Hamilton-Bates
Market Update
August 21, 2015

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The subtitle of our regular Update this week was 'preparing for the Fall' which was a reference to the upcoming change of seasons along with the increase in volatility that often brings. We also noted that 'caution remains the watchword'.

Just two trading days later we are all quite aware of the volatility the market can bring, and after a very tough week many investors are trying to figure out 'What Happened?' and 'What's Next?'. We'll try to cover both in this brief 'Special' Update.

It Started With China's Devaluation
Over the past week we have seen currency troubles in other Asian markets in the wake of China's move to weaken the Yuan to solve its own economic slowing. First it was Malaysia, then Thailand, and now Vietnam have all had issues with their own currencies and markets dropping precipitously. Shades of 1998's Asian Contagion and concerns over earnings spooked US investors causing our market to fall.

The trigger was more bad news out of China: Chinese manufacturing conditions fell back to levels not seen since the height of the financial crisis in 2009, a clear sign that China's economy is slowing. The preliminary China purchasing managers' index (PMI) fell to a 77-month low of 47.1 in August, any reading below 50 represents a contraction. The data had an immediate effect on the Chinese markets—the Shanghai Composite Index dropped over 4% to its lowest level since July 8—erasing all the gains in the wake of massive governmental support.

This triggered concerns around the world over potentially deeper troubles in global markets, especially since China has become critical to the growth story for many sectors. Everyone wants to sell to China. The persistent weakness in their market, along with their government's failure to stem the tide, caused a wave of selling across all financial markets as investors revalued many companies growth prospects.

It was all Technical
Our market had been trading in a six-month range, managing to hold the range lows and bounce each time the market touched the bottom of the range or the 200-day average.

This week that changed, as concerns over the Chinese market's drop to the panic lows of early July, along with fears of currency problems around the Pacific Rim, caused selling that broke the trading range, triggering even more selling. The trading range can be clearly seen in the chart on the next page, and the break of the lower end saw the bottom fall out of stocks.

The Fed should probably not move on rates in September, if they do it could be trouble. If they come out and announce 'no hike' it would likely be supportive for stocks. We are not sure if that will happen next week or if they will wait until the 10% correction level as they did last October, when Bullard's comments triggered a massive rebound. What the Chinese government does over the weekend along with how the Chinese market trades will determine how our market opens on Monday.

Portfolio Strategy
With increased levels of cash and bonds, managed portfolios can better weather the volatility and take advantage of weakness to get better prices in days and weeks ahead. We look for a temporary low and bounce to develop next week (which could be very strong), with an ultimate low just a bit below current levels around the FMOC meeting next month.

Managed Portfolios
Balanced
MPT Aggressive 58% Equity, 22% Bonds, 20% MM
MPT Moderate 54% Equity, 28% Bonds, 18% MM
MPT Conservative 40% Equity, 42% Bond, 18% MM

Tactical 60% Equity, 40% Cash

Separate Accounts 60% Equity, 40% Cash

SPECIAL EDITION

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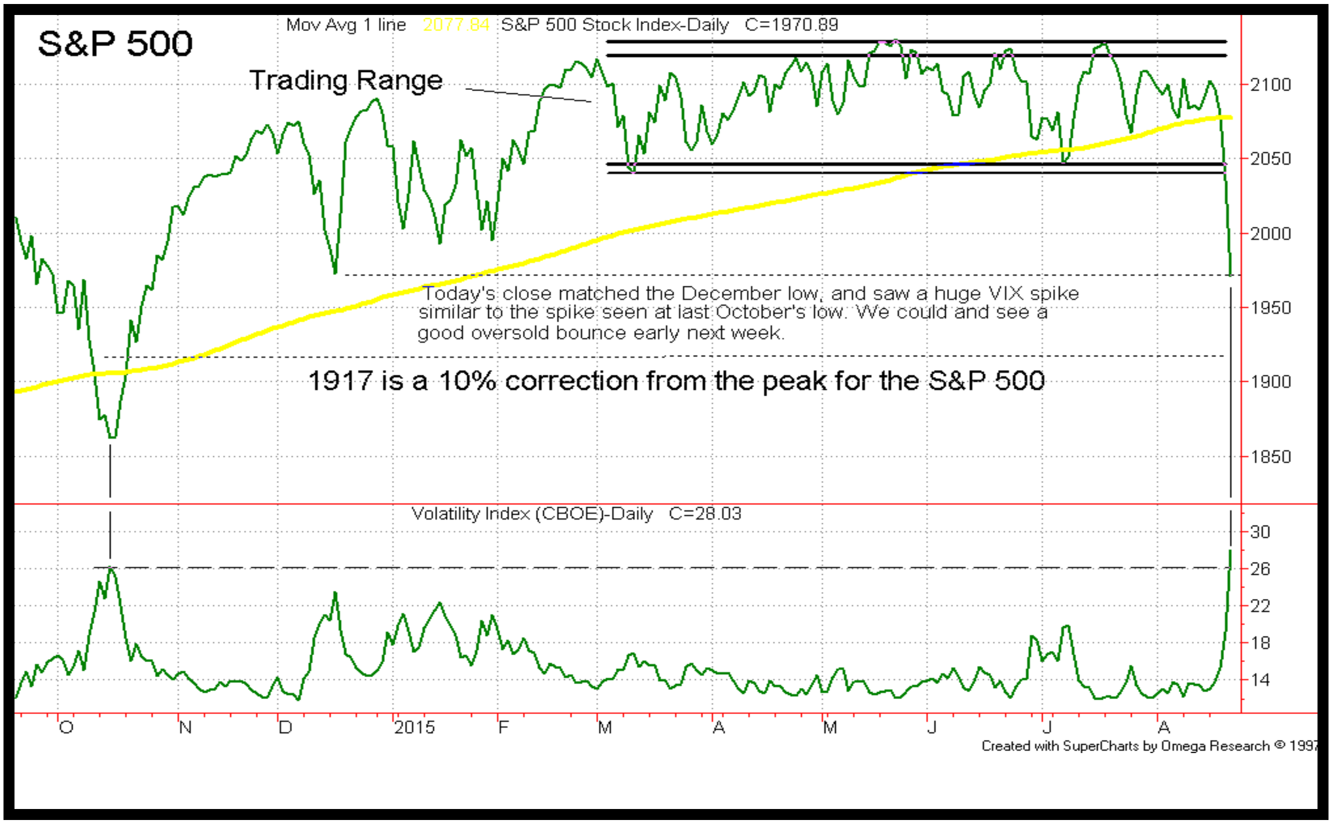

After six months within a tight range and no 5% corrections, the market was hit hard this week. The break of the trading range (shown by the bold black lines and noted above) suggests the odds of a 10% correction are pretty good.

This week's drop accelerated over just two days as sellers sold in volume as soon as the market broke the low of the range on Thursday. The market's 'fear gauge', the volatility index, spiked on Friday to levels seen at the October 2014 low (lower panel of chart above). Even if the low isn't in, at the very least the market is likely to see a pretty sharp bounce sometime next week.

If China announces major economic stimulus and market support over the weekend we could see stocks start off the week with a rally. If nothing is done or the effort is seen as weak, we could see a bit more of a drop on Monday before a sizable rebound tests resistance at S&P 2040 and 2080, which would suggest at the very least a rebound rally of 3-6% from current levels. We will likely be looking at buying weakness down toward 1900 next week.

Ultimately we believe a 10-12% correction is likely, with the first rebound that develops proving to be just a temporary bounce and likely to be better used to selling. A more durable low is not likely until September and after or coincident with the FMOC meeting.