Hamilton-Bates Market Update

Portfolios back to Balanced as Market Uptrend has been Re-Established

April 4th, 2016

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

As the first quarter came to a close the DJIA and S&P 500 Indexes have come back from the severe drop that started the year to squeeze into the black. What started as a response to a deeply oversold market dominated by short covering developed into a more long lasting move higher, although it seems premature to conclude that the entire episode is behind us.

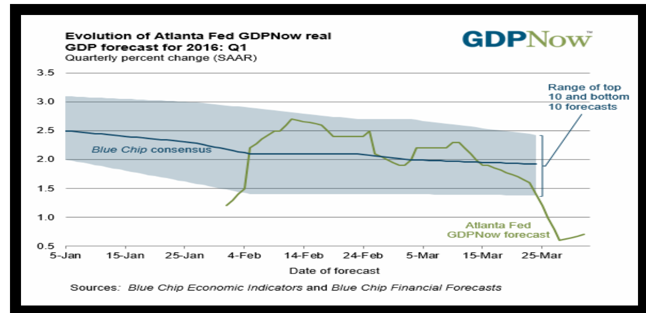
Of course the central banks have once more been key agents in this reversal of fortunes. The ECB helped accelerate the recovery of credit markets by announcing its foray into 'QE' via the direct purchase of local investment grade credit on top of an increase to its ongoing easing program. Our Fed also chipped in with a stepping back from the 'rate hike' rhetoric of last December.

Earnings, Interest Rates, & the Economy

The recovery in the stock market averages has not been mirrored by a recovery in economic data or earnings. The BLS Payroll Report remains 'strong' but we continue to suspect the data is 'tainted' by a significant amount of part-time jobs. If someone loses a full-time job making but takes two par-time jobs at a lower wage the BLS report will show a net job created even though the economic value is much less.

In the charts above right you can see that GDP growth has come down, as have earnings expectations, even as stocks have bounced back (thanks to the Central Banks). Thanks to the decline in Oil, corporate capital expenditure has been very weak. Corporate earnings have increased greatly from the 2009 bottom, but the trend of earnings growth stopped last year and the trailing figures have now turned sharply downward.

The overall weakness of the US economy has been partially masked by pockets of growth in autos and real estate thanks to Fed easing. Both areas have



*After picking up to start the year, the Atlanta Fed's GDP Model (**chart above**) has dipped once again, now calling for GDP growth of just 0.70% in 2Q.*

*While the Market has come back (**shown as the S&P 500 in green in the chart below**), S&P earnings expectations have failed to move up, and in fact have continued to drift lower.*

recently shown signs of weakness, and the fracking boom, which lived off cheap credit and accounted for a large part of the growth of high-paying jobs and capital expenditure, is now in full rout. This leaves the economy ripe for a pull-back just as the Fed backs itself into a corner for another hike now that the capital markets have come back from another brink.

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 *April 4th, 2016*

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

Rate Hikes Back on the Table in Q2?
The FMOC took a very dovish tilt at the March meeting, a move which was broadly defended by Chair Yellen in her speech to the New York Economic Club this past week. We have long been skeptical of the willingness of the Fed (or any of the Central Banks) to be truly data driven, and the latest policy-swerve removed all doubts on the matter. The Fed held off hiking rates because the stock markets around the world fell, even as signs of some inflation according to the Fed's own guidelines have shown up.

The market rebound back toward the highs may bring talk of a Q2 rate hike back up, and that talk itself could trigger a pull-back. But unless the market continues to run higher unabated we'd be surprised if they moved.

We believe the economy is weak, and despite their talk of job growth and signs of some inflation, the Central Banks worldwide remain afraid to upset the financial markets. It would apparently require an unambiguous message of growth with higher prices together with calm in global markets to convince the current FOMC that this level had been reached.

Market Outlook
Our big-picture view is that the cycle in economic and earnings growth is maturing, and in fact peaked out back in 2012. Central Banks have tried to extend the cycle and avoid any downside by continued easing. A normal economic cycle would (and eventually will) leading us to the eventual recession.

With corporate profit margins contracting from cycle peak levels at a time when revenue growth is falling as well, its clear the current expansion cycle is on borrowed time. Our view remains that the US economy is more likely than not to contract over the next 1-2 years in response to falling profits. The Central Banks have delayed nature but they cant repeal it.

Investment Strategy
Once again the markets have come back from the brink of a severe breakdown, thanks to a 'kick-save' by the Central Banks. Growth holdings have been added to a bit over the past few weeks, and we also added to bond holdings. For as long as the uptrend remains in force (see charts on next page) we'll hold to equity positions. We want to own blue-chip stocks with little debt, especially in defensive sectors like consumer staples, telecom, and utilities. In fixed income we favor investment grade & government bonds.

Here is a listing of our major portfolios and where they stand. As you can see the holdings are very defensive:

Portfolios & Positions
MPT Aggressive
40% Equity / 60% Bonds & Cash
MPT Moderate
37.5% Equity / 62.5% Bonds & Cash
MPT Conservative
27.5% Equity / 72.5% Bonds & Cash
MAC Growth
45% Equity / 55% Cash
Separate Accounts
50% Equity / 50% Bonds/Cash
Managed VA Accounts
25-30% Equity / 70-75% Bonds

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

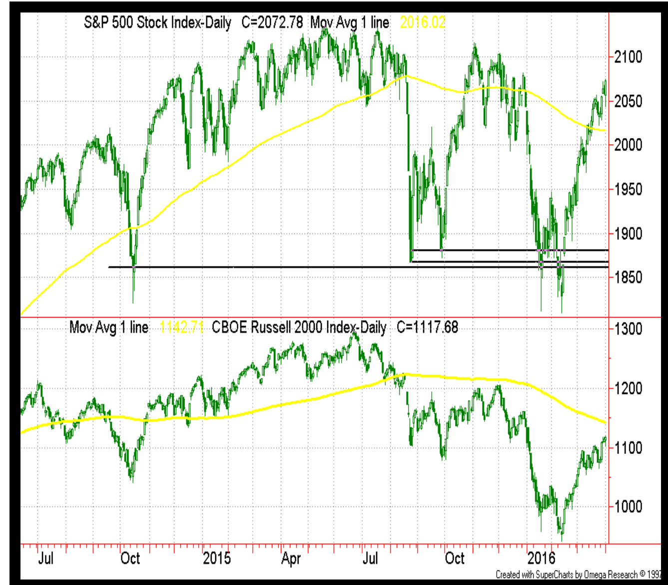
April 4th, 2016

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

Market Charts—Blue-Chips Re-Establish Bullish Trend

S&P 500 vs Small Caps Near-Term (Top)
The near-term chart shows both the S&P 500 and Russell 2000 Small-Cap (bottom panel) Indexes rallying sharply from the February low. The rally has been a 'barbell' type advance though, with blue-chip high quality companies leadings, along with the very beaten down sectors like Energy and Commodities. The 'average' stock, exhibited by the Russell 2000, is still well below its 2015 peak.

<u>The move above 1950 on the S&P 500 turned the short-term trend to bullish in early March, and the move back above the 200-day average at 2017 turned the long-term trend to bullish. Growth positions have been gradually re-established over the past few weeks. As long as the S&P holds above 2020 trend is bullish.</u>



S&P 500 Long-Term (Bottom)
The break below the 10-month average (red line) along with the break of a long-term trend line in late 2015 threw up caution flags as similar events preceded the prior two bear markets in 2001 and 2008. The market has managed two recoveries now, one last November-December and the rebound since mid-February to avoid a similar fate.

Breaks of the 10-month average so close on the heels of one another is rare, and the S&P has spent a lot of time below its 10-month average in the past 6 months, something its not done during the last two bull markets. This suggests the market is still at risk of further volatility. <u>With the S&P above its 10-month average at 2020 the long-term trend is bullish. A break of the 10-month average would cause us to defensive immediately.</u>

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.