# Hamilton-Bates
# Market Update
*April 11, 2017*

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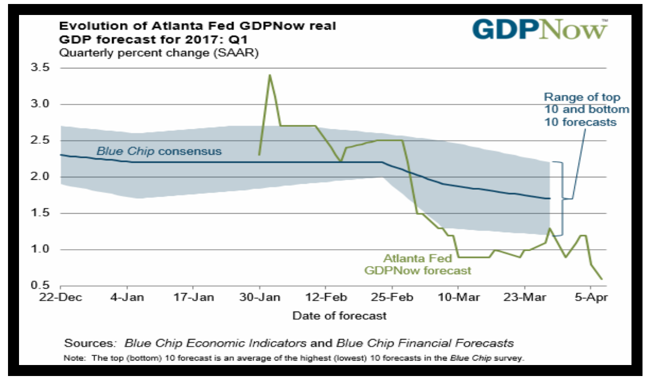
The first quarter started with high expectations that the incoming administration would deliver on fiscal stimulus, regulatory relief, and tax cuts, but those hopes faded over the past two weeks with the failure to pass healthcare reform. That has now called into question the timing and prospects for impactful stimulus and overseas dollar repatriation. The Trump Train ran squarely into the wall of Washington politics, and the market has entered Q2 with some concerns as the market digests these prospects and deals with rising overseas tensions.

Uncertainty around the upcoming French election and lack of clarity on timing of the US tax reform could continue to weigh on the market in the near term. However, unless market breadth deteriorates, and we a sustained break of key levels, the market is likely to remain resilient and supported by belief in the Trump and Fed ‘puts’ (the idea that Trump and the Fed ultimately would backstop the market doing whatever it takes to prevent a big sell-off). On balance, we continue to maintain a positive view, but the skies aren’t completely blue. <u>Faith</u> and <u>Hope</u> in Trump will have to be met with some <u>Reality</u> in coming months if favorable conditions are to come together and set the stage for the market to reach new highs in the second half of 2017.

**Economy—Q1 GDP Expectation drops to 0.6%**
Could the Fed be making a mistake once again? After hiking in 2008, and missing their opportunity to raise rates in 2013, the Fed is now hiking at a time when ‘hard economic data’ are starting to roll over. Continued Fed hikes in the face of a slowing economy is becoming a risk for the financial markets.




The Atlanta Fed’s GDPNow model forecast (chart above), which tries to show economic data in real time and give a real-time projection for GDP growth, is now down to 0.6% for Q1, falling 2.8% from a 3.4% expectation in late January. That is an 80% cut in GDP expectations in 2 months!

The forecast for first-quarter real GDP growth fell after a weaker light vehicle sales release, a softer ISM Non-Manufacturing Report On Business, and weaker March employment release from the U.S. Bureau of Labor Statistics. The labor market had been fairly strong, but the March jobs report showed a creation of just 98,000 jobs, well below the expectations of 178,000. Many dismissed the data as weather related, but coupled with the sharp drop in the Atlanta Fed model and related economic data, dismissing this weakness may be a bad idea. Perhaps the recent drop in bond yields and flattening of the yield curve are telling us something. Quarterly earnings are out over the next few weeks, and we’ll be playing special attention to forward looking comments on the economy.

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**Trump Hope Hits Political Wall**

In the last Update we noted that the biggest risk to the market was policy risk, where investors hopes for favorable fiscal and tax policy are dashed by Washington politics. That seems to be playing out in spades, with the Freedom Caucus stopping the repeal of Obamacare, and with last week's announcement that Trump's 'huge' tax reform would be scuttled for a new plan. Its back to square one for Trump. Washington politics seems to be the one thing that could derail the Trump train, and now we have geopolitical concerns in Syria and North Korea. The market has been pretty resilient of late but that resiliency could be tested over the next few weeks. A lot is now riding on good earnings coming from corporate America.

**Market and Investment Outlook**

Policy remains a source of upside risk for equities, but now in addition to Washington we have added the Federal Reserve. We don't want to see them continue a trend of hiking should data weaken from here. The failed AHCA bill and follow-up announcement of a scuttled tax cut plan has led investors to question the administration's legislative efficacy. On the positive side, perhaps the repeal of ACA won't be seen as so negative IF it pulls forward the timeline for the tax reform. At least tax cuts have broader and more bipartisan support than the healthcare bill. Even if a Tax Reform plan proves to be less ambitious than once thought, it still would be an upside boost for earnings and the financial markets.

While the longer trend remains positive, the market has hit the first real hiccup of 2017. The past two weeks have seen a return of volatility after a record run of sub 1% daily moves for the market. Buying the dips remains the prudent plan until its proven to be otherwise, as most bouts of market weakness find willing buyers after a drop of 2-3%. We have seen the consolidation we expected in the opening weeks of the second quarter.

We expect this dip to once again be one that is bought. Some positive signs are coming from the small-cap sector, which lagged in Q1 and even went negative on the year at one point last week. This week has seen small-caps get a bit of a boost, even turning positive today on a day when the rest of the market is still red. Should it last this strength could be an early sign that the current market weakness will soon pass. Should small-caps reverse and continue to head lower, however, we'd once again consider this a negative sign.

**Managed Accounts**

We remained generally sanguine in Q1 and largely exposed to the equity markets and high yield sector of the fixed income arena. These positions allowed our portfolios to make solid gain after a frustrating 2016. Here are Q1 results for our portfolios:

| | |
|---|---|
| **Tactical Equity (MAC Growth)** | **8.36%** |
| **Tactical Sectors** | **6.21%** |
| **Tactical Income** | **3.20%** |
| | |
| **Balanced Aggressive (MPT Agg)** | **5.35%** |
| **Balanced Moderate (MPT Mod)** | **4.40%** |
| **Balanced Conservative (MPT Con)** | **3.01%** |
| | |
| *Indexes* | |
| *S&P 500* | *5.50%* |
| *NYSE Composite* | *3.94%* |
| *Russell 2000 Small Cap* | *1.69%* |
| *US Government Bond Index* | *0.68%* |

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


**Pause to Refresh? Or Breakdown?**
The market tired in Q1 after four months of gains as stocks peaked in late Feb and took March off. So far the consolidation has resolved into a gradual pull-back to the 50-day average, a natural level of support.

Some backing and filling around this level makes sense, although a break below the 50-day AND the mid-March low around 2330 would tell us the correction was becoming a little more severe.


**Indexes Pushing Up to Highs**
The breakout from the 2015-2016 range projects a move to 2430, still about 3-4% higher than current levels. As long as economic data doesn't fall off a cliff that is our minimum target for the 1H of 2017. After four months of gains however, the market could need a pause.

**Only a break below the 10-month average now at 2220 would turn the long-term trend down.**