Hamilton-Bates

Market Update

September 2, 2014

September 22, 1862 - President Lincoln issues the *Emancipation Proclamation* declaring all slaves 'free'.

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

Stocks have traded in mixed up/down action in recent weeks as investors worked their way through the latest disappointing Employment Report, an FOMC meeting, quarterly options expiration, and the much hyped Alibaba IPO. This mixed market action was evident last week as the blue-chips rallied while small caps struggled. The DJIA and S&P 500 showed gains of over 1%, while the Russell 2000 lost better than 1%. Not only hasn't the Russell 2000 made a 2014 high along with the other averages, it is actually negative for the year. Its an odd reflection of the real economy where the richest Americans are doing well while the great majority struggle. In the financial markets we are seeing the 'blue blood blue-chips' rise while the 'small-cap masses' fall.

Saving the Banks Didn't Help the Middle-Class

In response to the banking crisis in 2008 the Federal Reserve and Washington policymakers took deliberate monetary and fiscal action targeted to helping the biggest banks and corporations along with Wall St., with the hope that they in turn would quickly breathe life into the market, the economy, and small businesses. Thus benefiting all Americans. It was simply another take on 'trickle down' economics where helping the wealthy (individuals and corporations) at the top helps everyone since this money then trickles down through the economy. the This viewpoint can be seen in comments from Chairman Bernanke in a November 2010 Washington Post op-ed:

"*Easier financial conditions will promote economic growth. For example, lower mortgage rates will make housing more affordable and allow more homeowners to refinance. Lower corporate bond rates will encourage investment. And higher stock prices will boost consumer wealth and help increase confidence, which can also spur spending. Increased spending will lead to higher incomes and profits that, in a virtuous circle, will further support economic expansion.*"

Unfortunately that isn't how things worked out. While lower mortgage rates have helped the housing market, far fewer homeowners have refinanced high interest rate loans since many of those who would benefit lost their homes during the prior collapse. Rentership is growing as home ownership falls. First-time buyers don't have the down payment or qualify to benefit from these low mortgage rates. Household real estate assets (based on the Federal Reserve's own data) show real estate wealth is still $2.0 trillion below the pre-crisis peak. The largest beneficiaries of the real estate rebound have been Wall St. private equity funds; which bought hundreds of thousands of foreclosed homes in 2008 and 2009 using cheap money, and then sold them in packaged securities to yield starved investors in 2013-2014.

Meanwhile, lower corporate bond rates have done little to spur capital investment. Instead of investing in their business or heaven forbid hire more workers, corporations have used low cost debt to buy back stock and increase shareholder dividends. All the while continuing to squeeze workers in an effort to maximize efficiency.

Higher stock prices have certainly made headlines and captured attention, but these gains have almost exclusively boosted the wealth of just a select few. Again from the Federal Reserve's own data— only the top 3% of all Americans have seen an increase in their wealth since 2010. Everyone else has held steady or declined. Also, at the end of 2013, the top 3% held a record 54% of all wealth, while the bottom 90% held just 25%. The wealth of the bottom 90% is just 25% of total wealth. That is a good deal of wealth concentration. Those figures seem more appropriate to medieval Europe where a large proportion of the population were serfs rather than a modern 'land of opportunity'. More than just populist blather, these figures matter. A healthy economy largely benefits the majority– something seen during the industrial revolution in the late 1800's and during the 30 years after WWII. Since the mid-1980s, and especially since 2000, we have seen the financialization of the economy which has boosted GDP—but really hasn't benefited a large swath of society.

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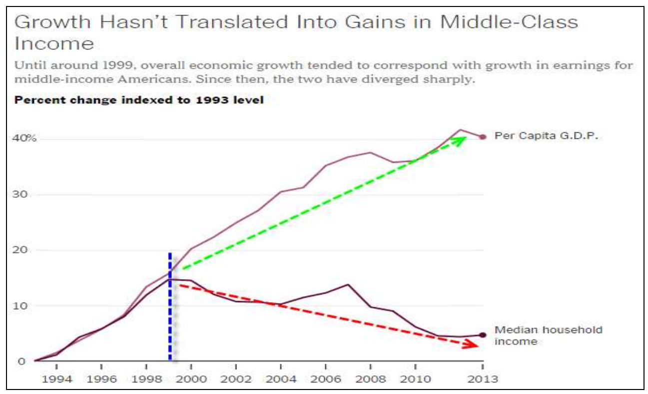
One area this disparity can be seen is in the population's confidence in the Economy, which has remained flat since 2010 despite a booming stock market. Gallup Economic Confidence was recently a negative (-17) versus a negative (-19) in November 2010. The average income for the wealthiest 10% of US families rose 10% in 2013 from 2010, while families in the bottom 40% saw their average inflation-adjusted income decline over the same period.

Outside of the wealthiest Americans, increased monetary intervention has not led to higher incomes for average Americans. And for corporations, sales growth has barely kept pace with inflation over the past four years. Growth in corporate profits has come not from top line sales growth, but through expense reductions and a boost from share buybacks.

The chart that follows on this page is from the NY Times and shows the clear divergence between headline economic growth and income growth for average Americans. The chart shows that all growth is not equal. Up until the late 1990's economic growth correlated to median household income. Since then we have seen GDP rise but median household income has fallen (adjusted for the inflation the Fed says does not exist). This chart along with others we have shown illustrate why more than 5 years into a recovery the economy still doesn't feel right. Because it isn't.

Since 2008 the S&P 500 has more than doubled as the Fed took steps to save the banks and boost Wall St. in the hope it would trickle down to Main St. It has not.

The banks, Wall St. firms, and the wealthiest citizens have experienced a period of exceptional reward. For this group it has most definitely been the virtuous cycle envisioned by Chairman Bernanke in his 2010 op-ed. For the rest of America, though, the past four years have been a slow-turning cycle in which wage growth has not kept up with rising food, energy and healthcare costs. Looking at the chart of median income we have had a recovery without any recovery in median income. The choice by the Federal Reserve prior to 2008 and especially since to boost Wall St at all costs has benefited the few without helping the many. Its no wonder that confidence data remains weak. If Americans feel disappointed in the economy its because they have a reason to be.



Market Outlook & Investment Strategy
The major averages continue to hover near their highs supported by low interest rates and buybacks thanks to favorable credit markets. But we are seeing some fraying around the market's edges. Breadth has recently weakened and weakness in the small-caps is a concern. Normally small-caps lead a healthy market higher. High Yield bonds have also stumbled lately, and have not confirmed the most recent highs in the stock averages. Weakness in High Yield credit could be a precursor to weakness in stocks just ahead. We could definitely see a pullback or correction early in Q4, but this weakness would likely be short-lived and lead to a buying opportunity. Overall price action remains strong and market breadth confirmed the highs as recently as late August. This suggests that topping action could take weeks if not months to unfold.

The trend is still up and the bull market could have many more months to go, short-term corrections aside. The fact that this bull market has had a tendency to surprise on the up-side means the bull case holds sway until proven otherwise. **The suggest to be wary but be invested**.

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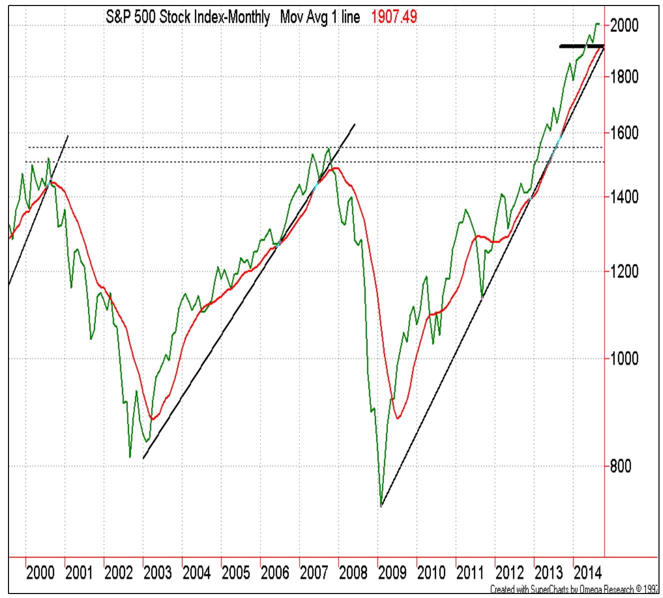
Charts—Short-Term and Long-Term Trends Intact



S&P 500 (Top Left)

The market hasn't really done much since our last Update a few weeks ago. New highs have been more grudging than euphoric and follow through has been tepid with weak volume. The market has really made little headway since late June with volatility seeing an increase.

If the S&P 500 index can eat through supply and advance through 2010 we could see a run higher begin sooner rather than later. A drop below the recent lows around 1970-1980 would suggest the market has more work to do in the corrective phase.

Nearby support comes in at 1970-1980. A drop below 1900 would suggest risk in the longer-term trend.

Long-Term S&P 500 Chart (Top Right)

The bull trend up from the 2009 lows remains intact despite a brief scare as the market threatened to break the key trend-lines in August. That was not to be as the market quickly recovered and the technical damage was undone.

Unless and until the rising trend-line from the 2009 low and 10-month average are broken, the up-trend remains intact. The first sign of trouble for investors would be a break of the 1900 level on the S&P 500, which would mean the S&P has broken both important agents of support.