Hamilton-Bates

Market Update

May 28, 2015

On May 28, 1957 -National League owners vote unanimously to allow the New York Giants and Brooklyn Dodgers to move to the West Coast. In 1957 the Dodgers were in the midst of quite a run; they had won five pennants and a Title in eight years. The team was profitable too, but their owner didn't like sharing the radio and television pie with the Giants and the Yankees. So off they went, leaving NY fans heartbroken.

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Market Slips on Greece, Gets Back Up

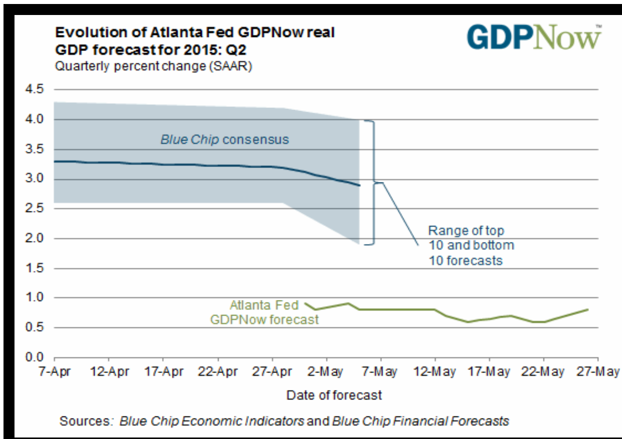
The U.S. market got off to a rough start to the Holiday-shortened week as the market was hit over concerns over a Federal Reserve rate hike along with increased chatter that Greece was close to running out of cash (again). There has been a subsequent rebound on M&A activity in the semiconductor sector, along with an alleged resolution to the ongoing Greek/euro zone debt saga.

We say 'alleged' since reports that Greece had secured funds from euro zone members or were close, were quickly refuted, yet despite the denials Wall Street and the Greek market ignored them as investors pushed stock prices higher anyway. June 5th is the next date where a default could come –or the can could be kicked down the road again. Greece seems like a problem that just won't go away, and we have some concern that the can has been kicked so long that there is some complacency. A Greek default or dual currency solution could give the financial markets a jolt.

Economy, Earnings, & Interest Rates

The economic data this week in the form of durable goods and existing home sales came in better than expected. It didn't do much to move the needle in terms of overall growth, but it was an improvement. It will take time for the string of poor reports we have seen to be squeezed out of the data. There was some talk about a potential seasonal bias to US data which has led to consecutive weak Q1 GDP reports beyond what could be excused by the weather. So we could see some data 're-revised' higher. We are not sure we trust any data that is revised again and again as if to goal-seek.

The Federal Reserve seemed to equivocate a bit with its April FMOC minutes. The data seem to suggest a soft economy, but if the data is revised higher it could be the opening the Fed needs to hike rates sometime this year. There have also been a number of statements from FMOC after the minutes that indicates the Fed is pretty eager to get a hike done. They are likely tired of



The latest GDPNow projection for GDP growth in Q2 by the Atlanta fed comes in at 0.8%, getting just a 0.1% bump from this week's 'good data'; and well below the 3% average expectation from Wall St. For us, the risk to the economy lies in a slow-down rather than inflation.

hearing about ZIRP. The only uncertainty of the move is that if the economy worsens even further, would they hold off and wait until next year.

The weakness in the bond market could have come from the realization that the Fed is determined to hike rates this year– and a data revision (even if on dubious ground) could give them the cover to do it. Many analysts think this would be bearish for investment grade and government bonds—but that many not be a certainty. If the Fed hikes rates bond prices could rise sharply in expectations that the hike would weaken the economy. So it could be a case of the yields rising into the hike, only to fall thereafter. In any case, given the data we've seen, a hike in June would be a major surprise. Given that the current Committee has no appetite for surprises, monetary policy is likely on hold until next quarter.

Companies are Buying Back Stock But Insiders Are Not

For some time now the only big buyers of stocks have been companies buying back their own shares with

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shareholder money. This year, 2015, buybacks will hit a new record at more than $1 TRILLION. According to Bloomberg, companies in the S&P 500 in 2014 used 95% of their profits on stock buybacks and dividends. Companies are buying back stock rather than hire employees and build plants. Capital investments are taking a backseat to financial engineering and stock price manipulation.

Another interesting item, especially given the above data is that Insider buying has nearly stopped. The current sell/buy ratio of corporate executives is 20 to 1, meaning twenty sales for every purchase. The norm is about 10 to 1, and at market low points you see 2 to 1 or even 3 to 1 ratios. In other words, company insiders won't put their money where they put their shareholders'.

Market and Investment Outlook

The S&P and major averages continue to struggle to hold onto any new high breakouts. This week's early drop and rebound left the market right back in its prior range. Such lethargic action is typical of an older bull that still has some legs left, and also one that has lost its upward momentum. It is too early to give up on the bull, but we'll be watching key trend levels closely. The tight trend will eventually be broken, and the next durable move will propel the next trend in the market whether higher or lower. A break below 2080 and especially 2040 on the S&P 500 could be signs that the uptrend is faltering and a correction is looming. Given the whipsaw action of 2015, it will take several closes above 2125 on the S&P 500, coupled with good breadth and volume, to convince us a breakout is for real.

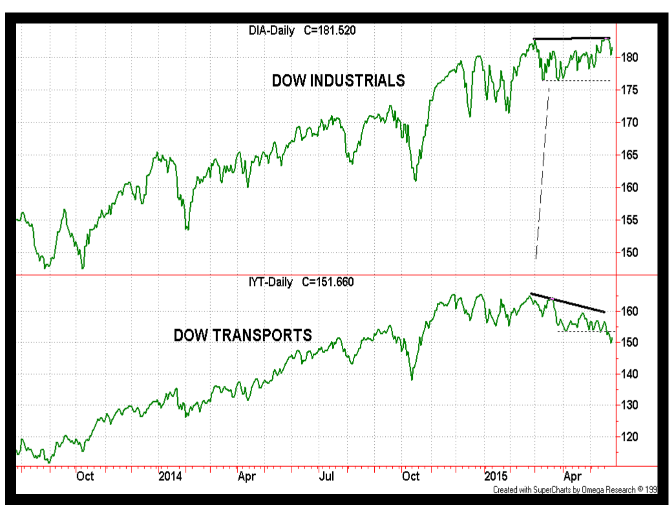
We remain invested with a focus on stocks over bonds and corporate bonds and high-yield over Treasuries. We also like preferred stocks for income purposes in this low-yield environment. We have been using preferred stocks for a few years now as part of our fixed income strategy. Bond yields have moderated of late, recovering some of the jump over a potential Fed hike. Fundamental concerns remain over slowing earnings and economy, but structurally the bull trend remains intact. We have seen some hesitation in market breadth, but it is now yet at the pronounced levels of prior market peaks. **We expect the market to push higher into the summer months, with the potential for a peak in July or August.** We don't want to see a break of 2080 and 2040 on the S&P 500, which would be a blow for the bull case. A move above 2125 that holds (for more than a day) could finally be the trigger for a rally toward 2200.

Dow Theory Update—Transports Lagging Industrials

The Dow Industrials and Dow Transports tend to move in unison. When they diverge it can be a sign of trouble brewing in the economy and the stock market. The Transports are indicative of the behavior of the economy since trucks and railroads are needed for transporting goods, and airlines for tourists and business travelers.

A yellow warning signal is being given by the Transports at this time (lower panel of chart at right). While the Dow Industrials (top panel of chart at right) have made new all-time highs, the Transports have not, and in fact have made a new six-month low.

According to Dow Theory, an outright sell signal would be given should the DJIA drop below 17600.



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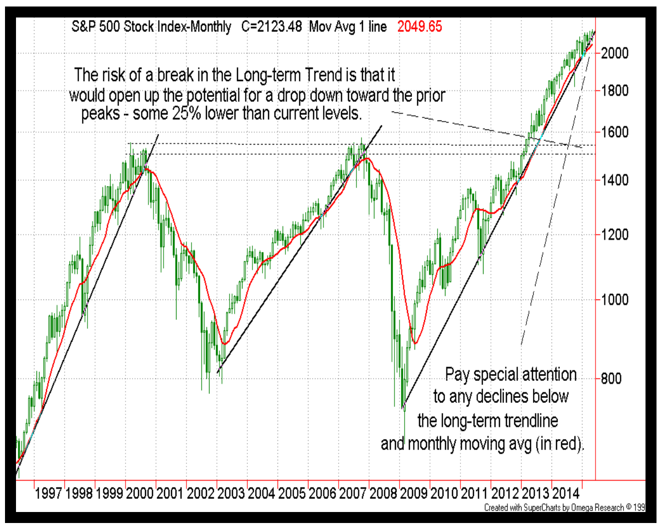
Charts—Short-Term Breakout or Fake-out; Long-Term Trend Still Holding

Near-Term S&P 500 Outlook (Above Right)
After finally 'breaking out' last week above the 2120 level that had rebuffed multiple attempts since February; the market promptly cracked back down into the range this week Even with the rebound many are wondering whether we'll see a breakout or breakdown in coming days.

The flat-top and rising bottoms pattern (bounded by the dotted lines) still has the overall look of a bullish pattern that should resolve itself higher. However, **a drop below 2080 would negate the breakout and turn the near-term outlook negative. A drop below 2040 would be quite bearish.**

S&P 500 Long-Term (Lower Right)
The bull market remains intact with the S&P riding the key trend-line and moving average higher. After six years the long-term trend is very over-extended, and the next serious break that occurs could see the S&P drop back to the 'breakout point', the prior highs of 2000 and 2007. That would be a 25% move.



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 bull market remains intact.