Hamilton-Bates
Market Update

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It has been another week of chaotic headlines, with trade missions and presidential telephone transcripts dominating the intraday mood of the market. This is partly due to a dearth of more meaningful news, with central bank decisions recently made, and most of the key economic data reported and earnings season still a couple of weeks away. It is also a reminder that that financial markets have been buffeted by political news for much of the period since the buildup to Brexit in 2016, and that this is likely to be increasingly so as we enter the political primaries and election windows in 2020, given that the Democratic race is at risk of being captured by economic populism. Redistribution of wealth, single payer healthcare, and the curbing of corporate excess may play well to the public at large, but they are unlikely to be warmly received by capital markets.

Against the odds, the market has continued to make forward progress. It hasn't been convincing progress, but progress none the less. However the going has gotten tougher as the indices have approached record-high territory. Investors are giving stocks the benefit of the doubt for now.

The next few weeks will be a big test, at a time of year when stocks don't typically perform well. They're already going against the grain in that regard, thanks to some encouraging chatter on the trade-relations front. It remains unclear if the chatter itself is the only thing driving stocks higher than they are already. The economic backdrop is pretty good as-is.

Economics, Earnings, and Interest Rates

Last week the Fed did indeed cut rates again by a quarter point. Investors expect another cut in December. Despite low interest rates, inflation remains tame. Core consumer inflation (not counting food and energy price increases) popped, but even at 2.39%, that's manageable. Those price increases are also being offset by lower prices of other goods, and ultimately August's jump in inflation feels like something of an anomaly. The nation's factories and production plants are seeing practically no inflation to speak of. Retail sales remain solid, suggesting consumers aren't sweating anything, and explaining the underlying demand that ratcheted consumer prices higher. Overall retail sales were up 4.6% year-over-year, improving for a third month in a row. Weakness in energy and transportation remain, but so far that weakness hasn't bled into the services sector of the economy.

While the Fed did cut, the Fed's governors have most recently hinted there's no immediate need to push rates lower, and if they could have they wouldn't have done so this time around. But their fear of disappointing the market forced their hand. An October rate cut has been priced out, so no cut is likely at the next meeting, while odds for a cut in December are 75%. The Fed board of governors is split on rate cuts so a pause until December to let the data and the markets shake it seems most likely.

Market and Investment Strategy

Three weeks ago, the market was hanging by a thread. The S&P 500 had bumped into a well-established technical ceiling that extends back to the early 2018 peak from just a few weeks prior, and was falling quickly, seemingly set on taking aim at support from the 200-day moving average line. But then the selling just evaporated. A couple of Fed comments here, some trade hope optimism there, was all it took to nudge the bulls back into action. They were looking for a reason to see the glass as half full rather than half empty, but it worked. As the long-term chart on the next page shows, the S&P 500 is almost back to the technical ceiling plotted as a white dashed line.

The US equity market has shown some resilience, and even at its low point during recent weakness, the major averages remained above their first support level at the 50 day moving average. The worst that

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can be said is that the market has made very little progress since the start of May when it stood at 2954, only 1% below its current level. Over all the global markets have proved to be quite resilient despite the considerable deterioration of economic sentiment in many major economies, including Japan and Germany, and although the USD remains at the top of its multi-month range it has not weighed much on investor sentiment.

In the current environment we remain invested in a balanced mix of stocks and bonds. Even though nominal rates are low, when the stock market hits bumps and recession fears grow, bonds are an extremely effective portfolio stabilizer.

The bullish trend that began in December 2018 remains in effect; and while the market is susceptible to headline risk we expect stocks (and bonds) to move higher into year-end.

S&P 500 Long-Term Chart

Lots of chop over the past 18 months with lots of up and down action but not a lot of net gain.

The S&P 500 is up just 4% since January of 2018,with a lot of chop in between. The market has really struggled in 2019 as it has approached 3000 on the S&P 500.

Note the thin spikes at the top of each of the last 3 monthly bars in the chart at left, they reflect the inability of the market to sustain a rally above 3000. At some point we'll need to see this for the advance to continue, and now we head into the challenging September/October period. It may come down to what companies say about earnings in the next few weeks.

As long as the S&P holds above its 10-month average (the red line now at 2835) the bulls remain in control.

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