Hamilton-Bates

Market Update

October 30, 2018

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Once again October has proven to be a scary month for stocks, and been much more TRICK than TREAT this year. In fact, this month's weakness has made it the worst October since 2008– and that was a pretty horrendous year.

The month kicked-off with the market in a modest uptrend, but things changed when Federal Reserve Chairman Powell almost glibly threw out there that "we are a long way from normal on rates", which market participants took as an extremely hawkish comment. See the chart below that pinpoints Powell's comments. You be the judge if they had an effect or not.

DE-FANGED!!!

FANG stocks (Facebook, Amazon, Netflix, and Google) lifted the market earlier in the year, but ever since Summer they have been gradually losing steam. October has been a horrible month for FANG, down an average of 25%. The decline has been swift, and FANG has broken its 200-day average (the maroon line) in the chart above. This creates some risk that the FANG stocks aren't through with their decline, and could fall further. If the decline has further to run, the rising trend line is likely where it would pause.

There are clear signs that housing is already buckling under rising mortgage costs, and a number of industrial and basic industry companies said during their most recent earnings outlooks that higher prices and tariffs are already hurting business. Powell's comment triggered real concerns over the Fed's competency, and caused fears that once again the Fed was way off base, and at risk of killing the economy. President Trump, much pilloried for his attacks on the Fed, was actually right on target this time. The Fed should hike once again in December, then pause and say they are taking a step back to re-evaluate. That would do wonders for the financial markets.

Economy, Earnings, and Interest Rates

Earnings season is just about wrapping up, and over all it was a good batch of reports. But current market weakness wasn't about THIS QUARTER's

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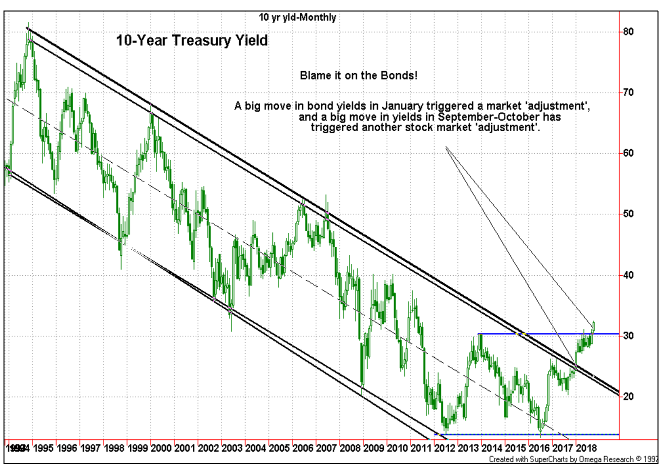
earnings, its about whether earnings growth has peaked or not, and if so how much would growth slow. A Fed cranking rates higher relentlessly would be a big drag on the economy and earnings. This is why the Fed Chair's comments on October 3 had such a negative effect.

Market Outlook and Investment Strategy
Nearly all of our portfolios have bonds and/or cash, with the average Managed Portfolios having 40-50% cash/bonds. That mitigates the pain of the current decline somewhat, but doesn't make us feel any better-as we much prefer the market to boom higher. But the these non-stock positions do is allow us to shift assets from assets that haven't fallen much, into stocks which are now much more attractively priced-and which we believe are positioned for a rally into early 2019. Pull-backs are tough, but so far this still has the look of a typical market correction rather than something more. **It's not time to panic, as that is one of the worst mistakes and investor can make. Signs are building that the market is near a turning point.** The market tried to sell-off early in the day today, but the decline fizzled, reversed, and stocks powered higher. We haven't had back-to-back up days even once, so closing the month with two up days in a row could be a big boost. It may take a little time, but by year-end the market should be appreciably higher.

Market Charts : Key Charts for Bond and Equity Markets



10-Year Bond Yields (Interest Rates)- TOP
Interest rates have risen in 2018 as the Fed hikes rates. The rate hike cycle has put pressure on bond prices, and yields have broken a downtrend that had been in force for three decades! The weakness in the bond market has been 'lumpy' though, with big moves in January and again in Sept-Oct causing most of the pain. The yield spike in January caused stocks to fall in February, and the latest spike which sent 10-year yields above a well-watched level added to the selling pressure this month. We would prefer yields to settle-in here, neither moving much higher (and hurt the economy) or fall too much which would point to a real economic slowdown.

S&P 500 Long-Term — BOTTOM
The long-term chart is a monthly chart, so each 'bar' is 1 month. This month's decline has created a big downdraft, which is threatening to push the market below its 10-month average. We still have 1 day to go, and a big up day could change things. Lets give the market a little wiggle room, and re-visit this chart in the next Update. The current weakness is a 'yellow light', that needs to improve to avoid a 'red light'.