Hamilton-Bates Market Update

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

April 18th, 2016

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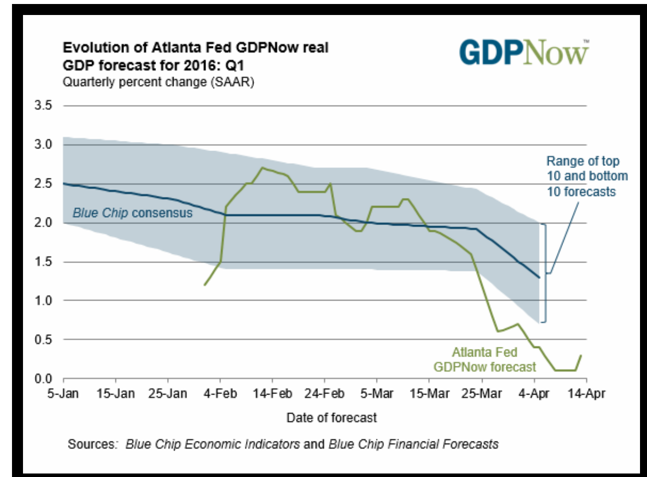
The markets edged higher last week, boosted by energy stocks as oil rallied in hopes of an output deal in DOHA. The S&P is now at a new recovery high and is inching near a breakout above the 2,100 level, although this will require corporate earnings to follow through with solid results over the next few weeks.

There has been a slight shift away performance away from defensive, bond proxy sectors such as Utilities and Staples back towards economic sensitivity in the form of Energy, Materials, Technology and Industrials. This move is at odds with the economic data which has been trending lower. Earnings season will likely decide whether this sector shift continues or fades.

Earnings, Interest Rates, & the Economy

Currently, the aging 'recovery' has hit a wall, as wage growth has remained weak and households are weighed down by surging debt. Overall the economy remains mired in a slow-growth funk. This slowdown in growth coupled with the Fed's zero interest rate policy has put powerful incentive pressure on corporate managers not to invest, and to put capital into dividends and buybacks instead which has led to a record level of corporate debt.

Economic softness came last week in the form of two weak economic reports starting with Consumer Sentiment with its fourth straight month of decline to a reading well below expectations at 89.7. The forward looking expectations component was especially weak at



*The GDPNow model forecast for real GDP growth in the first quarter of 2016 is **0.3 percent**, up from 0.1 percent on April 8. The forecast for first-quarter real consumer spending growth increased from 1.6%% percent to 1.8% boost the GDPNow model.*

79.6. Anything under 100 is considered negative. This data corresponds with the current weakness found in retail sales. There was also another poor showing for Industrial Production at -0.6% calling recent signs of manufacturing sector progress into question. When you look at these two reports together you understand why the outlook for the economy is still cloudy and why bond yields have hovered near their lows.

The key question at this time is how much longer investors can cheer bad economic news just because it keeps the Fed from raising rates if earnings continue to lose steam? We have now had 4 quarters of earnings declines. The 'Goldilocks' scenario would be 1-2% GDP

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growth. Low enough to keep the Fed on the sidelines and just high enough to produce earnings growth and higher share prices. Q4 GDP was +1.4%. The current Q1 GDPNow estimate is just a meager +0.3%. The economy looks too cold right now and could see stocks stall near their old highs. Once again, a lot is falling on the upcoming earnings season.

Market Outlook

Stocks continue to rebound, but the advance has been choppy with 5 weeks in a row of alternating positive and negative performance. Some slightly better Chinese trade data have allayed fears of an imminent 'hard landing' in China's economy. but is the data trustworthy? While aggregate first-quarter earnings are expected to be down 9.1% year-over-year, some stabilization in the dollar and the rebound in the price of oil could relieve some earnings headwinds, allowing for the chance profits to resume their upward trend. The market needs profits to rebound.

An assertive close above 2080-2100 on the S&P would provide a clear sign of a breakout, and open up the possibility of a run of another 10%. That would certainly be the 'pain trade' since the divergence between fundamentals and the market remains high.

Investment Strategy

The market's rebound continues, largely thanks to a rebound in oil and the intervention of the Central Banks. Portfolios have adjusted with the market, as Growth holdings have been added to, 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 (dotted line in top panel) turned the short-term trend to bullish by having the S&P make a higher high. The move back above the 200-day average (yellow line) turned the long-term trend to bullish.

No change here. As long as the S&P holds above the 200-day average the bulls are in control. The Russell 2000 (lower panel) still hasn't broken above its 200-day average (yellow line), neither has the NASDAQ 100.

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.

The sideways action since 2015 (bound by dashed lines) could be an early sign that the market is losing long-term momentum. A re-break below the 10-month average would cause us to move defensive immediately. On the bullish side, a break-out to a new high could see a rally of another 10%.

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