Hamilton-Bates
Market Update
January 7th, 2016

P.O. BOX 270 Newtown Square, PA 19073 877.768.4247 www.hbir.com

2015 Ends With a Whimper and 2016 Starts Off With Chinese Fireworks.

The US stock market was much like a rollercoaster in 2015 with a lot of ups and downs and you end up about where you started. The market recovered from the depths of the Fall sell-off but a hoped for year-end rally was very muted. Stocks and bonds of all categories had a tough year, but the broader stock averages where much weaker than the S&P 500 and DJIA.

2015 Market Index Returns	
Dow Jones Industrial Average	-2.20%
S&P 500	-1.70%
Russell 2000 Small Cap	-4.70%
Value-Line Arithmetic Index	-5.20%
Government Bonds	0.82%
High-Yield Bonds	-6.77%

China Again!

The global markets have so far stumbled out of the gate, and hopes for a fast start to 2016 have been dashed by China, which just this morning devalued its currency once again. The Chinese stock market has been halted twice in the first four days of trading with two 7% declines that have ended trading for that day. The last time China devalued back in August the markets were struck by fear of a currency war, which could send the dollar higher and hurt corporate profits across the board. Add in a continued collapse in oil, which has fallen 15% in 3 days and is now under $33 a barrel, and you get financial markets beset by a number of challenges in the very first trading week of the new year.

Oil Crashes to Near 2008 Lows

Remember how the drop in oil was supposed to be bullish for the economy? We never thought so and felt that a gradual decline could be beneficial but a severe and persistent drop reflected poorly on the economy and would hurt growth through a reduction of capital expenditures. Check and check.

Rather than stimulate consumption the contagion of the oil price plunge has been drifting into other sectors of the US economy, housing and office space in energy hubs like Houston, the state budget in Alaska, loss of Shale tax revenues in ND, PA, TX. Huge capital expenditures cuts by energy companies have cost jobs in manufacturing for energy components. Investments have gone up in smoke and loans have gone bad. Banks are tightening credit to these companies. Defaults, restructurings, and bankruptcies are now a routine occurrence. This has been reflected in the high-yield bond market where many of these companies reside. PE firms are licking their wounds from their mega-bets on fracking made in prior years, so an infusion of cash is likely not coming. The drop in oil is a case of be careful what you wish for, because too much of a drop has not and is not a good thing.

In the fourth quarter, global production of crude oil and other liquids dropped, but so did global consumption. Storage capacity for oil is starting to near practical limits. Oil below $32 would break the 2008 lows and reflect severe negative pressures on the energy sector and the economy. Something is seriously wrong in China, whether or not the government wants to admit it, their currency and market tells us that. And their troubles are hitting global oil consumption. This isn’t going to be an easy bust to get through for many energy companies. It’s not just a US problem, it’s a global problem.

Disclosures:
This report has been produced and compiled by Hamilton-Bates on a best efforts basis, and is provided for information purposes only. Under no circumstances is it to be used or considered as an offer to sell, or a solicitation of any offer to buy. While all reasonable care has been taken to ensure that the information contained herein is not untrue or misleading at the time of publication, we make no representation as to its accuracy or completeness and it should not be relied upon as such. The investments referred to herein may not be suitable investments for all persons accessing these pages. You should carefully consider whether all or any of these are suitable investments for you and if in any doubt consult an independent adviser. This report is prepared solely for the information of clients of Hamilton-Bates and readers are expected to make their own investment decisions after consulting with their personal financial advisor and without reliance on this report.

“If Santa Claus Fails to Call,
Bears Could Come to Broad and Wall.”
Stock Market Almanac

“He came in 2015 but left lousy gifts.”
Annonymous

Hamilton-Bates
Market Update

January 7th, 2016

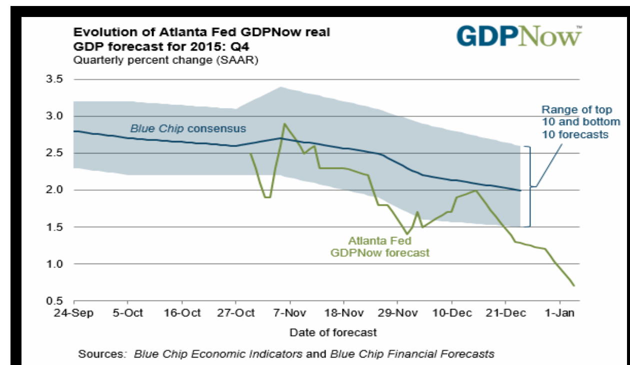
P.O. BOX 270 Newtown Square, PA 19073 877.768.4247 www.hbir.com

The Fed, Earnings, Interest Rates, and the Economy

The root of all the problems we see going on with the markets right now-China, Oil, and High-Yield Bond weakness, is traceable to the fact that the US and indeed Global Economy is struggling. Despite prognostications for growth, the 2015 4Q GDP growth rate is now at 0.7%, well under the 2-3% target expected by the Fed. The drop in GDP growth can be seen in the Atlanta Fed’s GDPNOW Model shown in the chart above right. Global Economic Growth rates are crumbling. Slow growth means slowing earnings growth or even an earnings contraction, and that eventually weighs on stocks. Chinese companies are still dependent on exports, and their struggles continue to reflect a weak global economy. High-yield bonds are issues by companies with poor balance sheets, and when the economy slows these companies have trouble paying their debts. Weak oil has also impacted the energy sector with many drillers and exploration companies struggling to pay their debts.

<u>The Fed Rate Hike Looks Poorly Timed</u>

Since the Fed raised rates by 25 basis points on December 16th, the Dow has dropped by some 3%, and the Global markets double that. It is clear by the comments around the hike that they were boxed into a corner by earlier comments they made, and their continued optimistic outlook for future growth. The weak market reaction since then, along with the abysmal data, not to mention the China situation means there won’t be many, if any, hikes to come in 2016. The global economy is mired in ‘low or no growth’ land, and the programs of QE look like a total bust. The Chinese ‘juggernaut’ of 7% annual growth is looking more and more like a fraud and hopes for it to lead a recovery are fading.



The Fed’s Model for 4Q GDP Growth (in Green in the chart above) has fallen sharply, now at just 0.7% growth for Q4. The model fell 0.5 percentage points following last week’s weak construction spending and a very weak Manufacturing ISM Report On Business.

You also have some geopolitical concerns as the US, Saudi Arabia and Qatar are fighting a proxy war in Syria vs. Russia, Iran and the Syrian Government, and Saudi Arabia seems determined to pump as much crude as possible until either they or their global energy competitors go bankrupt. This puts pressure on all the economies dependent on the energy sector. And you also have North Korea, which apparently just tested a Nuclear Weapon.

Given our outlook that the economy remains challenged, it is likely that more creative QE measures could pop up once again sometime in 2016 if liquidity, markets, or commodities continue to head southward. So soon after a rate hike the Fed will have to wait and move slowly so as to avoid too much credibility loss, but when push comes to shove they will do so.

Disclosures:
This report has been produced and compiled by Hamilton-Bates on a best efforts basis, and is provided for information purposes only. Under no circumstances is it to be used or considered as an offer to sell, or a solicitation of any offer to buy. While all reasonable care has been taken to ensure that the information contained herein is not untrue or misleading at the time of publication, we make no representation as to its accuracy or completeness and it should not be relied upon as such. The investments referred to herein may not be suitable investments for all persons accessing these pages. You should carefully consider whether all or any of these are suitable investments for you and if in any doubt consult an independent adviser. This report is prepared solely for the information of clients of Hamilton-Bates and readers are expected to make their own investment decisions after consulting with their personal financial advisor and without reliance on this report.

Hamilton-Bates
Market Update

January 7th, 2016

P.O. BOX 270 Newtown Square, PA 19073 877.768.4247 www.hbir.com

Market Outlook

The lack of oomph in the 'Santa Claus Rally' coupled with the profound weakness to start the year was definitely not part of the normal seasonal tendency, and it seems much of this weakness can be traced back to what is happening in China with its market and currency. A 19% drop in China's stock market has definitely spilled over globally and caused selling worldwide. Weakness in energy is collateral damage due to the weakness in China's economy, a key source of demand.

Alert! China has just this morning suspended its trading halt policy. This is actually a good move as selling this week was often triggered as people rushed to get out ahead of feared trading halts. This move could help stem the global slide as the weakness in our market has largely been triggered by overnight negative pressure in the futures markets due to the selling in Asia and then Europe.

History is on Our Side with One Caveat

Past years that followed a flat to slightly down year like 2015 have traditionally been followed by very good years. 2011s flat year was followed by a strong 2012 return, 1994's slightly down year saw a 1995 year that was among the best ever for stocks. Despite the poor start to 2016 its too early to give up on the year being a good one, even if we have an early hurdle to overcome. The one caveat and it is a big one is a recession. If the economy is headed into a recession then the market is headed for trouble, as a flat 2000 saw weakness in 2001 and 2002, and a flat 2007 saw weakness in 2008, all caused by recession. The market's flat 2015 should lead to a really good 2016 or a recession. Quite a disparity of outcomes.

Investment Strategy

January is a very pivotal month for the market. January can set the tone (hence the saying as goes January as goes the year), and January can be a month where the lows of the year are made. January weakness is also common into the second week of the month. We don't like seeing this decline and the lack of seasonal strength in the first few days of the year, but it is also important to not jump the gun on current weakness and expect that to be the trend for the entire year.

The low made this month will be very critical however , as a break of a low made in January later in the year can often set the tone for the rest of the year—but it is important to let this month play out. We look for a low to form this week or next, and for a rally into March.

Managed portfolios currently have 8-14% cash or even a bit more, a little higher than 'normal'. We also have increased holdings in Government and Investment Grade bonds which we have added to in the last quarter. We continue to focus on high-grade bonds wherever possible as investment holdings. By avoiding high-yield bonds and energy exposure accounts sidestepped the worst of 2015, but it still has been a challenging period for investors.

We are focused on blue-chip stocks with little debt, and investment grade/government bonds in credits. A slowing economy and a Fed forced to halt rate increases would boost these bond sectors. Our bond holdings helped cushion portfolios in 2015 and so far in 2016. Municipal Bonds have done very well and the Managed Tax-Free Portfolio had a good 2015. In the stock market we see continued volatility with the early year weakness likely being an opportunity for trading a rebound into March.

Disclosures:
This report has been produced and compiled by Hamilton-Bates on a best efforts basis, and is provided for information purposes only. Under no circumstances is it to be used or considered as an offer to sell, or a solicitation of any offer to buy. While all reasonable care has been taken to ensure that the information contained herein is not untrue or misleading at the time of publication, we make no representation as to its accuracy or completeness and it should not be relied upon as such. The investments referred to herein may not be suitable investments for all persons accessing these pages. You should carefully consider whether all or any of these are suitable investments for you and if in any doubt consult an independent adviser. This report is prepared solely for the information of clients of Hamilton-Bates and readers are expected to make their own investment decisions after consulting with their personal financial advisor and without reliance on this report.

Hamilton-Bates

Market Update

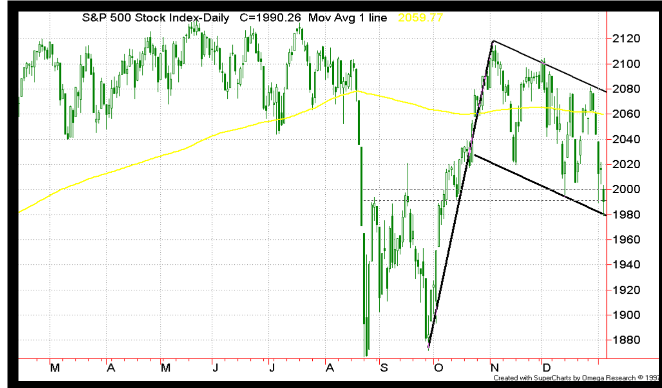
January 7th, 2016

P.O. BOX 270 Newtown Square, PA 19073 877.768.4247 www.hbir.com

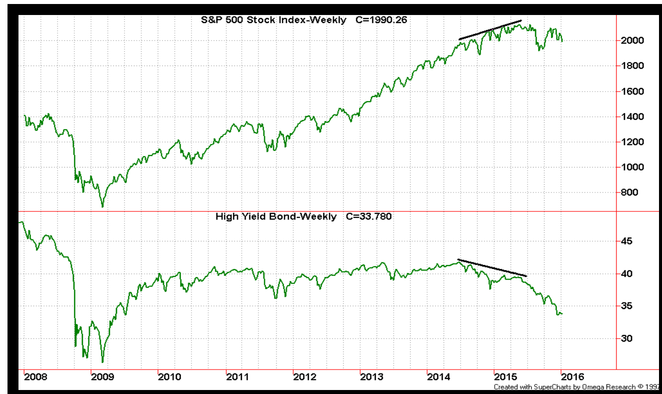
Market Charts

S&P 500 Long-Term (Top)
The S&P 500 dipped below its 10-Month average last week (in dark red), threatening the recovery if it cannot rebound above 2040-2050. We would like to see stocks quickly above this key long-term moving average, thereby re-establishing the long-term uptrend. Should the S&P end the month below this moving average it would be two months in a row below it, a negative sign. For now this is a yellow light warning. **The bulls need the S&P 500 above 2060 to have control.**

S&P 500 Near-Term (Middle)
The S&P has oscillated above and below its 200-day average (in yellow) the past two months, now below it. Technically this can still be constructive in the form of a 'bullish flag pattern' for its resemblance to a flag (highlighted by the bold black lines). **As long the bull flag remains intact (we are now testing the bottom part of the flag), the projection allows for a move well above 2200. This chart is a potential positive for the market but we need to see a bullish reversal this week.**



High-Yield (Junk) Bond Market (Bottom)
You can see in the chart that high-yield bonds and stocks (S&P is in top panel of bottom chart) traditionally trade together, so this divergence is a concern. This drop has taken the well-known Junk EFT (JNK) (bottom panel of bottom chart) below its Fall low and to levels not seen since 2009. **Unless and until there is significant stabilization in this part of the credit market, risk hangs over stocks for 2016. We continue to avoid this credit sector.**



Disclosures:
This report has been produced and compiled by Hamilton-Bates on a best efforts basis, and is provided for information purposes only. Under no circumstances is it to be used or considered as an offer to sell, or a solicitation of any offer to buy. While all reasonable care has been taken to ensure that the information contained herein is not untrue or misleading at the time of publication, we make no representation as to its accuracy or completeness and it should not be relied upon as such. The investments referred to herein may not be suitable investments for all persons accessing these pages. You should carefully consider whether all or any of these are suitable investments for you and if in any doubt consult an independent adviser. This report is prepared solely for the information of clients of Hamilton-Bates and readers are expected to make their own investment decisions after consulting with their personal financial advisor and without reliance on this report.