Hamilton-Bates

Market Update

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Tariffs, Trade Wars, and Tweets
After furious two week rebound that saw the major averages recoup 2/3 of their early February decline and had the NASDAQ within a hairsbreadth of the old high, the rally ran out of steam and we have seen the re-emergence of selling.

The 'cause' presumably was President Trump's tariffs on steel and aluminum from China, and a tweet about trade wars. But even prior to that, the market was looking like it had come back too far too fast. When a market is vulnerable nearly any bad news is enough to topple it over. That is what happened. Tariff's aren't popular with the GOP, even if they are justified, and after a number of departures from the White House there is one more we are worried about. That would be a departure of Gary Cohen, the key Economic advisor and driver of the tax cut plan. If he were to leave the market likely would not like it.

Economy and Earnings
GDP was revised slightly lower to 2.5%, but still a respectable number after barely getting above 2% for any sustained period the past few years. Earnings have been strong but comparisons from here will get tougher. The key we think to the outlook is whether the Fed will get the rate hike cycle correct or will they overdue it at the wrong time and roll the economy over. So far they seem measured. So far so good.

Market Outlook
Its been a tough week with the market on track for 4 days of nasty selling (depending on how it trades after the open today). But this market isn't doing anything wrong, in fact it is keeping to a typical correction playbook whereby an initial plunge is followed by a powerful snapback rally and then a period of violent range-bound trading. Eventually either a secondary collapse below or to prior support takes place, then the market recovers and the up trend resumes. We are not worried so much about day to day ups and downs, as much as were are looking at the overall structure of the market. This second pullback after an initial rebound is historically very normal.

Our assumption is that the bullish scenario will prove to be true for the US market and for emerging markets, but this may not be true for certain markets and sectors that may have already entered a more adverse operating or valuation environment (Staples, REITs & Utilities come to mind). Staples recorded a new 2018 closing low on Wednesday, after having a very weak rebound. This looks to be an area to avoid. With a few sectors showing vulnerability, it is likely to be a narrower market that emerges and one that may continue to see more volatility than the unusually placid year of 2017.

The market's strong initial rebound, one that took many indexes back above their 50-day averages (before rolling over this week) tells us there is still solid momentum in the market. The NASDAQ nearly hit the old high. Many will scream 'double top' but we consider that move to be a plus. Its providing leadership. This doesn't guarantee that a full retest of the February low can be avoided, but tells us not all sectors will perform equally. How deep we go depends mostly on the nerve of investors and how many 'weak holders' were really shaken out during the first decline. What we would say is that without seeing true deterioration of overall fundamental conditions (we are not), the early February decline to around 2500 in the S&P 500 should have been sufficient to correct the excess that had built up in early 2018, and that a retest close to this level would not really change anything.

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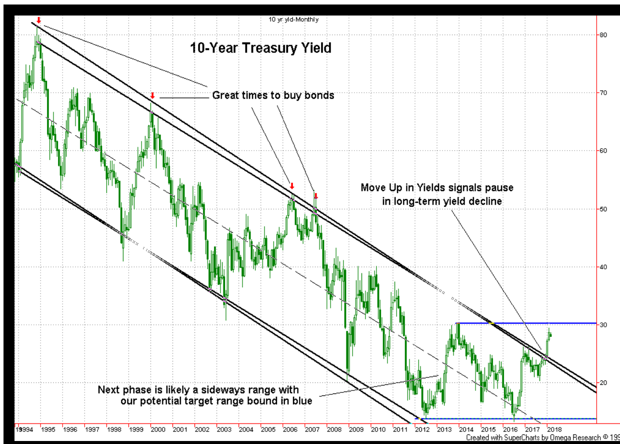
Market Game Plan
The sharp rebound had us pausing any buying for NEW clients and NEW money. That buying will resume over the course of this decline in measured fashion. What we did do for managed portfolios was EXCHANGE a couple of high-growth funds for more conservative indexes, reducing our portfolios overall risk levels. This de-risking occurred prior to the current selling wave and have our portfolios falling much less than the overall market. They should now react much more defensively.

We are prepared if there is more selling to come. High levels of cash and bonds should mitigate the declines in portfolios. So far we held through the first decline and lightened up on the ensuing rally. We believe there will be better and safer opportunities in the days and weeks ahead. This decline is normal and moving the entire 'corrective phase' that much closer to its completion. Now we will look to buy back positions sometime over the next week or so.

Market Charts : Stock Rebound Runs Out of Steam—So Does the Spike in Yields

S&P 500—The first drop in the market was steep, dare we say almost 'crash-like'. But the drop was stopped dead at the 200-day average (yellow line). From there we had a strong rally that nearly made a 'V' in many sectors and indexes—especially those related to technology. This week's decline is not unexpected and tracks with historical market performance. We'd expect the market to hold in and around the prior lows +/- a few percentage points. See the idealized correction pattern in the chart at left.



Bond Market & Interest Rates—long-term US interest rates actually declined in recent sessions, with the 10 year yield falling back 10 basis points from recent highs near 3%. That first try at a push above 3% failed as the bonds found willing buyers, and that level remains the one to watch. A push above 3% that sustains could be a problem for stocks. Yields are overbought and should drop down toward 2.6%, giving the equity market some breathing room with regard to interest rates.