Hamilton-Bates

Market Update

September 2, 2014

September 2, 1969 - America's first automatic teller machine (ATM) makes its public debut, dispensing cash to customers at Chemical Bank in Rockville Center, New York.

P.O. BOX 270 Newtown Square, PA 19073 877.768.4247 www.hbir.com

Stocks continued their positive momentum during the pre-holiday week as an assortment of good economic news kept sellers on the sidelines and allowed many major indexes to end the month at record new highs. The S&P 500 even managed to hit the milestone of 2,000. Given the records, you'd think there'd be some volume, suggesting some serious buying to back it up. But on the day when the S&P hit 2000, it was on the lightest non-holiday volume day since 2006!

Despite the low volume, the market hasn't been able to see any selling pressure—as sellers often can push prices around in a low-volume environment. But the market hasn't seen correction of 10% in almost three years though these corrections occur about every 12 months in normal times. With zero interest rates funding any and all carry trades, dips are getting smaller and shorter as traders are motivated by the only remaining fear, the fear of missing a rally.

Earnings Economy, and Interest Rates

The stock market continues to hit new highs but the underlying economy hasn't really been that robust. The data have been 'OK', but have been made out to be more than the mediocre reality by Wall St. economists. The stock market has become the one and only economic thermometer. But beyond the hype, the US economy, as measured by real final sales, breadwinner jobs, and real GDP, continues to grow at about 2%, despite predictions year after year of escape velocity (3-4%+) being just around the corner.

Earnings Per Share, as measured by GAAP, is in fact growing at a slightly slower than 2% rate. Real wages are stagnating for all but the top .01%. The problems aren't isolated to the US, as much of the world appears to be slowing. Just this past week key data for Germany and Japan show those economies much weaker than anticipated.

The outlook for the rest of the year and early 2015 doesn't seem to be on the verge of take-off either. Construction and sales of new homes, a big contributor to GDP, are slowing as prices have moved out of reach for first-time homebuyers and Wall St hedge-funds turn from home buyers to sellers. Automakers continue to see good volume, but have had to resort to heavy discounting and zero percent financing to bring down their inventories and move cars. As for hiring; the one area where the US had some momentum was in big tech, but this group is laying off tens of thousands of people led by Intel.

We are now through second quarter earnings season, so that catalyst is gone. Results were once again decent but not spectacular, and the all-important forward guidance was muddied by events in Europe. As for Europe (and the Middle East), geopolitical events continue to concern investors, but decent U.S. economic news and easy Central Bank policy has trumped those concerns. Worries about the Fed and the taper are due to come back in the spotlight as QE wraps up in October, but bull markets have historically continued for quite a while after the beginning of a rate tightening cycle, and we have not even seen the first rate increase.

Market Outlook

Seasonally September is the weakest month of the year—despite October's reputation for declines and panics. But seasonal trends can't trump a bull market, and this bull remains intact. But should weakness finally start to develop we can then consider the negative seasonal trends into October especially when we consider historical trends following a strong August. Looking back to August for a moment—it was certainly a good month. Even though the month started out with a decline, a big recovery saw the S&P 500 gain 3.76% on the month. But these gains don't necessarily mean more to come. According to Jason Goepfert with SentimenTrader, if the S&P 500 closed August with a gain of 3% or more, then it added to its gains in September only 36% of the time. If it also closed at a 12-month high in August, then September was positive only 1 out of 12 times, averaging -2.6% (based on data since 1928). So even with a market at record highs, we should keep a wary eye on the market even as it continues its upward arc.

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Investment Strategy

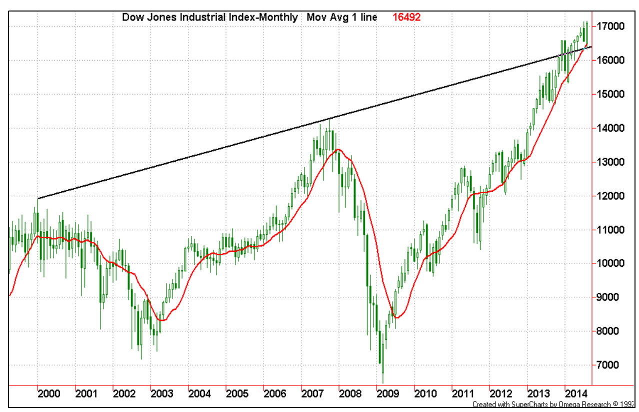
Stock market price action remains strong. The trend is up and the bull market could have many more months to go. Market breadth in terms of the advance-decline line confirmed the latest highs suggesting the market has room to go. <u>This doesn't mean there can't be a pullback within the larger up trend, especially given the aforementioned negatives in the form of seasonal and historic trends</u>.

Unless and until the market sees downside pressure the near-term trend is up, and the long-term trend has been since 2011. The recent rebound and breakouts on the major averages suggest upside of at least a few percent and possible much more if the market enters a 'blow-off' phase. Given the strength in the biotech sector and the breakout of the NASDAQ to levels not seen since 1999, it is possible we get a 10% move in the NASDAQ led by biotech that carries the blue-chip averages higher as well. The fact that this bull market has had a tendency to surprise on the up-side further means the bull case holds sway until proven otherwise. So far any and all periods where it seems the market is finally rolling over to the long-anticipated correction is met with enough buying to reverse course. Since 2012 any defensive selling has been thoroughly punished. Eventually that won't be the case should enough 'negatives' pile up. But for now this is a momentum market with the arrow pointed up.

As we enter the third quarter we remain invested with the latest correction attempt reversed. We will evaluate how the 'end of QE' will affect the prospects of the year-end rally, the next hurdle for stocks. A September/October correction would increase confidence in a strong 2014 finish and be considered a buying opportunity.

Charts—Short-Term and Long-Term Trends Intact

The S&P has broken out above the prior high around 1985 (top dashed line above left), suggesting a move into the 2000's. Only a move back below 1985, and then 1950, would turn the short-term negative.



The long-term DJIA chart (above right) shows the index surging to a new high well-above the 2007 peak. A drop below the upwardly sloping trend-line coupled with a break of the 10-month average (in red) would be a potential warning for investors.