Hamilton-Bates
Market Update

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The Fed has backed off the rate hike stance that crushed the market in 2018, and as a result stocks have recovered to levels last seen in July-August of last year—just ahead of Powell's now infamous 'we are a long way from normal on rates' comment.

Since the Fed flip flop on rates in late December the market has been up 10 of 11 weeks, but the last several days have seemed as though the market is 'tired', and could be in the need of a rest before moving much further. This week the Fed meets on rates, but no hike is expected and the key question is whether they change their outlook for two potential hikes later this year or cut it to one. The Fed is on the sidelines for now—and that's a good thing. The less the Fed gets involved the better. 12 people in a room cannot manage an economy.

Economy, Earnings, and Interest Rates
The Fed started hiking rates in earnest in 2017, and by early 2018 their effects started to show. Housing struggled, as did autos, which had gotten used to 'zero money' for so long. By late summer many interest rate sensitive sectors were showing weakness, but the Fed didn't seem to notice. When Chairman Powell made comments in early October that suggested the Fed was tone deaf to what was happening in the economy, the market tumbled. The Fed has now tried to walk back their mistake, but the effects of the prior hikes are just now starting to bite—it takes time for rate hikes to work through the system.

First quarter GDP growth is expected to slow to 2% or even less. Earnings growth has tumbled from 20%+ to the single digits. If the dip in growth is just temporary, we should see activity bottom this month or nest, and gradually pick up as the year moves along.

Housing and autos remain weak, and much of the world is still struggling—with Europe near recession and China taking a big hit given the tariff situation.

The good news is that in addition to the Fed position change, both the Japanese and Chinese Central Banks have continued to flood the financial system with liquidity to boost economic activity. If a trade deal materializes it could be a big boost to sentiment and the market in the second half of the year.

Shipping and Transportation Industries Showing Signs of Stress
For the goods economy, they must be moved to the consumer, thus the shipping and transporation sectors are good gauges for this activity. The Cass Freight Index covers shipments of merchandise for the consumer and industrial economy via all modes of transportation, but it does not include bulk commodities, such as grains or chemicals.
A recession in the US is always preceded by a contraction in the flow of goods across the US. But not each contraction in the flow of goods leads to a recession. Services – healthcare, finance, shelter (rent), education, barber shops, etc. – are the far bigger part of the economy; and even in 2016, as a recession in the goods-based economy triggered a

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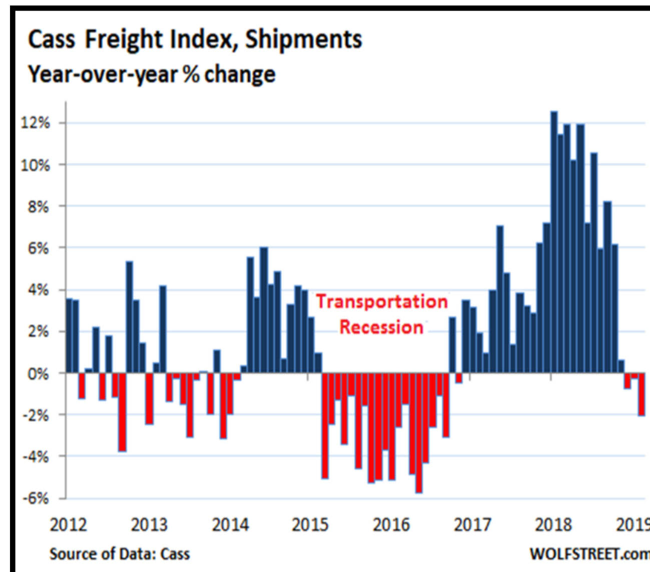

steep transportation recession, services kept growing, and GDP still eked out a gain of 1.6%. As long as services hold up, the economy will grow.

We already know that the first-quarter GDP growth is going to be weaker than the growth rates seen last year: The government shutdown, the reduced tax refunds, some bad weather, Fed rate hikes…. These factors are one-time items and their impact will dissipate in Q2.But consumers are only part of the demand in the transportation sector; industrial demand — oil-and-gas drilling, construction, manufacturing, etc. — also plays a large role.

The index is shown in the chart above, and as you can see after the major BOOM in 2017-2018 freight and shipping has really slowed down. (Just today FEDEX announced lower guidance and earnings for 2019) Now it's the third month in a row, and the red flag is getting more visible and a little harder to ignore about the goods-based economy: Freight shipment volume in the US across all modes of transportation – truck, rail, air, and barge is down. This largely reflects the weakness in Europe and Asia, but we still don't want to see this trend continue. While the economy as a whole can still grow even if there is weakness in the good sector, it will be a lot harder to do so. The Cass Freight Index and the performance of the Transportation sector bear watching in 2019.

Market and Investment Outlook
Stocks have recovered to levels unthinkable back when the market was in near free-fall around Christmas-and we are very happy for it. We were looking for a rebound, but we are even happier to see the economy avoid another Fed induced recession.

With gains in 10 of 11 weeks its tough to expect more from the market right now, and although there is daily talk of the market 'breaking out' above 2800—the market looks a bit 'tired' to us. It has expended a lot of energy to get where it is, so some sideways action is to be expected—and could be very helpful to set-up for the next leg higher. If the Fed stays out of the way we could see another 10-15% on top of what we have seen so far. The NYSE Advance-Decline Line has already moved to new highs, and when this measure does so, it normally leads to the stock market eventually doing so as well.

With so many having SOLD the December weakness (not us and our clients of course), there are many still on the sidelines, and eventually underinvested investors need to come back. We look for a bit of slack in the market over the next few weeks, and with Corporate Stock buyback programs 'locked out' during earnings season, it's yet another reason to look for some weakness. We'll look to add exposure on any weakness over the next few weeks, to get ahead of a rally we see coming over the next several months.

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