Hamilton-Bates Market Update

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

April 11th, 2016

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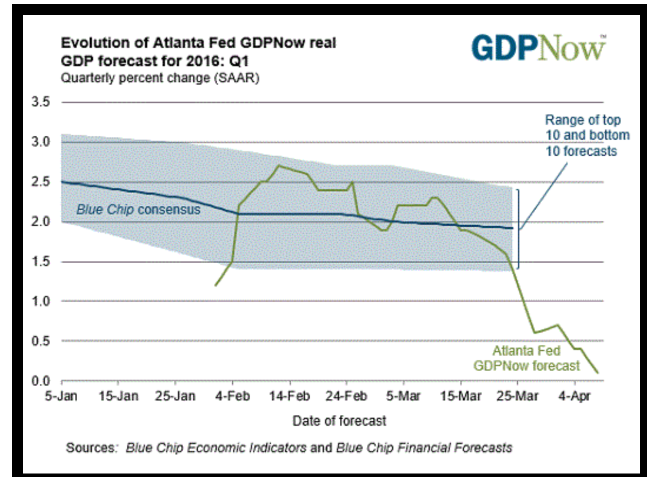
The market has been chopping higher over the past week, with the S&P 500 closing just below a recovery high at 2066, before pulling back a bit at week's end. The market was helped by a 'strong' Employment Report and a better than expected ISM Manufacturing survey.

With the FOMC effectively declaring its dovishness for all to see at its March meeting, good economic news is once more 'good news' for the equity market, while the bond market relaxed against the promise of FOMC inactivity and positive acts of stimulus elsewhere.



*After picking up to start the year, the Atlanta Fed's GDP Model (**chart above**) has nose-dived, with the latest reading calling for GDP growth of just 0.10%.*

Earnings, Interest Rates, & the Economy

Our big-picture view remains that the cycle in economic and earnings growth is maturing, peaking 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. The Central Banks have delayed nature but they cant repeal it. The only folks who can't see the recession risk are the same central bankers who are paid to lie and mislead, politicians trying to get re-elected, and media types whose job is to keep pumping positive spin.

The average person has been experiencing a 'recession' for the last eight years, with stagnant wages, rising living costs, no return on their savings, and rising taxes. Now, even the government economic statistics can no longer hide the true deterioration. The Fed's own **GDPNow** Model (shown above right) has Q2 GDP growth at 0.1%. From an economic standpoint, economic deterioration typically follows a well-defined pattern, with weakness in new orders and backlogs first, followed by deterioration in industrial production (and manufacturing), and then by weaker retail sales (which have declined for two consecutive months), followed by personal income. Last comes weakness in employment indicators.

We've seen the first three items above, with the eye now on Personal Income. A deterioration there could see weakness in employment in months ahead. Nothing in recent weeks has changed our assessment of a weak economic environment, and a continued trend of weak revenues and earnings.

The central banker action plan of monetary easing, negative interest rates, printing trillions of new fiat currency, and buying the bad of the banks, has not improved the lives of average people living in the real

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world. They have improved the net worth of the folks who run Wall Street. Without a doubt, the Central Bankers have made the lives of senior citizens far worse, the lives of middle income working class families challenged, and the lives of most of those just entering the workforce overloaded with debt and struggling to find a well-paying job difficult to say the least.

By encouraging financial distortions, enabling massive issuance of speculative-grade securities, and stock buybacks at near-record valuations, the Central Banks have embarked on a policy of serial asset bubble creation in a vain attempt to restart the demand economy. It just doesn't work. All they can do is to buy interest-earning bonds and replace them with zero-interest paper. Creating more debt to solve a debt problem will not carry the economy to us to prosperity without consequences. In developed financial economies, lowering interest rates to near zero has produced negative consequences. The best examples of this include the business models of insurance companies and pension funds. Insurers have long-term liabilities and base their death benefits and health benefits, on earning a certain rate of interest on their premium dollars. When that rate is zero or close to it, their model is destroyed. Pension plans are having trouble matching their cash-flow needs with income matching investments. Will we see insurance company and pension plan bailouts next?

Market Outlook

Aside from a very short-term 'goose', the latest easing moves by the Central Banks have seen diminishing impact on the equity markets. Japan's Nikkei index is now down about 5% since the day after Kuroda's rate-cut announcement. The Dow Jones EuroStoxx Index is down since the day after Draghi's bazooka talk.

The response of the S&P 500 to Yellen's recent dovishness could be similarly short-lived, though we won't rely on that. Given the continued sequence of erosion in economic measures, all central bankers have left is to point to the financial markets as evidence that their policies are 'working.' They will continue to try everything to prop the financial markets up. It's when those efforts fail that the real trouble begins.

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 continue to add to fixed income holdings on any dip.

For as long as the uptrend remains in force 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. Holdings are Balanced with a slight emphasis on Fixed Income.

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

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Market Charts—Blue-Chips Re-Establish Bullish Trend

Near-Term (Above Left)
The move above 1950 on the S&P 500 (top panel) turned the short-term trend to bullish in early March, and the move back above the 200-day average (yellow line) turned the long-term trend to bullish. As long as the S&P holds above the 200-day average the bulls are in control. The broad market hasn't come back as strong as the blue-chips, as the Russell 2000 (lower panel) remains well below its 2015 high.

Long-Term (Above Right)
With the S&P back above its 10-month average (red line) at 2020, the long-term trend has been restored. But the sideways action since 2015 (bound by dashed lines) paints the picture of a market that could be losing long-term momentum. A re-break below the 10-month average would cause us to move defensive immediately.

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