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

Hamilton-Bates
Market Update

May 10th, 2016

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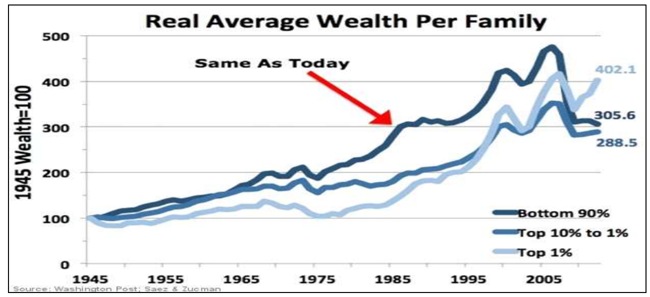
The last few weeks have seen the first clear signs of fatigue for the strong rally that broke out in mid-February. The S&P 500 remains trapped in its wide 1,800 to 2,150 range that has contained the index since September 2014 (see top panel of chart on page 3), a time period which is not so coincidentally the time-frame when QE ended. From the end of QE the market has made no headway. Small-caps have struggled. Thus far the overall damage is modest, and buying could pickup shortly; but a decline below 2020 (the level of the key 200-day and 10-month averages) would be quite negative.

Earnings, Interest Rates, & the Economy
In the most recent GDP release the Bureau of Economic Analysis (BEA) reported 0.50% annualized economic growth, a sharp decline from the 1.40% growth of the prior quarter. Economic growth is now running below a 1.00% annualized rate for the last two quarters, and has been trending lower for the last two years. Gone are the days of 3% growth projections. Corporate sales growth is also gone, as aggregate S&P 500 revenue has not declined 5 quarters in a row. Earnings have managed to grow thanks to buy-backs and increased efficiencies (job-cuts). The economy remains at or just slightly above stall-rate. But for most it feels like a recession anyhow.

Wall St vs Main St—Most Americans Worse Off
Here we are now 7 years into this economic 'recovery' and it still remains pathetically weak. And well it should in the wake of one of the biggest private sector credit bubbles in history. Not only did the Fed avoid a financial market seizure in 2009 with QE1(which was worthwhile), but they went on to create asset bubbles with QE3,4,5...as an economic cure all. This quick-fix monetary nonsense has made no difference to the economic recovery other than to inflate asset prices, make the rich richer, make inequality worse, and make



it clear to the average person on the street that the government works for Wall St. not Main St. The public doesn't believe the economy is as 'great' as Washington touts it as, and the recent political landscape on both sides of the aisle suggests as much. The voting public are rejecting the establishment candidates at almost every electoral turn and seeking out more extreme alternatives at both ends of the political spectrum.

The chart above from the Washington Post has not been updated to include results for 2015, but the trend is clear. The two DARKER lines represent the inflation adjusted wealth of the bottom 99% of US income-earning households. This group has seen their net worth decline since the financial crisis of 2007-2009, with the bottom 90% making no net gains since 1985! The lightest line shows the wealth of the top 1%, now back near its all-time high, thanks to the Central Banks.

Back in 1973 65% of Americans were at or near middle class. Now its less than 50%. Once upon a time, the American economy worked for nearly everybody, and everyone got richer. Things were quite different in the decades preceding the 70s, a period that stretches back to the late 1940s, when real incomes rose for all groups. For the vast majority of Americans, the dream of a steady increase in income and wealth was lost back in the early 1970s.

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This early 1970's time-frame coincides with the growing openness of the American economy to international trade and investments. Many believe that globalization is largely to blame as companies outsourced jobs overseas. NAFTA in the 1990s continued the problem. Those who called these 'free trade' agreements 'job suckers' were proven correct in time.

The shift in income and wealth distribution became worse in the aftermath of the Great Recession in 2008-2009, which brings up yet another reason for the decline: the ultra-low interest rate monetary policy, which boosted the prices of stocks and bonds, mostly benefiting the top 1%, which were very likely to own these assets. The terrible weakness in the economy in terms of 'breadwinner' job creation likely explains why so many people are rallying behind Donald Trump and Bernie Sanders, who blame both globalization and Wall Street for depriving many Americans of the dream for a better life.

The Next Crisis Will Be a Crisis of Confidence in Central Banks

The seeming inability, or unwillingness, of those setting monetary policy (the Central Banks) to stop feeding the market support if not QE is a sign that QE has led to dangerous addiction. The US market has made little headway since official QE ended. Banks elsewhere are trying to pick-up the slack but its having diminished effects.

"Unconventional easing (QE) is above all an expectations game, where it is necessary to shock markets," as Goldman Sachs wrote earlier this week. They are correct. QE is like an adrenaline shot to stimulate the markets and in turn stimulate the economy. The problem is it hasn't worked and won't. At best it bought time while waiting for enlightened fiscal policy, but in the current political environment that isn't likely. Even worse, Central Bank intervention destroyed investors' concerns, forced risk taking by naturally risk averse investors seeking yield, and heightened complacency. The market is now discounting significant risks in terms of valuations and earnings expectations. It's become market conceit to assume that QE will always provide support. For now it does, when it doesn't, well that will be the next real crisis.

Market Outlook

Interest rates should not be going up soon. Last week's Jobs Report showed the US economy is sputtering as job creation came in below estimates. 7 of the last 9 Jobs' monthly reports showed a drop from 12 months before (yoy). A pattern of monthly deterioration in the Jobs' numbers of 2007 led to a severe bear market in 2008-2009 The FED is likely aware of this. There is job growth, the numbers are positive even though they are not matching what is needed to keep up with the rising population. That weakness helps explain why NASDAQ and small-cap stocks, are trailing the blue-chips. Many defensive stocks remain in bull markets, and we continue to favor the defensive consumer staples and utilities sectors.

As a result also of the weakening economic data, it does seem much less likely that the FED will jar the market. Rate hikes aren't likely, so holding bonds (and perhaps REITs), along with defensive stocks remains a good plan.

A listing of our major portfolios and where they stand is on the next page. Holdings are Balanced with an emphasis on Fixed Income.

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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
100% Cash
Separate Accounts
50% Equity / 50% Bonds/Cash
Managed VA Accounts

Market Charts—Blue-Chips Re-Establish Bullish Trend but Small Caps Lag

Short-Term (Top)
The S&P and DJIA (not shown) are back near the highs of the past 15 months, but even so these are levels the market has been unable to overcome since QE ended. Market tone has been decidedly in favor of blue-chip defensive names, as the NASDAQ (middle panel) and Russell 2000 (bottom panel) are well below their 2015 highs.

S&P 500 Long-Term (Bottom)
The S&P has broken the long-term uptrend line dating from the 2009 lows, but has collapsed like 2002 or 2008. Instead the market has moved in a sideways band (dashed horizontal lines). This sideways action is due to the supportive actions of the Central Banks, who don't seem to have the stomach for a market decline.

As long as the S&P holds above its 10-month average now at 2022, the bull trend holds. Below that levels warrants a DEFENSIVE stance.