Hamilton-Bates
Market Update

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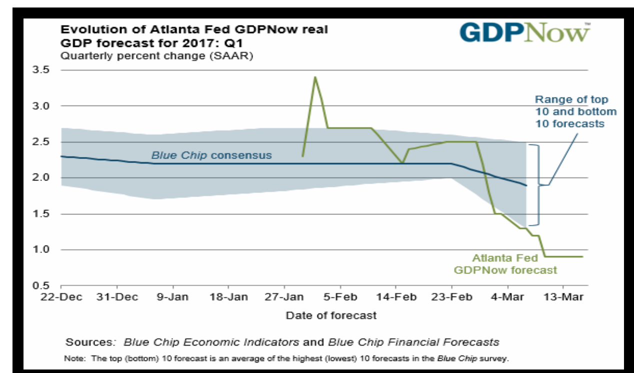
U.S. equities continue to inch their way forward, digesting another rate hike of .25% by the Federal Reserve. In fact, after the hike, rates dropped and equities rallied. Even metals like gold and copper, ended the week strong after being under pressure for the past month in anticipation of the hike. Keeping things in perspective, short term rates are now at .75%, and still historically low. Generally, to choke off bull markets short term rates have to get to around 3%.

Since the start of the year large-cap stocks (like the S&P) have gained an impressive +6.5% That's better than both mid-cap (+4.41%) and small-cap stocks (+2.6%). Meanwhile, long-term U.S. Treasuries (TLT) remain under pressure as investors see a tough road ahead with the threat of more rate hikes by the U.S. Federal Reserve.

As the first quarter enters its final two weeks, and we can't believe we are nearing the quarter pole already, our sense that this would be a period of accelerating global equity markets has continued to play out, bringing with it the likelihood that quarter-end flows will favor increased gains, particularly to economically sensitive equities. The fact that this has taken place even as some of the bloom on the new US administration has come off strengthens our belief that the main driver is a belief in fundamental improvement, as well as the promise of political stimulus in the months ahead.

Economy, Interest Rates, and Earnings

The Fed has now hiked at the last two meetings, seemingly just now getting serious about rate hikes at a time when hard economic data are actually starting to slow. First, the Atlanta Fed's GDPNow model forecast for real GDP growth (seasonally adjusted annual rate) in Q1 is now just **0.9% percent**, down sharply from 2.5% as late as early March and over 3% early in the year. Expectations for economic growth remain embedded in stock prices, but the underlying data is beginning to diverge. This could set up for economic and earnings disappointment ahead. See the GDPNow Model in the chart below.



As long as there are no 'jolts' from the Fed, like a 50 basis point surprise hike, the market has room and appetite for gradual increases. That is, of course, as long as modest growth continues and earnings do not fall off a cliff.

Trump Hope Hits Political Wall

There is a clear risk building that the hope for growth that investors have on the back of Trump Fiscal policy goes unmet, as Trump plans run into the reality of Washington politics. Healthcare reform, tax cuts, and fiscal stimulus sound great, but will be difficult to achieve legislatively in a short amount of time. It still remains possible that some of the goals will be achieved, but the idea that Trump can immediately push the economy forward is likely to get dispelled. Politics on both sides of the aisle is likely to mire things down. Consequently many of the sectors and

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that saw maximum interest and gains in the immediate aftermath of the election have seen fast money exit in recent weeks. Sectors like Materials, Real Estate, and Energy have come in a good bit and erased a good deal of gains. So we may be in a period where the some sectors and the overall market struggle a bit as the reality that Trump Policy may take time to implement, and that disappointment may create an opportunity for purchases.

Market and Investment Outlook

The Federal Reserve just raised the federal funds rate target for just the third time in 10 years, with all three coming in the last 14 months. The move was widely expected as the economy has been perceived as gaining traction, and inflation has picked up.

The good news is that the S&P 500 index has historically has risen during the early stages of a rate tightening cycle. The reason is because rates tend to rise when the economy is improving, which should ultimately bode well for stocks. Stocks only fall in the face of rate hikes when the weight of the hikes finally takes its toll on the economy.

We remain a bit weary in the short term only because the market could be disappointed in the lack of policy measures, and the data seem to be indicating a slowing of growth. We could be nearing a hiccup point for the market.

While the longer trend suggests the path of least resistance and may be higher over time, the slowing of upside momentum could see stocks consolidate here or early in the second quarter. One thing that has our attention is the lack of participation from small-cap stocks. Given favorable domestic policies, we would have expected small-cap stocks to emerge as leaders here. So far in 2017 they have not. Should their relative weakness turn into outright weakness, it would be a negative sign.

So far in 2017 stocks have been remarkably resilient and calm has permeated the investing landscape; the Volatility Index has dropped near multi-year lows. But that doesn’t mean investors should be complacent. The British Parliament passed a law this week allowing the Prime Minister to formally submit official notice of "Brexit" to the EU, and begin what may be two years of negotiations. This could be something that could add some headline risk to stocks in the months ahead. So could earnings that come in worse than expected. Economic growth is generally holding, but may not be accelerating as many expected. Market strength likely buoyed the Fed's confidence to raise rates again. The U.S. bull market is likely to continue, but we also believe volatility will pick up and pullbacks will occur, so remain disciplined. We could see a market ‘hiccup’ just before or just after quarter end.

We are going to do a Performance Update and Review for our Portfolios right at quarter end.

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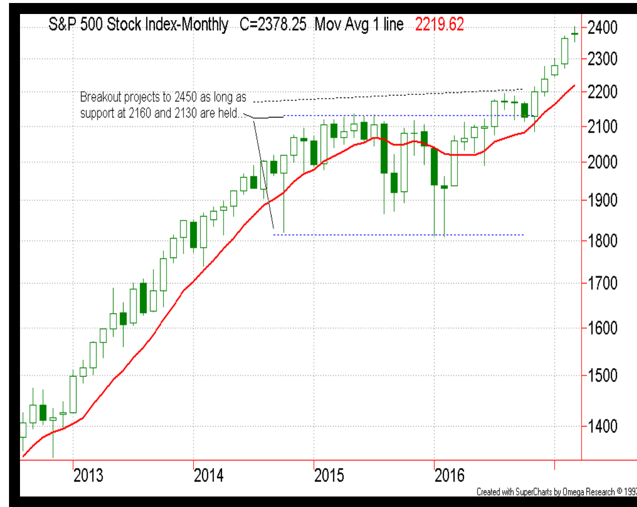
Market Charts—Market Up as Rates Test Key Trend-line



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.

The breakout from the 2015-2016 range projects a move to 2430, a gain of about 3-4%% 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.

If yields break this long-term down trend it would have huge ramifications for all assets. A rise in yields could spike the Dollar to unhealthy levels for business profits overseas.

Even with the Fed hiking rates twice yields haven't broken this long-term downtrend. With sentiment so universally negative on bonds it seems ripe for at least a short-term bond market rally.

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