# Hamilton-Bates
# Market Update

*January 18, 2017*

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The market moved sharply after the Election, surprising many (including us) with the speed that the market digested the somewhat unexpected result. Far from being an unknown, the market rally was fueled by optimism that regulations would be cut back and pro-growth policies would stimulate the economy. Rate expectations shot higher and bonds struggled, while heavily regulated sectors like financials and energy carried the indexes.

Now that we are into 2017, and with the inauguration nearing, the market has stalled. From here it will depend on how swiftly and decisively pro-business and pro-growth policies are enacted for the Trump rally to continue. Speaking of the inauguration, we have read about problems that could coincide with the inauguration. Recent news articles from sources, in the US and abroad, suggest that severe interruptions of the inauguration are being planned and could occur. How severe remains to be seen.

**Economy, Interest Rates, and Earnings**

The stock market has moved up 7% since the election but earnings expectations haven't budged. In fact the retailers had a tough Holiday Season. It seems consumers now buy more cars for themselves than presents for others these days. The economy is moving along at a 2-2.5% clip, but hopes are high that Trump's policies can push that above 3.0%, a level that was never achieved by the Obama Administration on an annual basis. We will see if the Trump Administration can deliver growth. The Fed moved rates a quarter point in December, and they expect 3 moves in 2017. Perhaps, but from here they are much more likely to follow the lead of the bond market rather than risk hiking rates too quickly and trigger a slowdown. The last thing the Fed needs under a Trump administration is for them to cause a recession.

From our perspective the general improvement of global economic data since mid-2016 should be recognized as potential for a period of strong recovery, with the election supplying the emotional catalyst that allowed investors to act on this improvement. This is an important since it makes future progress somewhat less reliant on the actual legislative achievements that follow, particularly in the case of global markets. Still it will be up to the Trump Administration to show some follow through on anticipated policy.

**The Trump Presidency**

Global markets have enjoyed a benign start to 2017, but now eyes will turn to how Trump acts as President, and the extent to which he acts and can deliver on his promises. The markets are expecting a more pro-business government, and this has definitely helped sentiment. Despite this, markets are having to adjust to a leader that seeks to comment on specific issues and corporations with a frequency that is unusual. He can't stay away from Twitter. We heard the CEO of Levi Straus say that the fact that Trump 'tweets' has affected their actions. He is probably not alone. Businesses now have a better regulatory environment but now fear being called on the carpet by the POTUS at any minute. At present each comment elicits an immediate market response but we suspect that a degree of fatigue will set in before too long.

We would also expect to see the public relations department of all major corporations try and portray their corporate strategy to be in alignment with the broad aims of the administration and in particular there is likely to be a great deal of highlighting plans for manufacturing within the US, along with hiring.

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How willing the new administration proves to be in forcing change remains to be seen, but although we can expect some regulatory relief and perhaps a reduction in the corporate tax burden, there are some obvious potential flash points between the administration and fellow Republicans on just how that gets done.

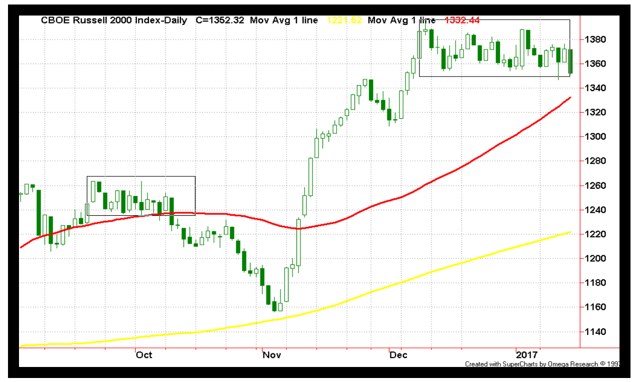
**Market and Investment Outlook**

We continue to see the post election rally as an adjustment to the improvement in the global economy along with a belief that less regulation could lead to improvements in the beaten down financial and energy sectors. The latter had been the engine of job creation domestically prior to the last oil price wipeout. Perhaps the energy sector could regain its footing under a favorable gaze from the Trump Administration.

Given the surge in consumer and corporate confidence that has taken place in recent weeks we would not deny that the election has had some role to play, but there has been a general improvement globally since October. The problem in the very near term is that the market rally has already discounted the next two years of what could be a most successful agenda. There little new reason to buy. And this coincides with an extreme in bullishness and almost an absence of bearish sentiment. That's a negative combination. The market hasn't done anything 'wrong' yet, but rather its gone sideways.

The chart of one of the strongest indices, the RUSSELL 2000 small cap index, is shown above right. It has gone nowhere the past month along with the DJIA. Should this index start to break down, it will look a lot like the pattern ahead of the weakness last September-October. Note that the sideways pattern of the last month is similar to that of Sept. 2016 (both boxed areas), which led to a strong decline at that time. Technically the market looks better, so hopefully support around the 50-day average just below current levels will contain any weakness. Even better, we'd see the averages break up and out of the last month's range. That could trigger enough momentum to see strength carry through Q1.

**Russell 2000 Chart**




The Trump Administration wont be without its stumbles, but if it can deliver even some of what it promised during the campaign it might allow the recently released business enthusiasm to spread throughout the economy, and give a boost to lagging earnings.

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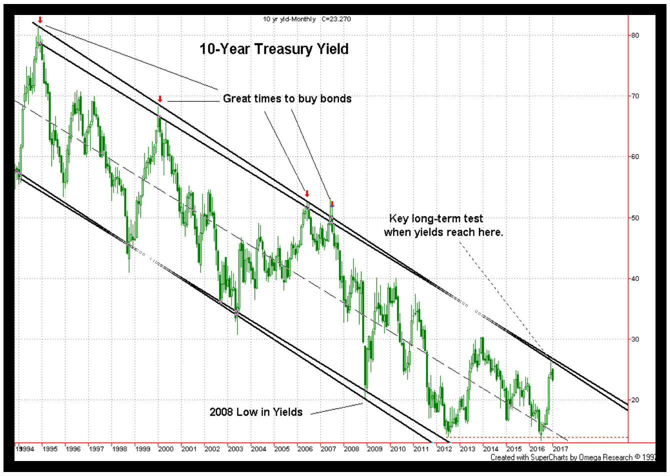
## Market Charts—Market Up Since Election but so are Rate Expectations


**Indexes Pushing Up to Highs**

After being stuck in a range for over a year the market started to move up and out just after the Election, a move which continues as we enter 2017.

**Market internals such as breadth and volume remain supportive, so as long as the S&P doesn't fall below key support around 2130-2150 the uptrend remains intact.**

The breakout from the 2015-2016 range projects a move to 2430, a gain of about 7% from current levels. That is our target for the 1H of 2017.




**Long-Term Down Trend in Yields Being Tested**

The long-term trend of falling rates has supported the financial markets for decades. The 10-year Treasury yield went from nearly 20% in the early 1980's to 8% in 2000, all the way down to 1.3% in July of 2016. That downtrend in yield is still technically intact, but for the first time it is at risk of changing. <u>If yields break this long-term down trend it would have huge ramifications for all assets</u>. A rise in yields could spike the Dollar to unhealthy levels for business profits overseas.

Fortunately, yields have dropped back after touching the trendline at the recent high of 2.64%. We look for yields on the 10-year to fall back toward 2.0% before any further attempt to move up. The short-term outlook for bonds is positive after a tough second half of 2016.