Hamilton-Bates

Market Update

August 29, 2017

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Storms, Missiles, and Disappointment

The last few weeks of the summer ahead of Labor Day are traditionally sleepy, with little volume and not much happening. Not this year. Mother Nature has inflicted a terrible blow with the worst rain event from a Hurricane in history. Four feet of water in a few days is an awful lot of water, essentially a years worth of rain, and the situation in Texas is a tragedy. Lets hope the weather abates <u>and</u> Washington can get put aside politics to relieve the situation.

As if that wasn't enough, North Korea continues to seek relevance through Saber Rattling, and launched a short-range missile over northern Japan. Rather than an attack, it seems most likely this was a move to show that North Korea could hit US assets in Guam if it wanted to do so. Initially futures dropped on this news, but once the market opened stocks have gradually recovered the early losses. We believe North Korea is seeking a better negotiating position, and in terms of personality traits we hear Kim Jung Un is more rational than his father was. China holds the key to the situation, but it has so far failed to put the screws on North Korea for fear of a massive influx of refugees should things completely fall apart there. Perhaps they secretly like having the US stuck at a stalemate and be otherwise pre-occupied with North Korea.

On top of it all, it seems the market is becoming increasingly disappointed with Washington, and the lack of virtually any meaningful legislation from a GOP controlled House, Senate, and White House. In addition, they are running out of time as there is a lot to do just in terms of the debt ceiling to avoid a shutdown, and not a lot of time to do it with just 12 legislative days before Congressional Break. Our own disappointment with the lack of initiatives from the GOP is sizable, and we wonder just what they have been doing for the last eight years other than complain about Obama. It seems the GOP just wasn't ready to lead—and that is disappointing. Investor 'hope' in the wake of Trump's election seems to be dissipated. The only positive from that is IF there is any tax reform it will most certainly boost a market that no longer has priced it in.

Economic and Earnings Outlook

The economy and earnings seem to be humming along, with moderate earnings gains for the year and quarterly GDP growth expectations north of 3% based on the current Atlanta Fed GDPNow model. But we continue to have concerns, largely based on how certain equity sectors and indexes are trading (see chart section on page 2). The market seems to be telling us we should have concern for things domestically. Global growth remains pretty steady thanks to Europe and a weak dollar. But the Fed should be more concerned about the economy than raising rates.

Market and Investment Outlook

While the majority believe the economy is on the verge of strengthening, we continue to see the market provide signs that it is weakening. Washington D.C. and the Fed need to wake up.

The long-term trend has not been broken yet, and we are currently just seeing typical corrective activity after a pretty big run from the 2016 lows. Now in a seasonally weak period, further equity market weakness is very possible into September. Unless we get confirmation of a long-term trend change, September weakness is a buying opportunity.

As the past several weeks have shown, interest rates are not likely to rise as fast as the Fed thinks; growth remains below trend, negative signals from key

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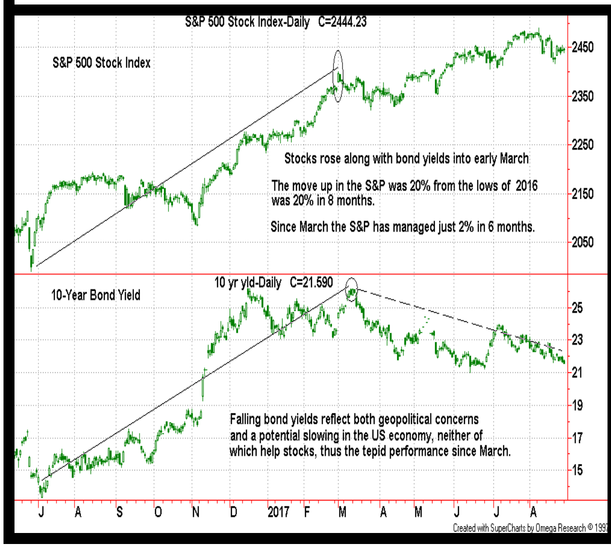
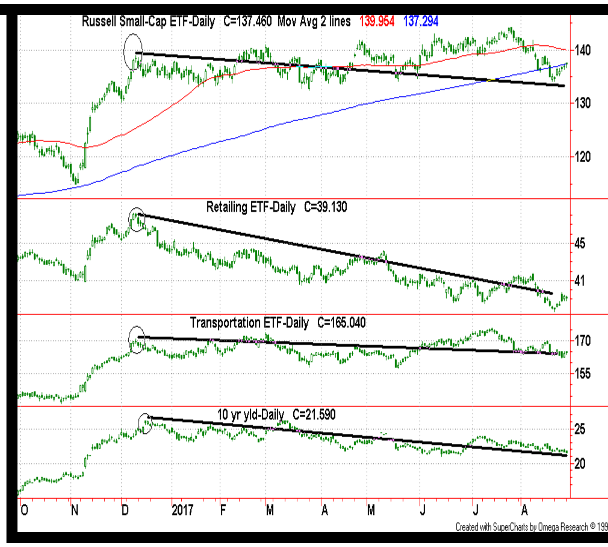
sectors remain, and geopolitical concerns remain. All these factors continue to support bond prices and make most segments of the bond market worth holding. The one segment of the bond market we have concerns for is High-Yield. Were the economy to slow, High-Yield bonds would fall, so we continue to monitor this fixed income area closely. Overall, despite a Fed that continues to talk up rates, bonds remain a solid portfolio holding for income and a portfolio hedge for any stock weakness. Stocks have room to bounce after an early Fall dip as the concerns we have for the economy are for 2018, although legislation such as tax reform or fiscal policy could avert any slowing.

Market Charts—Growth Hope Peaked Out in March





Stocks Stall as Bond Yields Fall (Above Left)
After a strong rally from the 2016 lows the stock market seems to have peaked out, and this peak coincides with a top in bond yields. Bond yields rise along with stocks when growth is at hand, and bond yields tend to fall (with stocks) when geopolitical and economic concerns rise. Since March yields have been falling, and the stock advance has slowed. We are also in a seasonally slow period, when vacations occur and stock market volume is low, so moves are magnified. September is shaping up as a key month.

Concern for the Economy (Above Right)
We know stocks have stalled and bond yields have fallen as investors seek safe havens amid geopolitical concerns with North Korea. GDP expectations for the current quarter remain above 3%, but should we be concerned about the economy? The chart above shows Small Caps (IWM), along with the Retailing and Transportation ETF's. All are tied to the health of the US economy. What we see that they all peaked out back in December, and have been generally falling since the peak in bond yields. This suggests there should be some concern about the domestic economy.