is actually flat on the year so far, but this is pretty impressive considering the dismal news flow. We have seen weakening domestic economic data (partly weather-related), an emerging market currency meltdown, uncertainty in China's economic prospects and in its shadow banking system; and the Russian invasion and sponsorship of the Crimea succession. One thing of note though is that the US markets rise has been pretty much a solo run, as the other global indexes did not participate. Europe has been weak, and the Chinese and Japanese markets have dropped sharply. The bright spot remains small and mid-cap stocks in the US, which have so far shrugged off most weakness.

Adding to the confusion is the fact that the DJIA did not make a new high in March along with the S&P 500, a bearish non-confirmation and a potential negative according to Dow Theory since the Transports made a new high. Periods when the DJIA goes one way and the S&P and NASDAQ go another can happen and persist, but eventually it usually is the blue-chip DJIA that is correct. We could be on a cusp of a period where small and mid-caps fair better than blue-chip stocks due to global political concerns.

The bulls and bears are battling for control. As long as the S&P 500 holds 1840 the bulls are in charge.

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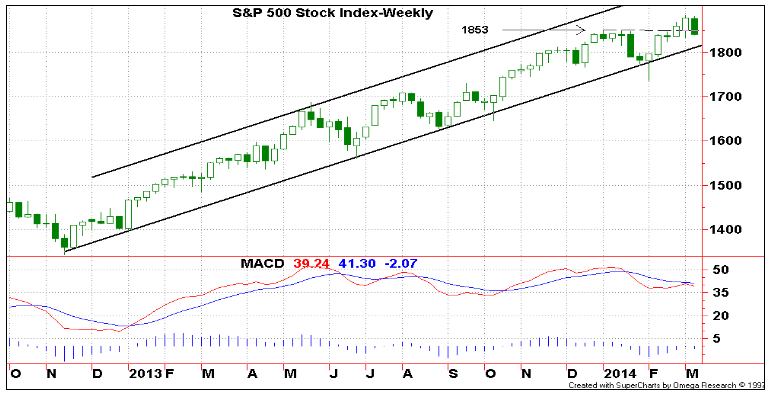
What We are Seeing in the Charts—The S&P 500 : Key Levels and Sectors to Watch

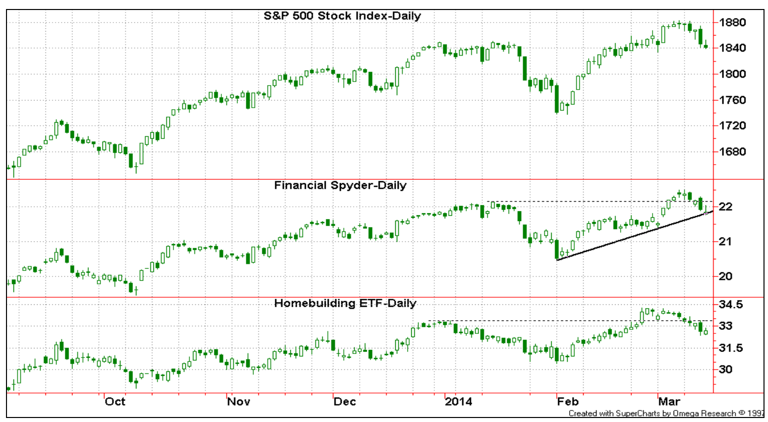
Near-Term S&P 500 (Top)
The S&P continues to flip-flop around 1850 as the bulls and bears battle over this key level (marked with dashed line). Our view remains unchanged : if the S&P holds above 1830 (expanding this range a bit down to account for day to day volatility) the bulls still have control.

Unless the S&P falls below 1840, which is the bottom trend line in the bullish channel drawn on the chart, the bulls have control.



Key Sectors to Watch (Middle)
The S&P 500 has surpassed and then lost the 1850 level (top panel). Key market sectors had also moved to confirm the S&P but they too have lost their best levels. The financial sector ETF (middle panel) held minor trend line support, but the homebuilders have fallen back sharply over weak housing data. Both are on the cusp of giving negative signals.

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.

<u>A drop below 1750 would be a major warning</u>.