Hamilton-Bates
Market Update

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What's not to like about current markets?
A strong US economy – the strength of last week's 3.2% GDP data was bolstered by a strong Jobs number this morning, overcoming some concerns from the last report. We also have a President determined to pump-prime an economic boom ahead of election year – and who will do anything to avoid a downturn. The Fed is now relatively compliant and is showing no sign of tightening policy. The Fed is also perceiving no concerns on inflation, painting a picture of a US economy on a 'healthy path'. We also have some signals that the President wants the China Trade deal signed asap – and is even rumored to be prepared to 'compromise' on key content – a deal could be another market booster.

Second quarter corporate results were expected to be poor – lower because of the global trade fracas and overstretched. Instead they'd generally been stronger than expected, hinting at a much firmer base. And Q2 reporting across the Tech sector – the sector many think most vulnerable to a correction – has been solid. Aside from Alphabet's lacklustre numbers, most Tech has done well. All in all, its not a bad picture. Economic growth, low rates, strong corporate performance, global trade not dead, and a market challenging its peak. **Is it smiles all round? Or is it a bit complacent?** First we'll look at the economy and rates and then delve into the outlook for stocks.

Economy, Earnings, and Interest Rates
On the heels of last Fall's concerns that the economy was rolling over, economic performance has to be considered stellar. Jobs data had a hiccup last month, but the latest report this morning showed better than expected job creation and the lowest unemployment rate in decades. Last week we got the first (of three) first-quarter GDP growth reports. The pros were calling for progress of around 2.0%. What we got was an unexpectedly strong improvement of 3.2%. Now this figure may have been boosted by a surge in corporate purchasing that may or may not last. But still this was a good report. The GDP number also suggests economists may be broadly underestimating the economy, so concerns of a slowdown may have been vastly overstated.

We still have some concerns we cant seem to reconcile, such as the recent 'inversion' in the yield curve, which occurs when long-term rates move lower than short-term rates. This is a condition that has historically presaged a slowdown. We also have a housing market that has seen volume slow, and only when prices drop do sales get done. Housing market weakness is worth paying attention to—along with the job market. If the jobs market heads south before housing picks up a real slowdown could be at hand. The latest Job Data puts that concern at ease for now.

Market and Investment Outlook
It has been such an effortless glide higher for the US equity market since late December that nearly any drop feels more severe than it actually was. Of course large corrections do not have to start with dramatic declines, and last September's peak was followed by a gentle glide lower that only really got going after a couple of weeks of small but consistent reversals (And some horrible bad comments from the Fed!) It is of course much too early to suggest a repeat performance, especially since the Fed has done a 180 degree about face, although we would note that the US equity market has become very stretched both on an absolute and relative basis.

What has really caught our eye in recent sessions has been the contrast between the calmness of the overall market and the severe reaction to the few blue chip names that reported disappointing results. Clearly bad news should be expected to generate bad performance, but intraday losses that exceed all those since the 1987 crash (MMM) or the financial crisis (INTC) are unusual responses to what were bad but not catastrophic reports during a generally benign investment landscape. The same could be said of the

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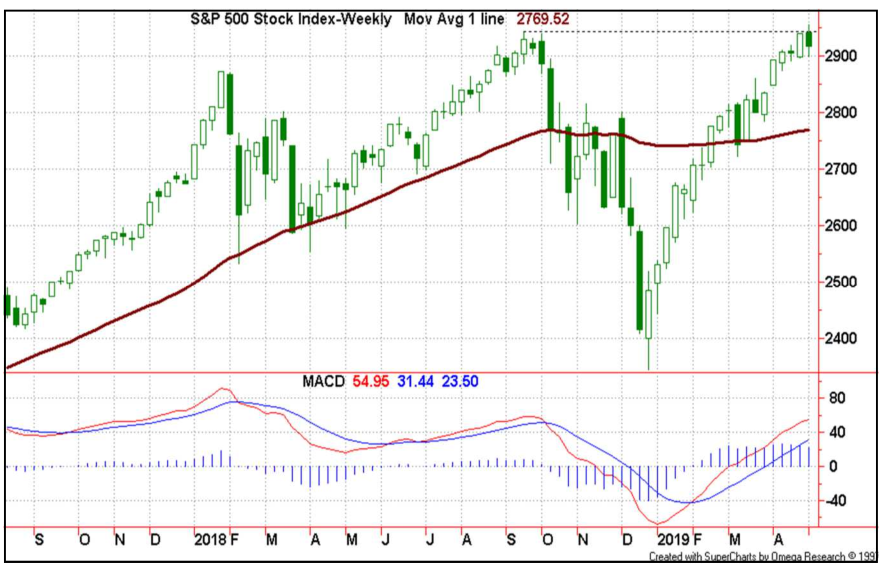
dramatic two day collapse of the healthcare sector two weeks ago (most of which has been recovered). All of the above suggests that this market lacks some of the emotional resilience that we would normally associate with a new all-time high being recorded. We see more fragility than one would expect with a market near its highs. With that in mind obvious support levels take on rather more importance than normal and we would mark 2900 on the S&P 500 and the rising 50-day moving average at 2846 as the first two to follow.

Also to the extent it matters, the S&P 500 is now valued at a trailing P/E of 19.37 and a forward-looking P/E of 17.23. We've seen higher on both fronts, but not much higher for very long. Again, it's making traders confused about what they're supposed to do here. With all of that being said, know that despite recent bullishness, the recent undertow has been anything but bullish. The amount of daily bullish volume has been dwindling since the beginning of the month, and the amount of bearish volume has grown. The number of daily advancers has dwindles since the middle of the month, and the number of decliners has grown. **The market rally over the past four months has confounded many investors and managers that sold during those brutal days of December, but finally the market is showing signs that the odds of some sort of pullback is growing, and now we'd put those odds at greater than 50-50. We aren't saying the bull is over, or that the market can't steamroll its old peaks and keep going—what we are saying is that some sort of decline is more likely now than at any point over the past few months. Some of our more sensitive models have flipped to (minor) sell signals, and we've moved some assets that are tactical in nature and objective to cash. A 3-6% pullback would be about what we'd expect right now. A lull before the Summer Sizzle.**

S&P 500 Long-Term Chart



Looking at a longer-term chart of the S&P 500 gives us some perspective. While the market had the advantage of starting out after a harrowing Q4 rout, the 25% bounce from the late-December low is one of fastest four-month rallies on record. The major indexes are now bumping up against their old highs already stretched. A melt-up would push things into unprecedented territory, and while possible, its tough to count on. A pullback toward support around 2800 seems more likely.