Hamilton-Bates

Market Update

June 6, 2016

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In recent weeks the US equity market has pushed back up toward the 2015 highs (at least in terms of the blue-chip averages) . Small-caps and High Beta names remain well-below those highs by some 10-15%. So far however the major averages have been unable to punch through to new highs since the end of QE in 2015. No momentum has come from earnings, which remain lousy.

Earnings, Interest Rates, & the Economy

We are now in month 83 of this so-called recovery. Yet there are still 45 million people on food stamps, some 14% of the population. The highest percentage in the history of the program. And median real household income is still 5% below its level in the fall of 2007. Wages are simply not keeping up with cost of living and Americans are getting pinched. Job creation has been fine in creating lower income jobs, but what are known as 'breadwinner jobs' are tough to come by. There are now only 71 million full-time, full-pay 'breadwinner' jobs in the nation (jobs in known high-pay sectors), which is 2 million fewer than 2000. The new millennia has been tough on the average American. (from David Stockman's Struggles in Flyover America).

At the same time, we have had monetary stimulus like never before. There has been 90 straight months of virtually zero interest rates. The balance sheet of the Fed has been expanded by $3.5 trillion. QE and zero interest rate policy has stimulated anything for the struggling main street economy of America. Instead, it has showered Wall Street and corporate insiders with windfall gains with the false prosperity derived from financial inflation and central bank intervention.

Last Friday's Jobs Report was brutal. May job creation came in at 38,000 well below the 160,000 expected. This should surely prevent the Fed from raising rates, but even so risk of a recession is rising. The May Jobs report raises the specter of a recession just ahead. Jobs started to falter in 2007 ahead of the 2008 crisis. If the next few months continue the trend of weak reports, watch out. With interest rates already low, how much more can the Fed do to stimulate the economy? Because of the Congressional gridlock and Obama's end of term indifference, there will be no new fiscal stimulus to help out a stalling national economy this year. Heck he is taking a victory lap. But manufacturing is weakening and consumers are tapped out as far as credit goes. What will propel the economy and the stock market higher? Manipulated earnings aren't doing the trick, and how many jobs can be cut in the name of efficiency? Will it take more share buy-backs and take-overs? None of this is healthy.

The market needs to keep rising and appear to shrug off this Jobs' report. Right now the market is holding above key moving averages and support levels, and market breadth has been positive. The market could power a breakout in the Summer if the market reacts favorably to the Fed's Policy decision for June.

Financial Fragility at All-Time High

Politics on both sides of the aisle are a reflection of what voters are feeling in their day-to-day lives—and that feeling is uncertainty. An increasing portion of Americans are very financially 'fragile'. 2014 survey study found that only 38% of Americans would cover a $1,000 emergency medical bill or a $500 car repair bill with money they had saved. Another academic study found that a quarter of households would definitely fail to get their hands on $2,000 within 30 days in an emergency.

On this basis the researchers concluded that nearly half of Americans are 'financially fragile' and that includes a sizeable chunk of folks considered 'middle class'. Some 44% of middle-income households said they would struggle to raise the $400. But lack of savings is spreading. A quarter of people living in households earning $100,000-$150,000 a year (at the higher-income end of the middle class) claim not to be able to raise $2,000 within a month.

A major new analysis of income in America published by Pew earlier this month found that more than 80% of the country's 229 metropolitan areas have seen **real (inflation-adjusted) incomes** fall steadily since the start of this century. The steepest declines in real median incomes have been seen in cities hit by industrial decline, such as a 27% drop in Springfield, Ohio and 18% in Detroit. But even cities thought of as vibrant and growing have seen incomes falling.

The area around Denver, Colorado, has seen its population grow by 600,000 since 1999, but its median income has fallen from $83,500 to less than $76,000. Similarly Raleigh, North Carolina, is a fast-growing city buoyed by a cluster of research universities and biotech firms. Yet its median income has fallen by more than $11,000 to about $74,000 from $85,000. A good majority of Americans are living pay-check to pay-check and that makes them economically fragile and thus threatened in an increasingly uncertain economy.

Market Outlook

The asset markets are rising and falling on central bank policy. This month we have another Fed decision on interest rates. Given Friday's pitiful Employment Report a move seems unlikely, but they could still make a mistake. A hike would likely turn out badly. On the other hand, a rally from here may still occur. The latest pull-back and 'topping patterns' was proven to be just a dip, and the patterns have been technically 'voided'. The equity market essentially shrugged off a disappointing May jobs report on Friday, which sent a negative signal for the U.S. economy but drove optimism the Federal Reserve could wait longer before pursuing any short-term interest rate hike. Considering how bad the job report was, US stocks had a 'good' day. The S&P 500 continues to battle overhead resistance at 2100. This opens the door for a surprising rally in the Summer if the market can manage to punch through that key level.

Investment Strategy

In the current environment our work continues to favor fixed income and defensive equity holdings such as those in the staples, utilities, and telecom sectors. The market's rebound since mid-February has been led by these sectors. That is likely to remain. We also like high-grade bonds and preferred stocks.

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
45% Equity / 55% Bonds & Cash
MPT Moderate
40% Equity / 60% Bonds & Cash
MPT Conservative
30% Equity / 70% Bonds & Cash
MAC Growth
50% Cash / 50% Cash
Separate Accounts
50% Equity / 50% Bonds/Cash
Managed VA Accounts
25-30% Equity / 70-75% Bonds

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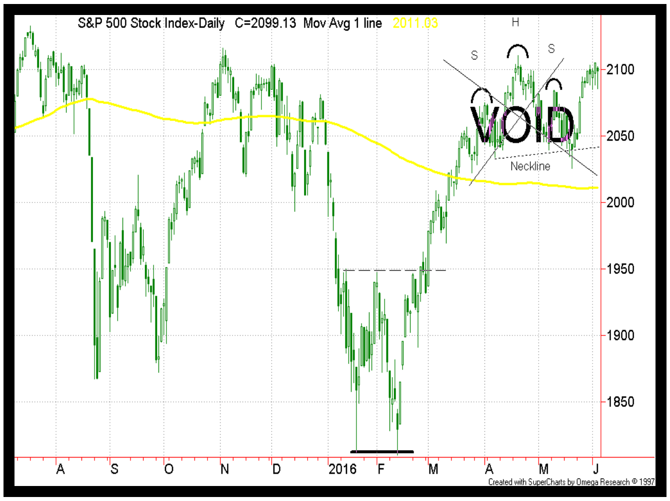
Market Charts—Bearish Pattern on S&P and Retail Sector Breaks Down



Head and Shoulders Pattern on S&P (Above Left)
April and May saw the S&P trace out a potential topping pattern called a 'head & shoulders' pattern for its resemblance as such. The pattern is noted above. The pattern fell below the neck-line in mid-May but the bears could not maintain downside momentum. As we noted in the last Update, "if the market can rebound and void the pattern, there is nothing more BULLISH than a failed bearish pattern. A failed head and shoulders topping pattern could see the S&P at 2300-2400 quickly. Between the Election and the Market it could be an interesting summer."

The move in late May invalidated the pattern, giving the bulls a chance for a break-out rally. Breadth has been solid and volume trends have been positive as well. The market managed to shrug-off Friday's bad employment report. Now it is imperative for the market to follow through on the gains of the past few weeks or the risk is another 'failure' at the old highs.

Hedge Fund Favorites Struggle (Above Right)
The High Beta ETF is filled with techs, biotechs, and other high growth / high beta stocks that hedge funds often favor. This ETF also represents a general gauge on risk-taking sentiment in the market.

Compared to the S&P in the lower panel above, the High Beta names are really struggling. This ETF remains 15% below its 2015 high, and that is WITH a 20% rally from the February lows. This while the S&P is back near its prior high. Clearly this rally has been on the back of blue-chips and the defensive consumer staple and utility sectors.

The High Beta ETF did break its down-trend line dating back to the 2015 highs, but diverged on last week's move. Until this ETF can get in synch high beta remains only high risk and not high reward.