Hamilton-Bates
Market Update

April 12, 2018

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What We Got Here is Failure to Communicate
There is no question volatility has picked up dramatically in 2018. We had the January run-up then subsequent decline. Now we are getting something different. Over the past few weeks, we have had big daily moves (up one day, down the next) but little overall movement. So despite the fact that the market has experienced considerable daily volatility, has been essentially running in place over the past few weeks.

We think this a fair reflection of the bold title above, where tweets and headlines over Syria, the Mueller Investigation, and Trade Wars often refute each other within days or hours. This 'failure to communicate' or lack of resolution creates a big 'tug of war' taking place within markets, making them subject to a wide and violent trading range without really going anywhere. Clearly the market is not getting definitive answers on any of the major concerns.

Earnings season is about to start, and expectations are pretty high. If earnings results and outlooks are good, that could be the impetus to start the next sustained rally.

Trade War?
It is ironic that the authoritarian Chinese regime has been the apparent defender of globalization and 'free trade' recently, but it is easy to argue in favor of the status quo when that status has been favoring one's own country and corporate sector for the last 20 years. The US arguably has a reasonable case to make on its behalf and on behalf of other nations, but the administration appears determined to make it using the least reasonable language possible. This has clearly unnerved investors and most of the market's recent moves could be traced directly to Presidential statements made regarding this issue (or Syria). It seems like this could be a battle of egos where no one wants to be seen as 'backing down'.

Economy, Earnings, and Interest Rates
It was a big week last week, data wise, kicking off with March's ISM data. Both the manufacturing version and the services version fell from February's levels, but both remain in solid up-trends. Last week's big report was March's jobs report. Following Wednesday's big ADP numbers, indicating another 241,000 new positions, hopes were high heading into Friday's report from the Department of Labor. Big mistake. On expectations of 175,000 new jobs we saw only 103,000. That translated into a slight up-tick in the unemployment rate, from 4.0% to 4.1%. There were upward revisions to prior numbers so overall not too bad a number. Now if we see a trend of lower numbers that would be another matter. Over the next few weeks earnings will take center stage, and how they are received will likely be a driver of the market's next move.

Market Outlook and Investment Strategy
Market action has indeed been unusual lately, as the chart that follows on the next page will show. For the two weeks leading up to last Friday, the S&P 500 (SPX) averaged a daily trading range of 2.3%. That's in the top 10% percentile for volatility since the inception of the SPX in 1950. The total range in the SPX over those 2 weeks was just 4.6%. So it was a lot of movement to go nowhere. Since 1950, there have been just 13 other times that saw as much daily volatility confined in such a relatively tight 2-week range. Those cases are marked above but calculated slightly differently.

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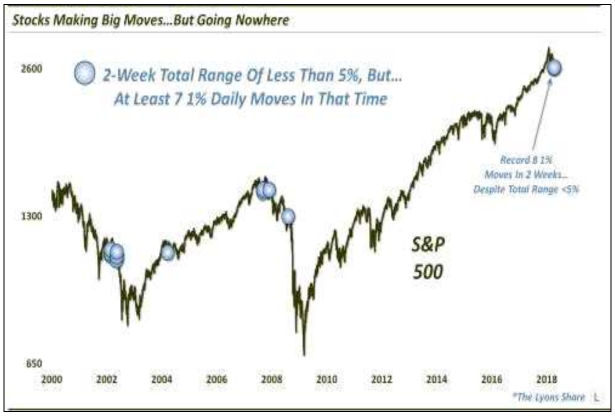

The only comment we would note on the chart above is that of all the cases, ONLY those in 2004 were NOT within the context of a larger bear market. Does that mean we are in a bear market? We don't think so. There isn't enough here to trade on per se, but it gives you an idea of why we consider the recent lows so important to market sentiment and psyche. A break of the dual lows from Feb and early April could deliver a pretty big negative blow to investor confidence. We continue to watch these levels carefully (see charts on page 3) as a break could see the market slide further.

What to Do When Growth Is Moderating? Don't Worry Just Yet

It appears that the synchronized global growth that was really heating up since mid-2016 is finally slowing a bit—and that make sense with the Fed hiking rates and the other uncertainties mentioned earlier. Unless it turns into a nasty meltdown, due to conflict or trade war, risk assets should do fine. For now it's a growth scare not an imminent recession. A flattening Treasury yield curve is what one should be expecting, and that is what's happening. Frankly that is preferred to a spike in yields. Gradual rate normalization is ok, a spike is not. As long as trade talk stays talk and not tariffs, it won't drag on the economy.

Slowing of growth is ok, as economies cannot grow above their long-term potential forever. Given the synchronization of nearly all Global economies, U.S. manufacturing (and the jobs report) can serve as a proxy for the health of the global economy. So far so good there—as the ISM Manufacturing numbers have been ok. We saw a below trend jobs number this time, we'd want to see a bounce back in the next month.

The Stock Market Continues to Hang Tough

For a market that has endured nearly constant negative headlines the past several weeks it is holding up well. 7-8% from the high is well within the bounds of a normal correction, and that's all that it is right now. The market came close with what could have turned into an ugly meltdown just a week or so ago, but the market held right where it needed to in order for the bulls to hang in there.

Stocks have managed to remain above what's arguably the market's most critical line in the sand right now, but not doing enough to relieve the tension hanging over the market. With such little breathing room above key levels, most traders and investors remain unsure about the market's nature at this time. The proverbial 'line-in-the-sand' we are discussing above is the general area that encompasses the 200-day moving average line (in yellow on the S&P chart on the next page) along with the twin lows made in February and earlier this month. So far the market has been able to hold above key levels, but not yet make a sustained push to create some breathing room above those levels.

Investment Strategy

If we had to bet on thing's we'd wager that the low is in and we'll work higher. But we don't 'bet' with client assets, and as of now it is still too early to commit sideline cash raised on the rebound rally in March. The reason for that is that a break of the 200-day along with the recent lows could start a chain reaction of selling. We'll wait for our market indicators to line-up and tell us that the low is indeed already in. Another decent week of market action could do that. Perhaps good earnings gets investors focused on the positives in the economy once more.

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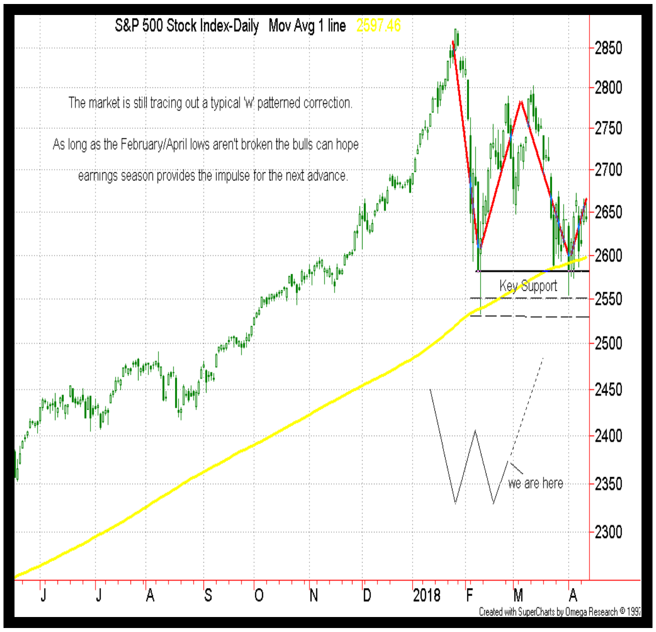
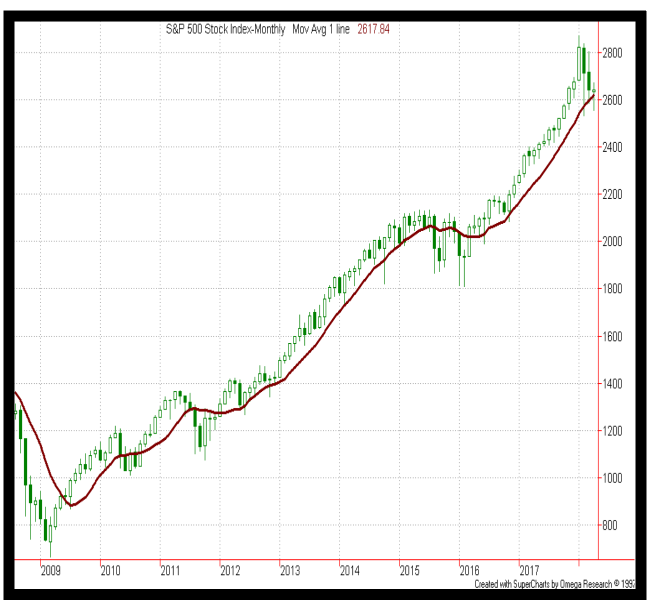
Market Charts : Key Levels Both Short-term and Long-term



S&P 500 Daily Chart—The 'W' pattern we referred to back in February sure looks to be coming into form now. We highlighted a model 'W' in red in the chart to make it even clearer. If the pattern holds true, the next long-term move is another rally leg higher.

However, a break of the recent lows and the 200-day average (in yellow) would be quite negative. Nearly every retail and institutional investor are watching these levels. As you can see, the S&P brushed below it briefly on an intra-day basis, but managed to close above key levels. When push came to shove the bulls won out by the closing bell.

Another week of closes (5 trading days) above the 200-day average would likely confirm that the low is in.



S&P Long-Term Chart—On the long-term chart all the recent 'volatility' looks like a little blip—that's why this big picture view can be so helpful—it puts things into perspective. The market broke below the 10-month average (red line) early on, but has so far held above this key level on a monthly closing basis. A monthly close below the 10-month would be an early sign that something was amiss. As you can see prior closes below the 10-month average coincided with pretty sizable corrective periods.

2600 is a key level for the S&P, as long as the S&P holds above that level the bull market is intact.