May 12, 1957—Race car driver A.J. Foyt scores his first professional victory, in a U.S. Automobile Club midget car race in Kansas City, Mo. With a win at the Daytona 500 in 1972, Foyt became the first driver to win all three major races in motor sports: the Indy 500, the Daytona 500 and the 24 Hours of LeMans.

Hamilton-Bates

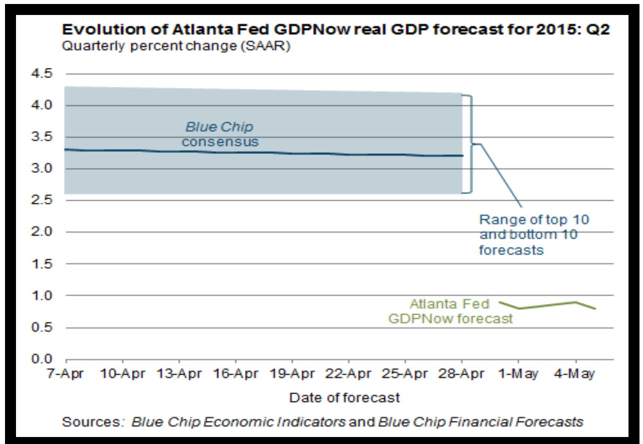
Market Update

May 12, 2015

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

Indexes continue to bounce within a tight range, and the latest short-term swing has seen stocks on the retreat again, with the **S&P 500** pulling back from its 2120-2230 peak. The other major averages pulled back as well, and on the whole the volatile range continues.

Much of the blame for the latest pullback lies with the bond market, as the yield on the US 10-year note closed at its highest level of the year. Yields have been rising since mid-April, but with the trend lasting a few weeks now other asset markets are paying attention. The German Bund yield is also rising, meaning that interest rates are bumping up around the world and that in turn is weakening the U.S. and many International equity markets. When stock markets decline, money tends to run to the safe haven of bonds, but when the bond markets decline it tends to hurt stocks as well. Greece once again looks to be the part of the problem, as it once again runs out of cash. Talk of default and Grexit have come back again making some investors nervous.



The chart above shows a live GDP Model put out by the Atlanta Fed, using economic data to generate a current GDP projection. The model forecast is in green, while the Blue-Chip consensus of Wall St forecasts is in blue. The model projects 2Q GDP at less than 1%, well below the consensus range of 2.5%-4.5%. The model has been accurate and continues to show a very sluggish economy.

Economy, Earnings, & Interest Rates

Last week we got the 1st revision of Q1 GDP, which came in much weaker than expected at 0.2%, well below consensus and in line with our thinking that the 'real economy' was not doing nearly was well as Wall St. We also got the April Jobs report, which saw the unemployment rate drop to 5.4%, and 223K in jobs created. But these numbers really don't convey much strength since the March number was revised lower to 85,000, the smallest since June 2012.

In addition to the Labor Market Report, we got a bleak report from private labor analysis firm Challenger, Gray & Christmas, which showed a surge in lay-offs. Firings jumped a hefty 52.8% year-over-year in April to the highest level in three years. Some of this was the energy sector, which saw 20K of job losses, but their were still 40K workers let go from companies in other industries.

Earnings season is coming to an end. Wall Street spin says "70% of companies beat estimates", the problem is those estimates have been revised sharply lower. Using estimates made in January, only 40% beat their numbers, and even fewer beat their revenue estimates. Earnings growth remains sluggish if not outright challenged, and unless the economy picks up some steam that isn't reflected yet in the GDP model above, it is possible we see a decline in earnings in 2015.

So far stock prices have not adjusted to this change in earnings from previous estimates. Eventually poor earnings do matter and an adjustment (correction) is made. Given their recent comments about the markets the Fed would likely welcome such a correction as long as it doesn't go too deep. The four major central banks (U.S., ECB, Japan and China) will do everything they can to keep equity markets going up as they have hitched their wagons to the 'wealth effect' of rising asset markets; and helps perpetuate the illusion that growth is right around the corner. Temporary corrections keep the speculation in check so they are ok. But managing the capital markets can't last forever, and somewhere there will be a kickback from the free-market which is bigger than the Central Banks can handle or jawbone.

The big-picture remains a battle between inflation brought about by the asset bubbles from the Central Banks, vs deflation caused by the massive amount of private debt from the early 2000's along with the massive public debt taken on since the 2008-2009 Great Recession. All in the hope of stimulating the economy. This battle is between market pressures vs. central bank actions. No one can know when it will end. It could be years from now. It could be this year. However, in the end its likely that the banks will lose. You can't solve a debt problem with more debt, and QE doesn't do anything for the real economy—it does however create asset bubbles.

The consensus is that this year's economic weakness is transitory and will be followed by stronger growth in the second half of the year. We think that is doubtful. We also don't expect the Fed to meaningfully raise rates. Wage growth is below 2%, and capital expenditures have now fallen at a 2.5% annualized rate. That is the sharpest drop since 2009. Rate hikes would crush the economy.

One part of the economy that does look healthy is real estate. Lack of building over multiple years has brought down supply for most home categories. There is also heavy demand at the high-end in strong markets like New York, Miami, and San Francisco. These areas benefit from foreign investors seeking to place large amounts of money away from their local governments. Luxury is hot. Vacation homes are hot again. Signs that at the high end discretionary income is growing nicely.

Another positive fundamental for the bulls remains buybacks. According to Bloomberg there were $141 billion in buyback authorizations in April. That is the biggest monthly authorization ever. These are only authorizations, that doesn't mean it will be committed. But it is buying power that would likely get used on any market setback, and thus a cushion if there is a correction.

Its clear that the agenda of the major central banks of the EU, US, Japan, and China is to keep the bull market in stocks going. They have the power to do that. They set interest rates and create the credit. They also intervene in the markets directly. This is a major reason why the bull market has lasted and can last longer than most expect—even as the fundamentals deteriorate as they have.

Market and Investment Outlook

This week's dip was tough to see coming. We did cut back on long positions in Tactical Accounts last week and other accounts a bit this week. But those were expected to be short-term shifts. The market has been whippy on both 'up' and 'down' moves. There has been a good deal of misdirection this year, and the trend does feel a bit tired in the sixth year of a major bull move. In the past few months, the market has regularly gone from feeling like we are about to correct 7-10% right back to feeling like we are about to break out to new highs. So far neither has happened.

Our investment stance remains unchanged. Fundamental concerns grow but structurally the bull trend remains intact. The concerns over the rise in bond yields has stalled the advance this week, but we believe only temporarily. As of yet there hasn't been a break of key technical levels, nor have we seen a decline in the number of stocks making new highs or a rise in the number of stocks making new lows. The financial sector has also been strong, and it would be rare for the market to decline with this sector doing well.

We expect the market to push higher into the summer months, with the potential for a peak in July or August. We are watching SPX has support at 2070-2080, then 2040-2050. We don't want to see a break of that lower level which would be a blow for the bull case. A move above 2125 that holds could finally be the trigger for a rally toward 2200.

Hamilton-Bates
Market Update *May 12, 2015*

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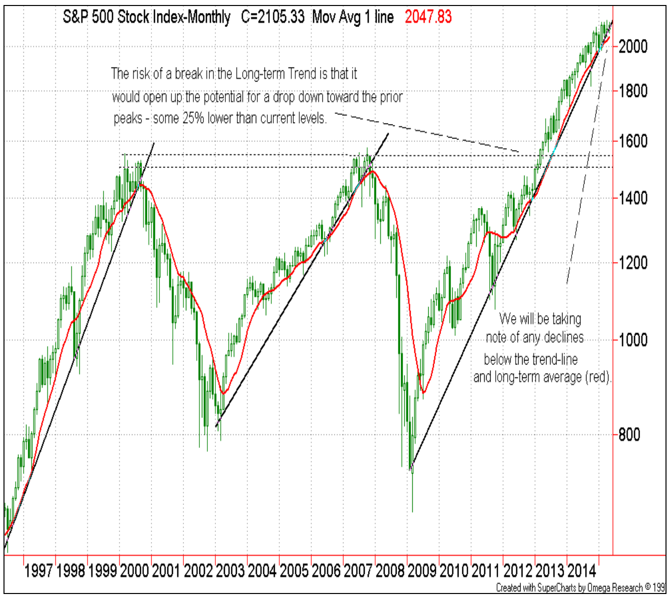
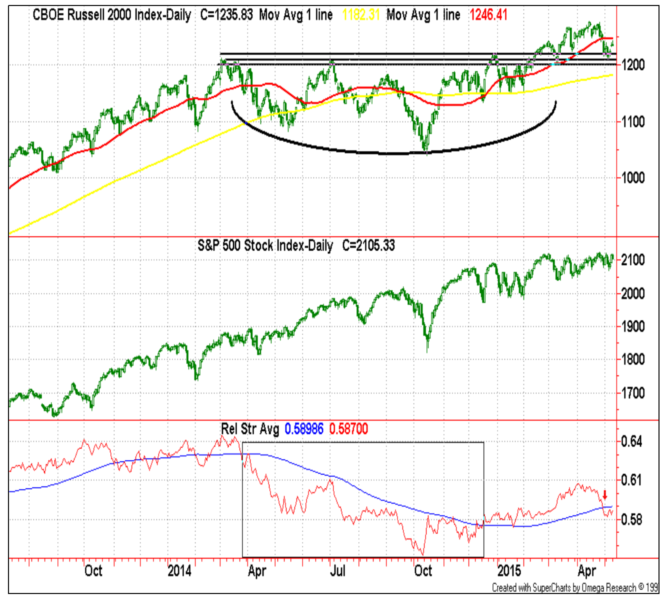
Charts—Long-Term Trend Intact; Small-Caps Still Talking but the Message is Changing





S&P 500 Long-Term (Above Left)
The bull market remains intact but the market is continuing to ride a very fine line. The long-term trend is very over-extended, moving just above key levels, and a relatively small decline could be enough to disrupt the bull trend back to 2009.

For now, as long as the S&P remains above its long-term trend-line and 10-month moving average (now in the area of 2040-2050), the long-term trend remains bullish.

Small-Caps Leading the Way (Above Right)
After a poor 2014 which saw the Russell 2000 remain flat, small caps had been leading on the upside. That early year strength has largely dissipated over the past few weeks and the Russell 2000 has broken its relative strength trend (bottom panel of chart above). The drop has to be respected as a similar drop in March of 2014 (boxed area of bottom panel) led to last year's under-performance. We rotated out of any small-caps over a week ago and remain focused on blue-chips. <u>The developing weakness in small-caps is a bearish sign for the broad market as well, as it suggest less willingness to take risk, as well as it is a potential reflection of a slowing U.S. economy</u>.

The Russell 2000 remains above the breakout level around 1200, but the loss of relative strength is a major negative.