HAMILTON BATES INVESTMENT RESEARCH

Hamilton-Bates
Market Update

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Deal or No Deal—Does it Matter?
The past week the market has been consumed with headlines and tweets over the outlook for a potential trade deal between the US and China; with market weakness early on when it looked like there may be no deal—followed by a rally at week's end when it seemed a deal had been struck.

There are now questions over the deal itself, whether it indeed was a deal at all, and that it really was not a comprehensive deal. On the surface the details seem sketchy and don't amount to much, but Mr. Market seemed to like it. This week earnings season begins, and we are glad to have the focus move away from trade talk—which we have had our fill of. How companies feel about the environment will go a long way toward setting the tone for Q4.

Economics, Earnings, and Interest Rates
It seems pretty clear the Global Economy is slowing. Japan and Germany are in recession. Growth in the US is slowing to the 1.5-2.0% range. The manufacturing sector in the US has entered contraction, and the question now is whether the services sector of the economy (70% of the overall economy) can hold the line and keep recession at bay.

What concerns us now, even with some relief on the trade front, is that too much damage may have already been done. The inversion of the yield-curve in the 3Q along with the deterioration of the manufacturing sector suggests a bumpy ride for the US economy in 2020, and we put the odds of a recession at 50/50. We will need to pay special attention to the services sector data– such as the Services ISM report. Its latest reading was just above 52, less than 3 points above contraction readings.

For its part the Fed is now cutting rates, and even adding liquidity to the market through 'repo' transactions. Without getting into the weeds, these purchases of securities have a similar effect as QE did, even if the Fed won't call it that. We are not sure if this will stave off a recession in 2020, but its good to see the Fed is no longer tightening. They seem to 'get it' now.

The 'Rocky' Market—Investment Outlook
Rocky Balboa, the fictional boxer from the 'ROCKY' movies, was known not for his pugilistic skills, but for his ability to take hits and keep getting up. In the 3Q the stock market was essentially flat (up 0.70%), but it managed to claw its way back yet again from a pretty big 'hit' when the yield curve inversion freaked-out investors.

Although the inversion of the yield curve a month ago was made out to be a big deal for the market immediately-historically that is not the case. The time period from inversion to trouble can be many months and that is normally the case. We view the inversion as a sign of potential trouble in 2020, and that the market could still make gains into year-end as long as the trend remains intact.

So far the 'Rocky' Market has taken a lot of punches, and still remained standing, and holding above key technical levels like the 10-month average shown on the next page. Some good news during earnings season, even if it amounts to less bad news than is expected, could help the market tremendously. If that news is coupled with something that can be legitimately called 'a trade deal', that could rekindle risk appetites both for investors and companies through share purchases and capital expenditures. We want to see positive momentum build as we head into

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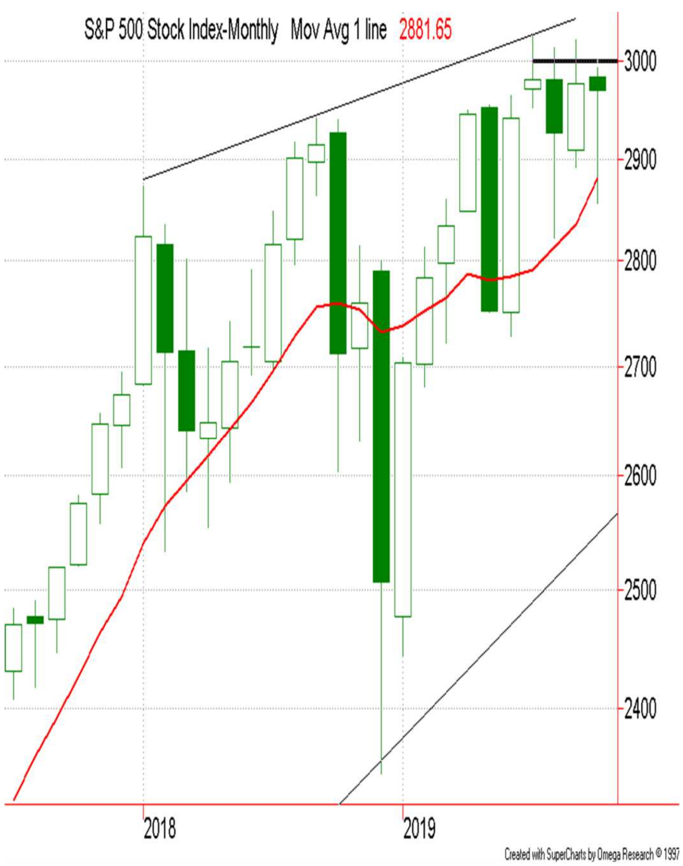
year-end. Managed portfolios remain invested, with additions recently to balanced funds and bonds as fixed income sold –off in October. With the Fed now buying bonds and easing, it is unlikely that yields move appreciably higher, US bonds remain very attractive.

The stock market is still standing, and short and long-term positive trends remain intact. We'll continue to buy dividend paying equity positions on any weakness. We expect the market to finish the year with a solid quarter, and impressive double digit gains for the year. Now that the calendar has hit mid-October, seasonal trends are favorable into May of 2020. Election year itself has also been good for stocks, with 18 of the last 21 election years generating positive returns. The next few months should be favorable for stocks.

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 looks to be mounting another challenge of the 3000 level, now the 4th in 4 months. None so far have managed to stay above this key level and round number milestone. With seasonal trends now favorable, and the Fed once again our friend, this time could be the charm. We'd want to see the S&P get above 3000 and stay there for a good week of trading, and close the month of October above that level. We could see buyers and money flows come rushing back into stocks the last few months of the year once 3000 is overcome.

As long as the S&P holds above its 10-month average (the red line now at 2880) the bulls remain in control. It would take a break below that level to turn the near-term trend negative.