Hamilton-Bates

Market Update

May 1, 2017

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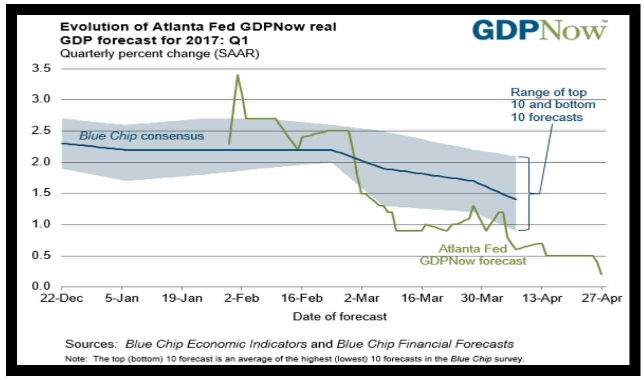
US equities rallied last week, rebounding after meandering sideways since late February. The DJIA and S&P were up 1% with the small-cap Russell 2000 adding over 2%. The NASDAQ 100 closed the week at an all-time high, finally eclipsing the tech-bubble peak back in 2000. Several sectors gained ground including semiconductors, which reasserted itself as the leading sector and regained its bullish phase. Consumer discretionary also is leading, while safe havens such as Utilities and Gold were weak.

Interestingly, the advance occurred despite increased geopolitical tensions that included a duel between the US and Russia regarding who's got the bigger bomb, and North Korea vowing to continue missile tests. As the market saying goes "Its not the news that matters but how the market reacts to it". For now at least geopolitical tensions don't seem to be a problem.

Economy—Q1 GDP Weakest Since 2011

What could be a problem is the economy. Q1 GDP came in at 0.7%, the weakest since the heels of the Great Recession and a sharp drop from the 3.5% expected as late as the end of January. The chart above right shows the precipitous slide GDP expectations made over the course of Q1 as data came out. It shows a clear weakening in economic data.
It appears the bond market WAS telling us something with its rebound after the post Election drubbing and its persistent strength in the face of Fed tightening policy.

Economic data now suggests there is some risk of a recession in 2018 if Fiscal or Tax stimulus is not provided, **especially if the Fed continues to tighten policy.** The question we have is why the Fed is raising rates when Q1 GDP growth is below 1%, there was under 100K Payroll job growth last month, and a



negative reading on both the headline and core rate of consumer price inflation? We are not saying the Fed is playing politics, but under Obama these numbers would have triggered an avalanche of Fed-speak about supporting the economy. Now, the Fed seems intent on hiking rates in the face of clearly slowing data. The fear we have is that the Fed has duped itself into believing it fixed the economy by its massive distortion of interest rates (100 months of less than 1% Fed Funds Rate), which has forced stock and home prices to record highs, and debt levels soaring to levels never before seen. If the data remain weak and the Fed continues to hike—there is real risk of a major policy error.

We have a sub-1% Q1 in the books, and Q2 isn't starting any better, as Services and Manufacturing PMI's have given back all of the post election bump, even as the stock market has held onto the majority of its gains. If PMI's need to move up or stocks will move down to join them. The chart at the top of the next page shows the PMI's versus the stock market. First quarter earnings were strong but that strength will be fleeting if the economic data continue to weaken.

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The PMI data suggest the US economy continues to flounder at the start of the second quarter. **The surveys are signaling a GDP growth rate of 1.1% after just 0.7% in the first quarter.** The services sector of the economy saw the weakest monthly expansion for seven months and the manufacturing sector showed signs of growth slowing further from the two-year high seen at the start of the year. The PMI's have given back all over their post election gains. The labor market also continued to soften. The PMI surveys signaled a marked step-down in the pace of hiring in March which has continued into April. The latest survey data are consistent with only around 100,000 non-farm payroll growth which is what we saw in March. The PMI surveys indicate that some of the bubbly hope has come off the economy since the post-election bounce seen at the end of last year.

Historically Q1 has been the trough in the economy, with strength and business picking up as the year moves along. As long as business optimism about the year ahead continues to brighten, there's good reason to believe that growth could revive again in coming months. Again we will continue to watch the bond market as we believe it will provide the clues on whether the economy is blooming or busting.

Market and Investment Outlook

Coming up we have the French election that can be added to the growing list of geopolitical events that based on recent history should be ignored by investors. At worst it seems we might get a similar post-Brexit dip that is likely to be bought.

In the US we still have the rumblings of politics to contend with, but it is notable that there seems to be an agreement to avoid a Government shutdown. Investors seem to have realized that progress on **ANY** legislative matters will be a slow process and that the initial proposals are likely to be altered considerably before any concrete legislation can be advanced. Thus while it would be wrong to suggest we have moved into a 'post political' environment, it seems we may have moved out of the period in which polls and tweets dominated short-term moves across indexes and asset classes.

The long-term trend remains up, and the intermediate-term rally in stocks that started after the election also remains intact. Stocks have been helped by solid first-quarter earnings reports that showed encouraging signs of improving economic growth, even as economic data itself weakened. Healthy corporate earnings have been a key contributor to market strength. Thus far, the S&P 500's first quarter year-over-year earnings growth rate of 12.5% is the highest mark since Q3 2011, according to FactSet. **As long as the economy rebounds from a Q1 nadir, there is reason for hope on the earnings front after several quarters of bad data**.

Looking ahead we have the NASDAQ at a new high which is bullish, but the S&P stalled at the Feb high around 2400. A breakout above 2400 could see a quick 3-4%. That is the level to watch.

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Managed Accounts in Q1

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%*