Hamilton-Bates
Market Update
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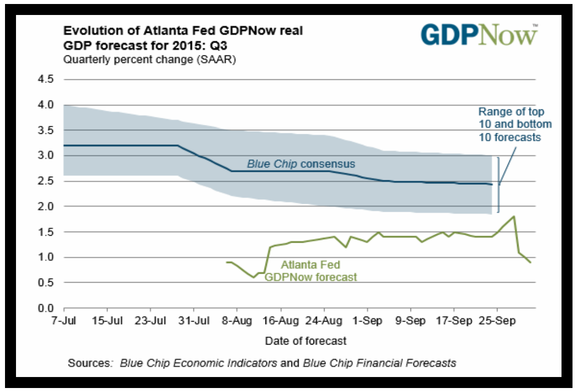
The last day of the third quarter was a positive cherry on a brutal quarterly sundae. Final day window dressing wasn't nearly enough to erase the damage as the major averages closed out the quarter with a 7% loss, leaving all major averages in the red for 2015.

The Fed, the Economy, and Earnings

The Fed has a credibility problem. The Fed declined to hike rates, which everyone thought was bullish, but then stocks got crushed. The data since the FMOC meeting supports the Fed's decision not to move, but they continue to talk about rate hikes and an economy on the upswing. The problem is that the data has been absolutely and unambiguously terrible over the past few weeks. **For the first time since 2009 (the last recession), all six regional Fed surveys show contraction**. The Atlanta Fed's live GDPNow Model is projecting less than 1% growth in Q3—3/4 point nosedive from a month ago. Clearly the US is not immune to the slowdown occurring in the other major global economies.

Once again the Fed is showing just how shamefully far behind they are on the economy. And these are supposed to be the pros—the best of the best in the economic world. It was like this in the financial crisis, too. The Fed was very slow to act. It is a known fact that the Fed has never forecasted a recession (in spite of employing hundreds of economists whose job it is to do precisely that). They don't even react to them very well. We aren't necessarily predicting a recession, but warning signs of a slowing economy are becoming more clear each day. QE has distorted the once important signals from the bond market, such as an inverted yield curve, which would normally warn us of such a thing. But the high-yield or junk bond market is one area we look at, and it continues to act poor. Unlike the stock market, junk bonds did make a new low last week, suggesting a very weak economy.

And then we have the aforementioned Atlanta GDPNow Model shown below.



The Economic Data has cliff-dived in the past month, resulting in the Atlanta Fed's GDPNow Model predicting less than 1% growth for Q3.

Forget a rate hike, the next major policy move by the Fed is likely to be more QE or other market supportive actions. The problem with them changing too quickly from talking about rate hikes to supportive measures is that they lose more credibility by showing themselves to be so misguided. But they have little choice. Over the course of coming weeks and months we believe the Fed is going to change their minds on rate hikes. Goldman Sachs now says no rate hike until 2017. We agree. If the Fed hikes rates it would be a disaster.

Market and Investment Outlook

So economic data have been bad and the latest jobs report was well below expectations with negative prior revisions. Signs point to potential trouble ahead but stocks rallied at the end of last week into this week. Why? Traders now believe that the economy is in bad enough shape to stop the Fed from raising rates. So the knee-jerk reaction was a bounce in stocks as the market quickly reverted to the 'bad news' is 'good news' mindset since it means a supportive Fed. That is true. But it also means earnings are going to remain weak and the market is not at overly attractive valuation levels. So we are back to a market that requires QE to survive. We could possibly get it sometime next year, maybe sooner if the data gets bad enough.

The short-term trend is UP for now. The DJIA and S&P 500 have so far successfully tested and held the late August lows. With rate hikes likely off the table an oversold market has had a nice reflex rally. Whether this move has staying power is to be determined.

Investors could start second guessing things upon further reflection of just how dismal the payroll numbers and other recent data were; and how difficult it will be for the Fed to prevent overseas' economic and stock market weakness from spilling over here.

We could even see negative job growth (ie losses) in coming months. This realization of this fear could lead to another bout of selling that sees the market test or even break those August lows.

We did see a drop-off in negative momentum at last week's lows, so we did some buying for managed accounts. Longer-term trend measures remain negative but we are heading into the seasonally strong Q4 period. We could see the market rally 10% or more just on stock buy-backs and sideline money being put to work. We will look to position long assets into the market at points of opportunity.

A move below the August low occurred in some indexes but not the DJIA and S&P 500. They could still do so this month. The 1820-1870 area looks like the ideal spot for the low to develop. From there we could see a 10-15% move higher into year-end.

Market Charts

S&P Short-Term Chart (Top)
The first bounce from the August low faded into last week's sell-off, which saw some averages break to new lows (Russell 2000 and High-Yield), while some did not (DJIA, S&P 500, NASDAQ). This could be enough to see a rally, as the market is trying to form a **'W'** bottom, but there is still a lot of overhead resistance in the 1980-2000 level on the S&P 500. It remains to be seen if there will be enough buying pressure to do more than revisit the September rebound highs or go slightly higher.

Disclosures: