Hamilton-Bates

Market Update

September 13, 2015

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Over the holiday shortened week the equity markets continued to exhibit a pronounced level of intraday volatility, which has been the norm since the initial sell-off into the August 24th low. The coiling but generally upward price action since that downdraft has been supported by the 'buy the dip bulls' and countered by some large hedge funds which have grown increasingly cautious. These counterbalancing forces have produced a series of higher lows and lower highs but do give us some points of support to now pay attention to.

China

China has been the epicenter of the current 'crisis', as its collapsing equity market has dampened investor sentiment worldwide and given rise to legitimate concerns over the strength of its economy, and in turn the strength of future corporate earnings. Economic slowing in China filters down to the earnings of many key companies and sectors, adding more concerns to a market that was already expensively priced and dealing with the withdrawal of QE.

Economy, Interest Rates, and Earnings

Even in the face of increasing concerns about the extent and spillover of China's slowdown, the good deal of US economic data continues to show slow (2-2.5%) growth. The labor market in particular is showing signs of continued improvement, but we wonder of the quality of the jobs being created. No offense to waiters and bartenders but a lot more of those jobs are being created while manufacturing jobs continue to shrink. We do see weakness in certain sectors, especially those tied to China for growth, but the overall US economy seems far from the risk of general recession. This is not the case for many global economies, as Brazil (7th), Japan (4th), and Canada (15th) are already there. These are significant trading partners and the weakness there will likely have an affect on earnings. On the positive side we see little signs of stress in the credit or money markets right now, which was a hallmark of the 2008 crisis.

The Fed

A lot of effort and energy has been spent in the financial media over whether the Fed will or wont raise rates this week. In reality it really doesn't matter all that much economically if they do or don't, its much more of an investor psychology issues. For us, it would be much better for the Fed to move once and then step back—getting it over with so to speak. If they don't move this week then the whole 'will they or won't they' moves to the next meeting in December and so on. From what we see, we expect them to move 25 basis points this week. For the Fed to not move it would mean they have real concerns over the economy and the market could end up taking it negatively even if the initial reflex move is higher.

Market and Investment Outlook

This has already proved to be a much more volatile and prolonged correction than last year's steep but brief October brief dip, and the other pullbacks that have been both quick and shallow.

It is our expectation that this will prove to be a much more significant decline than any correction we have seen since 2011. We are somewhere in the middle of what we suspect will become known as the "china pullback' in time, and the extent and duration is likely to not unfold completely for another several weeks.

There is still substantial cash in the US financial system which could be redeployed into equity and fixed income markets and we have seen 'bottom fishing' taking place in September. Should the flow of new funds be sufficient the current episode could be completed without further price damage, although the

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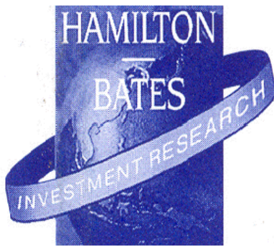

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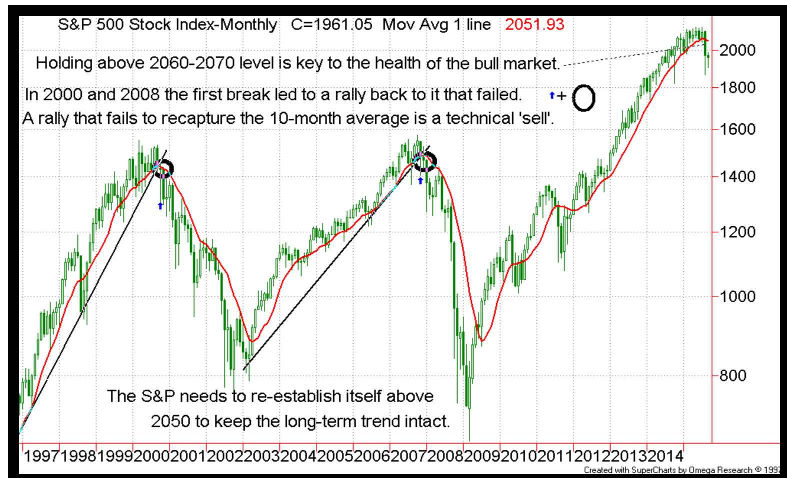
process of making the low the market moves out and up from is still likely to take some time.

Our overall sense is that the degree of risk present in financial markets is greater than consensus understands. Key long-term trend-lines and moving averages have been broken, and these breaks need to be respected. Our managed accounts have a good deal of assets positioned in cash and bonds at present, and this positioning will remain until the up-trends can be re-established, or at least it becomes clear the up-trends are likely to be established.

Market Charts

S&P 500 Near-Term (Top)
The market continues to consolidate higher after the last August sell-off. There is room and momentum for a further up-side rebound if the market perceives the FMOC positively. Eventually however we believe that another test of the late August lows is at the very least in the cards. **Prices could rebound back up to the bottom of the prior range, now resistance, near 2040. 1911 is key downside support.**

S&P Long-term Chart (Bottom)
The drop below the 10-month average shows increased risk to the market for a longer-term trend change. The S&P needs to get back above 2050 to re-establish the uptrend. The longer the S&P stays below the 10-month average the greater the risk becomes that the decline is more than just a correction.



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