Hamilton-Bates
Market Update
November 5th, 2015

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This week begins seasonally positive year-end period. After the September crash, we were somewhat cautious because another trip downward was a good possibility, as all up-trends (major and minor) were broken. The market looked fragile with huge intraday swings. Not all the evidence lined up for a big rally, but that is not always necessary. The market rallied in October not on good news, but bad news. After a brief period of looking for growth the market is now back to liking bad news, which stays the Fed's hand from hiking rates and could perhaps trigger more QE. There is also a strong year-end buyback season, so that could be the fuel that keeps the bull going. However, because the markets did very well in October, the typical year-end gains could be weaker than normal.

The Fed, the Economy, and Earnings

All the fundamental concerns we have been mentioning for some time are still in place, and are even increasing. Slowing economic growth and sub-par corporate earnings. Earnings are in a 'recession' and are expected to be down for the year. GDP growth is below 2%. However, we are in a phase of the market where a weak economy is interpreted as bullish as it reduces the fear of a Fed rate hike, and in fact could trigger more QE. Recently Q3 GDP growth Q3 was reported at a meager 1.5%, shocking Wall St economists. The economy is growing, but more like limping along and just skirting a recession. The divergence between the stock market and the economy has been increasing for some time, and perhaps ominously the market is ignoring the economic signals. We could see a recession in 2016 if things don't improve quickly. For now bad news in good news, but eventually continued economic weakness will have investors rethinking the bullish case.

The Fed

October's recovery rally continues to push forwards and even the recent hawkish tone in FOMC rhetoric failed to derail the market for more than a day. Earlier this week the major averages made their highest close since mid-August. As far as the Fed goes they will keep talking about hiking rates because that helps everyone to believe the economy is ok, but they never will because it is too weak for a hike and they fear the market response. They may hike once if the market gets too hot, but the next major policy move is likely to be more QE sometime next year.

Market Outlook—Seasonal Strength

In favor of the stock market bulls is the strong tendency for gains in the November to March period. In addition, we are seeing very strong powerful performance in the large-cap tech stocks, an area that rekindles investor enthusiasm when it does well. This is reflected by the out-performance of the NASDAQ 100 index, which has shrugged off recent weakness in biotech to move within 0.5% of its 2015 high. At the opposite end of the spectrum is the performance of the small-cap Russell 2000 index which even after a rebound is still down for the year.

The market and the economy eventually will move together so conditions will get better or stocks will fall back down. The next few months favor the bulls however, no matter the longer-term outlook. A change in sentiment away from faith in the Fed is not likely to wane soon. So as long as bad news is good news (more stimulus), bullish spirits should remain high.

Investment Strategy

The month of October saw us putting much of our sideline cash back to work in both the credit and equity markets. We still like bonds as the economic data remain week no matter

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the Fed talk about rate hikes. In the stock market we are now seeing big short covering as those who protected themselves from a continued market decline have been punished into buying those 'short' positions back in. Over the past month the vast majority of the biggest percentage gainers were stocks among the most shorted list. We like big-cap stocks and the NASDAQ in particular. We added assets in that area in October. Big cap stocks will be bought by large institutions as these are companies with plenty of volume to put capital to work quickly.

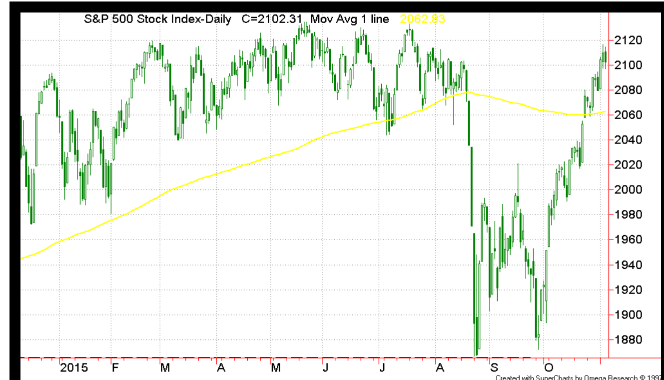
We expect favorable markets the next few months as momentum takes over and fundamental concerns are put aside until 2016.

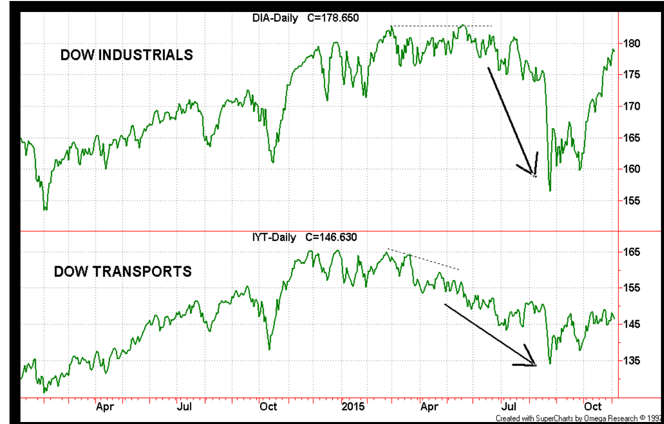
Market Charts

S&P 500 Near-Term (Top)
The S&P 500 has recaptured its 200-day average (in yellow), thereby re-establishing the long-term uptrend. **As long as the S&P 500 holds above 2060 the bulls have control.**

Dow Industrials versus Transports (Bottom)
While the market has come surging back in October, not all sectors are participating. Comparing the Industrials in the top panel of the bottom chart to transports in the bottom panel and it is easy to see how the transports are lagging. Normally these two indices move together; as the saying goes "the industrials make it while the transports take it." The weakness in the transports is another sign that things are not quite right with the economy.

The poor action in the transportation sector bears watching. In the past, divergence between these indices has been the precursor to a correction, as the dotted lines in the bottom chart show. Early 2015 weakness in the transports was felt by the broad market in late June.





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