Hamilton-Bates

Market Update

March 29, 2018

P.O. BOX 270 Newtown Square, PA 19073 877.768.4247 www.hbir.com

As we head into the last trading day of Q1, the major averages are down modestly (low single digits). But that really doesn't tell the whole story, as it was clearly a quarter of 'two halves'—the ramp up in January and the unwinding of the that ramp in February and March. The last two weeks especially have been enough to give one whiplash—or reaching for the Dramamine. The intraday, day to day, and week to week moves have been extreme. It appears that our call in the 2017 Year End Update for increased volatility in 2018 was spot on.

However, there has been some 'order' amidst the chaos, as the major averages now look to be tracing out the second low of the traditional 'W' shaped pattern for market corrections. We discussed this at length in the February notes, but by mid-March it looked like we might not need to make this second low at all. The small-caps and NASDAQ were challenging their peaks or making new highs. But in the end, 'history' prevailed, and the past two weeks have seen the market give back the rebound gains and move back to those early Feb. lows.

Now the market is in 'make it or break it' territory. So far the major averages like the S&P 500 have stopped at the right spot, respecting support around the early February lows of 2580-2600 on the S&P 500 (see the **Market Charts on Page 3**). So far this support has turned away any further weakness. We were disappointed to see Monday's big rally reversed, and we have been disappointed in the subsequent lethargic rebound attempt. Perhaps investors are hesitant ahead of the long Holiday weekend (the financial markets are CLOSED on Good Friday). As long as nearby support holds the chances for the completion of the corrective process remain good.

A concern we do have is that the longer the market lingers near the 200-day average, the better the chances of breaking it. We'd like to see the market put some distance between its price and a rising 200 day ma, and then continue to keep well above it for a period of time if it is to hold as valid support.

We cannot stress enough how important these nearby support levels are. Everyone is watching these levels. Double-bottoms are well-known and well-respected patterns, with a proven history of validity. If these levels hold and we see the market start to move higher—bullish enthusiasm could return quickly. On the other hand, if the 200-day average and early February lows are broken, it could get messy with the potential for a further accelerated decline, with DJIA 23000 and S&P 500 2500 as round number support and potential targets.

Economy, Earnings, and Interest Rates

The market volatility in 2018 has been greeted with some confusion, because it is such a contrast to 2017, and due to the lack of an obvious real-world reason. In 2017 the market responded to all news with equally bullish enthusiasm. Not so for 2018. Certainly the underlying

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fundamentals for both the economy and earnings remain strong at present. The latest data shows as much. The latest 4Q GDP Growth figure was revised up to a tick below 3.0% at 2.9%. That's not bad at all. Earnings have been robust, with the last quarter seeing the best earnings growth in years, and the upcoming quarter results (due in the next few weeks) are expected to be strong as well. We have also noted a lack of earnings warnings so far. If earnings come in strong this coming season, it will be a big boost for stocks, and could be the impetus that gets the market off the mat and sets it off on the next leg higher.

In addition to price volatility, there are some signs that very short-term coincident economic data are softening. These are short-term measures and are vulnerable to significant fluctuation, but their weakness is adding to investor concern. Both Westpac's data pulse index, which tracks economic data outcomes relative to prior reports, and Citigroup's economic surprise gauge are weakening.

There is no doubt the market is undergoing a 'growth scare' at present. For us, it is still way too early to make any prognostications on the economy, we'd have to see yields on the 10-year come down much further before we get concerned over growth. We'd also have to see more than just a flattening of the yield curve, we'd need to see an outright inversion (where short-term yields are above the 10-year).

There is also some concern that the current market volatility will sink consumer and corporate optimism—that the increase in market volatility itself is the key fundamental change. That could happen, but like the short-term economic data above, it might be a little premature to think that is happening right now. It did happen in 2008 but that decline was months not days. In 1987 a 20% crash, and 30% peak to trough drop over a much shorter period of time, did NOT sink the economy. A recession did not begin and was still nearly two years away. It would take a more sustained decline in the stock market to make a lasting change in overall economic sentiment.

Market Outlook and Investment Strategy
There is no doubt that after a very calm and benign 2017, the volatility of 2018 has fueled near-global risk aversion. Both stocks and bonds have had a tough go in Q1. The MSCI All-World Index of global stocks is poised to snap a seven-quarter winning streak, its longest positive stretch since 1997, and global bonds are set for their first decline in since 2016.

The bottom line though is that if current levels hold on the market averages, the corrective process is nearly over, despite all the hand-wringing on CNBC. If so the next move will take the market to new highs. There is no need to 'rush' too early or too quickly to make purchases though-since past history of 'failed' double bottoms isn't pretty.

Our models did trigger some moves in the past 10-days, causing a slight cash bump a little over a week ago, and a shift out of high-yield bonds into Government Bonds. As situated, our portfolios would be fairly insulated from further weakness, but positioned with cash to put into the appropriate areas if events unfold as anticipated. If we are correct, that money will be back at work over the next week or two.

The Financial Markets are Closed on Good Friday, so this is the last trading day of the week. Please have a safe and Happy Easter Holiday.

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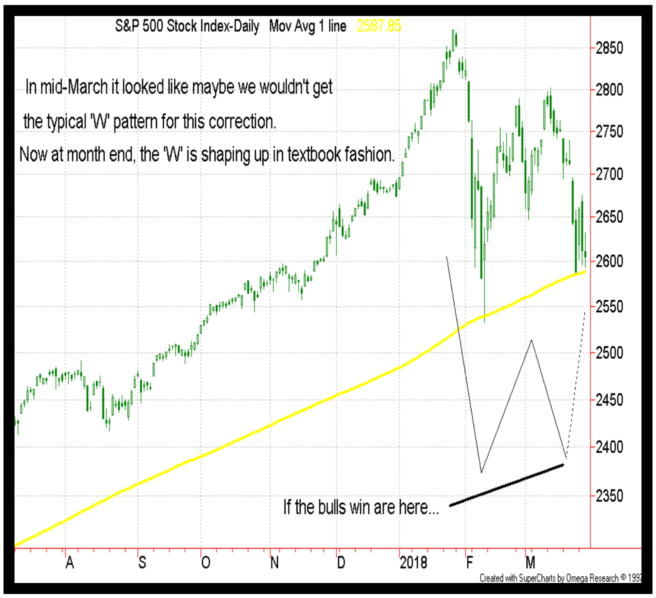
Market Charts : Key Levels Both Short-term and Long-term



S&P 500 Daily Chart—The S&P looks to be tracing out a normal 'W' shaped correction pattern. It normally takes more than one low to mark the end of a correction and the 'W' or slight variation allow for that. 'V' bottoms are not as common as recent market history has shown, with normal corrective processes taking some time as well as price.

The February low and the 200-day average (in yellow) are critical levels to watch. If they hold, and as long as they do—we could be progressing to near the end of the current corrective process.

If the market fails to hold, prior breaks have led to further declines and increased volatility, so the next week or two are very important.

S&P Long-Term Chart—Still no break in the long-term trend for the S&P 500, although the current decline has the S&P resting right on its 10-month average (in red). Since 2009 breaks of this average have been rare, so a move below it would have to be respected, especially after such a long bull run.

Just like our outlook for the S&P 500 Daily Chart above, we expect support to hold, and if a break does come we think there will be a quick flush and recovery. On a monthly chart like the one at left, the break would be intra-month with the market closing the month back above this key average. We still believe the bull market has some upside left to it, and until proven otherwise this bull gets the benefit of the doubt.