Hamilton-Bates
Market Update
June 19, 2016

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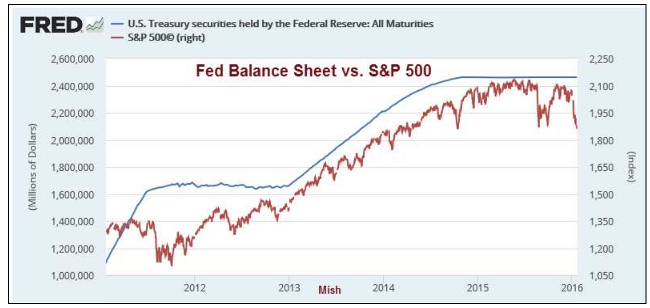
The market was within arm's reach of its highs but sold off from strong overhead resistance. The VIX witnessed a massive spike over the past few weeks as the market sold off. What worries us the most is the type of participation we are seeing in the market. Sectors like banks, biotech, and technology are not leading higher, but rather it's the more defensive areas like utilities, staples, and dividend stocks. Sentiment indicators continue to show most investors are in the "neutral" camp, so there is no real strong conviction in the market.

BREXIT?

The Brexit Vote on June 23 will keep investors on edge. Public opinion suggests about 45% of voters are in favor of Britain staying in the European Union (EU). In the event of a Brexit, we believe it would shock European markets, and other risk assets in general. The move to leave was leading the polls until this past week, when the tragic murder of Pro-EU MP Jo Cox by a lunatic put a dent in the exit momentum that had been building. European equity prices had been weak as investors feared the immediate negative impact on Britain's economy. It could also be the first falling domino of EU disintegration. The likely impact of an 'exit' vote would be a drop in the Euro, surge in the dollar, and near-term equity market weakness across the board. Should Britain vote to 'stay', we could see a rebound as recent weakness is unwound.

Earnings, Interest Rates, & the Economy

If we look back over the last 12-months or even little more, stocks have not really done much. That period corresponds with the ending of the Fed's QE program. The chart at the top of the next column put together by Mish Shedlock at www.mishtalk.com shows just how tight the relationship has been between QE and the US stock market.



In fact since 2012 each time the Fed has paused QE (the solid blue line moving sideways are the pauses), the market has dropped and ultimately gone nowhere.

On top of that, 'warnings'about failing central bank policy are emerging, from Deutsche Bank, Citigroup and Bank of America among others; as it seems confidence in Central Bank Policy is ebbing. The good old days when a simple quote to 'do whatever it takes' could move the markets are over. Now that interest rates are drifting below zero, and negative for much of the world, there's not much room left to move. **In fact, negative rates are proving to stimulate savings over demand- the opposite of intentions**.

The main beneficiary of growth in available money and credit since the Fed combined ZIRP and QE in the end of 2008 has been financial markets. An example is the outsized growth in U.S. equity markets compared to the tepid pace for GDP and earnings over the same period. The economy now clearly seems to be stalling.

At the start of the year, economists were expecting five rate hikes. But since December, the Federal Reserve has left short-term rates unchanged.
Several major economic indicators have recently disappointed, including both the May employment report and the ISM non-manufacturing survey.
For the 9th month in a row, US Industrial Production declined year over year. Most worryingly, and despite

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near record highs in stocks, **this is the longest streak of Industrial Production weakness without a broad economic recession in US history**. Could one be around the corner?

It is not just us that is concerned about the economy, Goldman Sachs' own economic indicator (CAI), a composite measure of economic activity based on the correlations between a large number of high-frequency indicators, **now stands at 1.2% in June, down from 2.2% in April. This is the lowest reading since 2009**. Perhaps not surprising is that this data series has been declining in virtually in lock step with the end of QE.

"Central banks are losing control and they don't know what to do ...," Jeff Gundlach of Doubleline

This quote echoes our thoughts, which is that the Fed doesn't understand what is going on in the economy, the other Central Banks are no better, and that confusion and their conflicted messages spills over into investor sentiment.

The experiment of zero interest rates and now negative rates is backfiring. In Japan they have had near zero interest rates for over a decade. And negative rates make things worse. Negative interest rates don't do what they're theoretically supposed to do. Negative rates don't stimulate demand as investors save MORE under such conditions because they are getting no return on assets. Negative rates are proving to not only have no stimulative effect, in fact it seems to be the opposite.

A nagging question stands out now. Has the FED used up all its anti-recessionary ammunition? Given the political gridlock, what can be done if the economy slides into recession. Would a DJI decline of 10-15% push the economy into a recession, given the importance of the consumption by those who in the top 1%? Perhaps this is why the Fed seems obsessed with the stock market.

Market Outlook
We are immediately focused on attractive opportunities and with the Fed unlikely to hike rates any time soon, fixed income remains attractive. The stock market has pulled back a couple percent but hovers just off all-time highs. As long as key support around 2015-2020 holds upside opportunity remains. Below that level we are more concerned with a return of our capital vs. a return on our capital.

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.

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—S&P Voids Bearish Pattern but Stalls at Long-Term Resistance

S&P Voids Head and Shoulders Pattern (Above Left)

The H&S Pattern was 'voided' by the move above 2080, but yet again the rally stalled at overhead resistance around 2140-2150. This level has resisted breakout attempts for over a year—ever since QE ended.

Historically failed bearish patterns such as what we just witness lead to higher prices, but Brexit concerns and the Fed's FMOC decision sidetracked the market this week. If the bulls can recapture momentum (say from a 'stay' vote in this week's Brexit vote, we could see a breakout and move to 2300-2400 quickly.

Long-Term S&P 500—Going Nowhere Fast

For much of 2015 and 2016 the S&P 500 has been stuck, going nowhere. Its no coincidence this period ties to the end of QE. With no QE, a sluggish economy, and lousy earnings, the market has gone nowhere. **Small-Caps and High Beta names are down 10-15%.**

A breakout above 2150 would be positive for the bulls and could lead to a move higher through the Summer. As long as key support around 2015-2020 on the S&P 500 (from the 200-day and 10-month averages) is not broken, the bulls have control.