Hamilton-Bates
Market Update

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Just when things appeared darkest for investors came the dawn. Our last few Updates were bunched together around the Christmas Holiday as the market really seemed to come a bit 'unglued'. We stated at that time (on the heels of the worst Christmas Eve decline ever) that the market was extremely oversold and that 'bull or bear' the market was due for a 'big' rally.

What happened to change the market's tone was actually a few things. First Trump stopped criticizing Fed Chairman Powell as his constant string of comments wasn't helping. Second, and more important, was that **the Fed changed course**—their bold talk of how further rate hikes, how strong the economy was, and the bond selling program on autopilot all proved to be hallow as the market fell 20%.

That course change by the Fed along with deep oversold conditions set the market up as ripe for a short-squeeze, and get one we did. Since the Christmas Eve low the S&P 500 has rallied over 12%, regaining about 60% of the prior market decline.

The uber-rebound by the market looks to have finally run into a bit of resistance this week—as it should—as the market revisits a key technical area and as most of those Hedge-Funds betting on further market declines at the end of 2018 have been forced to cover.

Bull Market or Bear Market?

Whether the stock market was in a bear market or bull market really didn't come into play with our stance around Christmas that a rally was coming. In fact, even in horrible years (like 2008) the market is more likely to rally after a 20% decline than continue to fall. Our view was simply that the decline had come too far too fast and a snap back was overdue.

Now that we have seen a rebound this is where things start to 'get real' for the market. If the rally rolls over and takes out the December lows clearly the Bear Case is on. On the other hand, were the market to have minor pullbacks but maintain this rally, it could very well be that the worst is over. Frankly its still too early to tell. Much will depend on things yet 'unknowable'—like what the Fed will do.

Economics, Earnings and Interest Rates

The bull case for stocks from here holds that the 4Q decline was an anomaly—an air pocket if you will. Interest rates are still low, corporate profitability is high, and the now wishy washy Fed continues to put a floor under stocks. Furthermore most economists believe there is no recession in sight and the economic data have remained relatively strong. That much is true. However, its important to note that interest rates where low because we were a decade into the worst recovery on record, one that clearly was losing steam as the benefits of the Trump tax-cut ran out. While profits have been good—they were given a huge goose from stock buybacks which improved EPS. The rest of the world is slowing, with both pockets of Europe and Asia experiencing flash recessions (1 quarter of GDP declines). With China's economy clearly struggling over the trade war with the US, how much growth will there be in 2019? The Fed, it seems, is now on the sidelines; but if the market continues to rally how long will they sit before hiking again?

Market Outlook and Investment Strategy

The market rebounded quickly and forcibly

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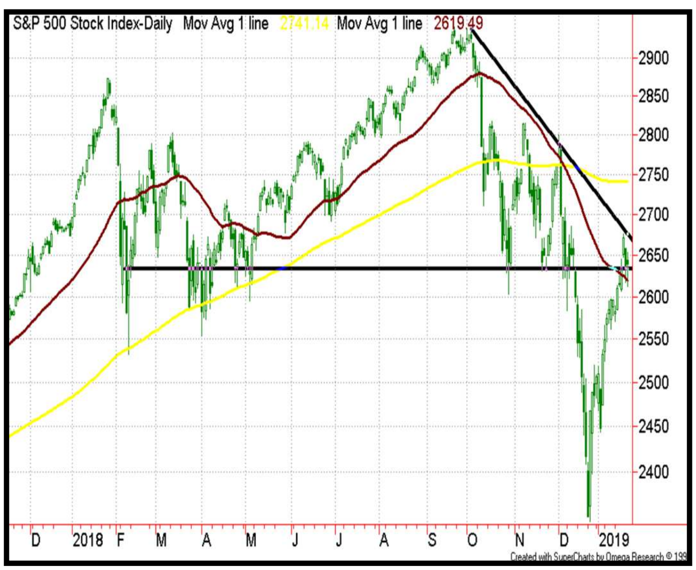
toward key levels over the past few weeks. The strength of the rebound should not be understated. The breadth and scope of the rebound was powerful. But now the going gets tougher, with what should be significant technical resistance levels in the zone just above current S&P levels. How the market responds over the next week or two will tell us much about the course of 2019.

Prior to seeing the rebound rally it was our thought that a rebound into early 2019 would likely fail, and that some sort of 'bear market' was nearly a given. However, the strength of the rebound has been better than expected, and more importantly, the Fed has tucked its tail much faster than we would have thought. If the Fed stays on the sidelines (and how long they do) could be a big determinant of the market's course for the rest of the year. The market is due for a little rest or pullback about now, and as long as that decline doesn't completely erase the rebound we'd expect stocks to continue to work higher in Q1.

We did some buying around Christmas, then cut back just a bit last week. We'll look to add to holdings on any weakness that develops over the next week or so.

As long as the Fed remains our 'friend', there is room for higher prices—especially if a trade deal is worked out (although one is nearly priced in right now). If the Fed proves to be more 'frenemy' than friend, and start talk of renewing the hike cycle too soon—they risk nipping the rally off too soon. The Fed giveth and the Fed can take away. **2650-2750 is a key area on the S&P 500 that must be overcome—but the market may need to rest first before making that attempt.**

Market Chart—S&P 500 Approaches Key Levels



Since the October 2018 top the market has been trading very technically, meaning it has tended to drop to support and rise to resistance, and each technical break of support has seen the market fall to another key technical level. Once the market broke the October/November lows in December (solid black horizontal line), the sellers took the market down until all the selling was washed out. Now we have seen a rebound right back into the prior area of breakdown. From here the going gets a little tougher as technical resistance from the 50 and 200-day averages, and the declining trendline from the top all start to come into play. Some sort of pullback after a straight-up 10% move is to be expected.