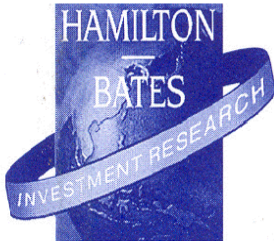

Hamilton-Bates
Market Update

July 2, 2019

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The financial markets wrapped up the best first half for stocks since 1998, and given the backdrop of a trade-war, slowing economic data, and waffling Fed policy—its been a pretty improbable run. Coming on the heels of the worst December since the Great Depression, the market was due a reprieve and we more than got one. Looking ahead we'll need to see just how much 'good news' is already priced-in, and whether the President and the Fed can thread the needle on policy—finding the right mix of rates and rhetoric to keep the economy and stock market run intact.

1st Half Performance	
Stocks (S&P 500)	17.3%
Bonds (US Govt 5-7yr)	3.7%
Money Market	1.0%
Balanced Port (Stk/Bnd)	10.4%

The Big News is the Fed—Now Likely to Cut
The direction for rates now is no longer in doubt. Now the question is the quantity, magnitude and timing of rate cuts for the rest of the year. What a complete about face from last October when the Fed insisted they had a long way to go (in raising rates). Economics PHD's much not be worth much. The hubris that a room full of people could project/guide something as large and diverse as the US economy is amazing.

The past few weeks have been important as we were privy to several important Fed speeches as well as some informative data about the state of the economy. The takeaway in aggregate was muddled. On one hand we had both Chairman Powell as well as St. Louis Fed President Bullard hinting that the Fed would start with a 25bps point cut in July. This came as a bit of a disappointment because Powell last week during his press conference indicated a 50bps cut in July could be in the cards. Bullard did say that another cut later in the year (read October or December) could be warranted, but this was less than what was expected. Bullard is one of the most dovish of Fed policy makers.

On the other hand, economic data has continued to come in on the weak side including durable goods orders and initial unemployment claims that both missed expectations. **Data misses like we have seen this would warrant a far more aggressive rate cutting campaign than what is being signaled by the Fed currently.**

When you look at what the bond market is pricing compared to the Fed - the market appears to be much more in line with the softening economic data and the future trajectory of that data than the Fed. Currently, the market places a 100% probability on a cut of at least 25bps points in July and a 20% probability of a 50bps cut. Those odds are in line with the Fed speeches this week. Moving ahead, the market places an 83% probability that the Fed Funds rate will be 50bps lower than today by September – well ahead of Fed signaling. By December the market assigns a 62% probability that the the Fed Funds rate will 75bps lower than today and by next year the market is pricing greater than a 50% probability than the Fed Funds rate will be 1% lower than it is today. Therefore, the market is placing higher odds on 75bps of cuts in 2019 than 50bps of cuts, and at the same time the market is expecting another 25bps of cuts in 2020. The Fed will need to get in line to avoid getting even further behind the curve.

Market Outlook and Investment Strategy
The post-FOMC enthusiasm proved sufficient to take the major averages up near the highs, with the S&P 500 touching a marginal new high but not up to challenge the 3000 level. That will be a key level to watch. A decisive break above that level would likely

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be taken by sideline money to get on board. With stocks back near their 2019 and 2018 peaks, a decline down as low as the 50-day moving average (not shown but the level is 2879) could be viewed as constructive, while below that a more significant retracement of June's explosive recovery would be indicated.

Historically July is a good month for stocks. Since 1965, the DJI has risen 67.3% of the time and gains on average are 2.1%, 4.2% and 6.0% over a month, two month and three month periods, respectively. The Fed is now our friend it seems, and past trends are bullish. So why then are the 'big boys' still net sellers, and why are professional investors and retail investors so under-invested? Professional managers are notably underinvested as well, and without this money-flow how much higher can the market go? It does seem to come down to interest rates? Perhaps, they will be formally lowered by the FED when the Jobs' numbers for June come out on Friday. A surprise cut would be quite a jolt.

In this environment it's probably a lot riskier than usual chasing the dividend stocks and bond funds that the market now favors and that have already run so far. Better buys will likely come at lower levels, especially for Treasury bonds. The market is searching for new leaders. For example, at the recent SP-500 new high, only 37 of these 500 stocks made new highs along with the index – that is a cautionary sign that the rising tide isn't lifting all boats. Lately its been a mega-cap market. Another cautionary sign - 28.7% of the SP-500 stocks are still below the key support of their 65-dma. This compares with 30% last September when the SP-500 was reaching its peak just ahead of a 20% drop last year.

While we continue to view overall upside as somewhat limited from here, with market rotations in and out of sectors looking more likely than a true break-out (for now). **As we have written many times, we do not believe the bull market is done just yet, it just seems like the market would be better off for a little bit more consolidation ahead of it**.

Bottom Line: We remain invested but need more evidence that it's safe to (buy more) despite the bullish seasonality.

S&P-500 Chart

Look at the chart at left. For all intents and purposes 'the market' has gone nowhere for 18 months—see boxed area. The S&P peaked at 2875 in 2018, and subsequent peaks have come at 2950 (twice) with a few big drops in between. The S&P is now challenging the highs once again. **If** it can clear 2950 decisively, it would be a big signal that a **major** breakout was occurring. Such an even could see a surge higher as money flows back in.

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