Hamilton-Bates
Market Update
August 10, 2016

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We are in the 'dog days' of summer and the market is about as lethargic as we ourselves feel when we go outside and feel the oppressive heat (90 degrees 90% humidity) smack us in the face. There is also a clear lack of excitement in the market, even in the face of what is shaping up to be a 'bullish' breakout.

Just one year ago things were anything but lethargic, as the bottom fell out of the US equity market during the Wednesday before the August expiration, triggering one of the sharpest 3 day drops in recent history. This year there is no credit market meltdown, and there have been no lasting negative connotations over the Brexit vote. Things are quiet, but so far a good quiet.

Earnings, Interest Rates, & the Economy

On the economic front we saw a 'better than expected' employment report last week, but the majority of the gain was from 'seasonal' adjustments. We just don't trust the numbers, especially ahead of an election where there is a sure narrative to show 'growth'.

Even if you take the numbers on face value, things aren't great. Despite a better-than-expected July payroll gain of 255,000 jobs, the 1.7% year-over-year growth in payroll employment is just above the 1.4% rate that has typically been slow enough to observe at the start of most U.S. recessions. Essentially job growth is on par with very weak economic conditions no matter how you try to spin it.

The industrial and manufacturing sectors have been under serious pressure for some time, as U.S. industrial production has been in decline for over 18 months, and GDP growth has also slowed to rates consistent with the start of recessions.

Since 1948 all recessions started with an average growth rate greater than the current 1.20% rate. There have been only three instances where the 1-year growth rate was below the current level and a recession did not occur. Two of which were earlier in this historically weak recovery (2011/2012), but at that time weak growth was met with renewed rounds of extraordinary stimulus in the form of quantitative easing (QE). Since it would be tough for the Fed to argue that the economy was both healthy and in need of QE, its likely the Fed will do nothing this time around. The economy is on its own.

For now the world equity markets are acting well, but should there be a technical breakdown coupled with the weak fundamentals as a backdrop, things could get ugly quick.

Consumer Remains Pressured—Restaurants Soft

Restaurants are considered a leading indicator of the economy into a downturn. The theory is that restaurant revenues slow when consumers, whose spending accounts for about 70% of GDP, start having trouble with their wallets. Some call the current situation a 'restaurant recession.' The Restaurant Performance Index, released at the end of July, was just above the contraction level, following a recent decline. But the current situation component did fall into contraction mode (99.9) reported a net decline in same-store sales and customer traffic. The Fastfood sector which caters to the average consumer, has been hit hard lately. We'll keep watching the restauarant sector for clues on the overall economy. If this sector remains weak we could see further economic weakness ahead.

Negative Interest Rates have the Opposite Effect than What is Desired

Policy makers in Europe and Japan have turned to negative rates for the same reason—to stimulate their

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lackluster economies. Yet the results have left some economists scratching their heads. Instead of spending, many consumers and businesses are squirreling away more money.

When rates go to zero and below a strange thing happens, people stop spending and save MORE. Why? Because rates go negative only in extremely uncertain times, and in those times people save more. Also, when rates are zero or worse negative, you get no return on risk free assets, so you must save EVERY dollar you need for the future.

Consider this example from Bloomberg about a German fruit vendor. Anecdotal for sure, but likely a reflection of most sane folks in response to negative rates.

Two years ago, the European Central Bank cut interest rates below zero to encourage people such as Heike Hofmann, who sells fruits and vegetables in a small southern German City, to spend more. But When Ms. Hofmann heard the ECB was knocking rates below zero in June 2014, she considered it "madness" and promptly cut her spending, set aside more money and bought gold. "I now need to save more than before to have enough to retire," says Ms. Hofmann, 54 years old. "This is Madness". Yes, Central Bank madness indeed.

Market Outlook

The market continues its strong run up from the Brexit vote lows, and remain as it remains overbought we have seen only shallow and temporary pull-backs. Market Breadth has been strong and with no negative divergences, suggesting the highs for this move haven't been seen yet. Technically we are also seeing a 'breakout' by the market above its 2015 highs and above the trading range it has been in for over a year. There is no doubt that we are seeing a great divergence between stock prices and market fundamentals, but this condition can persist for a long time. If the current breakout holds we could see stocks rally another 10% before year-end. We are also seeing improvement in the technology and financial sectors, which could be getting ready to assume the leadership mantle. If so, it would have additional bullish implications for the market.

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. But with improvement in more growth oriented areas like technology and even small-caps, we are looking to increase our holdings in those areas.

Here is a listing of our **Portfolios** and where they stand.

MPT Aggressive
63% Equity / 37% Bonds & Cash

MPT Moderate
55% Equity / 45% Bonds & Cash

MPT Conservative
40% Equity / 60% Bonds & Cash

MAC Growth
50% Cash / 50% Cash

SECTORS
80% Equity / 20% Cash

Separate Accounts
60% Equity / 40% Bonds/Cash

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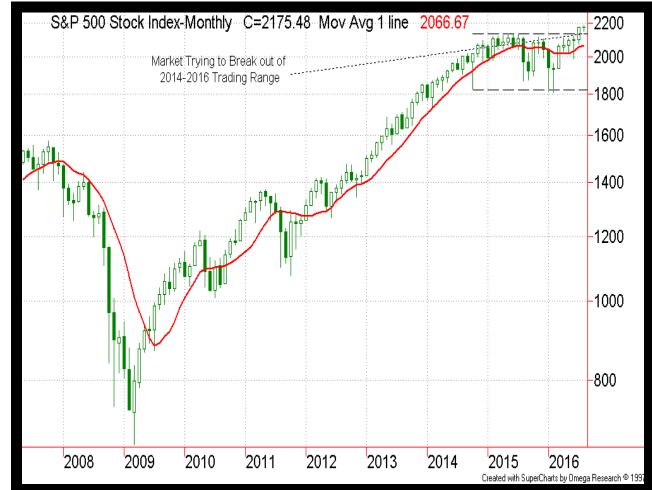
Market Charts—Market Trying to Build on Breakout



S&P Breakout (Above Left)
The S&P has moved sideways over the past three sessions and held short term support at the top of the tight three week consolidation pattern around 2150 on the S&P 500. We continue to mark first support there (2,150), and more important support at the 50-day ma, which now matches up with previous resistance around 2130. This level should act as firm support.

The key level is the prior highs around 2130, as long as 2130 holds on the S&P the bulls are in control. A legitimate breakout could see the S&P reach 2300 in 2016.

Long-Term S&P 500—Trying For Open Space (Above Right)
For much of 2015 and 2016 the S&P 500 has been stuck, going nowhere. But we are now seeing the S&P trying to break above the top end of the range. If we can see the market hold above 2130 for another few weeks, we could see money come pouring into US stocks pushing the S&P to 2300-2400 before year end. Could this be QE from the Japanese and European Central Banks?

A breakout would be very positive for the bulls and could lead to a move higher through the Summer into the Fall. The key levels are 2130 and 2060.

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