Hamilton-Bates
Market Update

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2019 is in the books and it was a very good year for the financial markets. There were strong gains for both stocks and bonds, and the conditions at year-end seemed a mirror opposite of the near despair at the end of 2018. The market navigated the treacherous waters of a trade-war with China, along with Impeachment, largely due to the about face from the Federal Reverse—who become very supportive for stocks during the year.

The fact that the Fed—who were at one point hiking rates and cutting the size of their balance sheet—reversed course was the single most important factor driving the market in 2019, and will be so into 2020 and beyond. What the Fed does will be critical in the months and years ahead.

Economics & the Fed

The economy's glide wasn't as smooth as the market's in 2019. Economic activity did pick up in early 2019, only to stutter mid-year as the trade-war heated up. Concerns deepened enough that bonds were bid-up, the yield curve inverted, and the Fed started to pour on the stimulus once again. As a result the economy which had flirted with recession, lifted back up to slow-growth mode once more. With the trade-war seemingly cooling down, the key for 2020 will be whether the economy can ramp back up and pull earnings up with it.

The Fed is likely to remain on hold with interest rates this year, as they have stated they will tolerate more inflation in order to give the economy room to expand. The Fed does remains supportive through the use of market operations to ensure amply liquidity. No matter what its called, if the Fed is adding funds into the system– its been supportive for stocks.

Market Outlook

Stocks have started the New Year as the ended 2019—in positive fashion. Even a flare-up of tensions with Iran proved to be only a brief pause. However, after 12 months of generally upward stock prices the market has nearly reversed the very pessimistic conditions that prevailed 1 year ago. Conditions are definitely a bit frothy. By a number of measures the stock market is now technically 'overbought' and 'overstretched', with the S&P 500 trading 10% above its long-term moving average (200-day). This is an extreme reading that could lead to a period of mean-reversion, so some period of corrective action should be expected.

The Election

It is election time again so we can all look forward to the ramping up of political commercials and rhetoric although it feels as though 'election' season is 24/7/365 these days. Clearly the election and its results will have an impact on the stock market and the economy. The historic pattern for election years is actually favorable. Since 1952, the DJIA has climbed an average of 10.2% during election years when a sitting president has run for re-election.

A win for the GOP will likely mean status quo for the financial markets, and stocks will probably like that. For the Democrats, a number of the leading contenders are fairly harsh on financials and business, and to the extent a progressive candidate represents the party, it's a risk for stocks. A Biden/Trump election might be taken as a 'win/win' for the financial markets, since Biden is considered very moderate– so a Trump—Biden scenario could be very favorable for stocks in 2020 should it occur.

Investment Strategy

The bullish trend remains intact, but the market is a bit stretched and due for a pullback. Election Year trends have seen the market peak in January and trade sideways into Spring, something that could happen once again. Such a move could allow the market to rally up into year-end, especially if it's a Trump/Biden contest. In all we expect gains for 2020, just not as grand as 2019.

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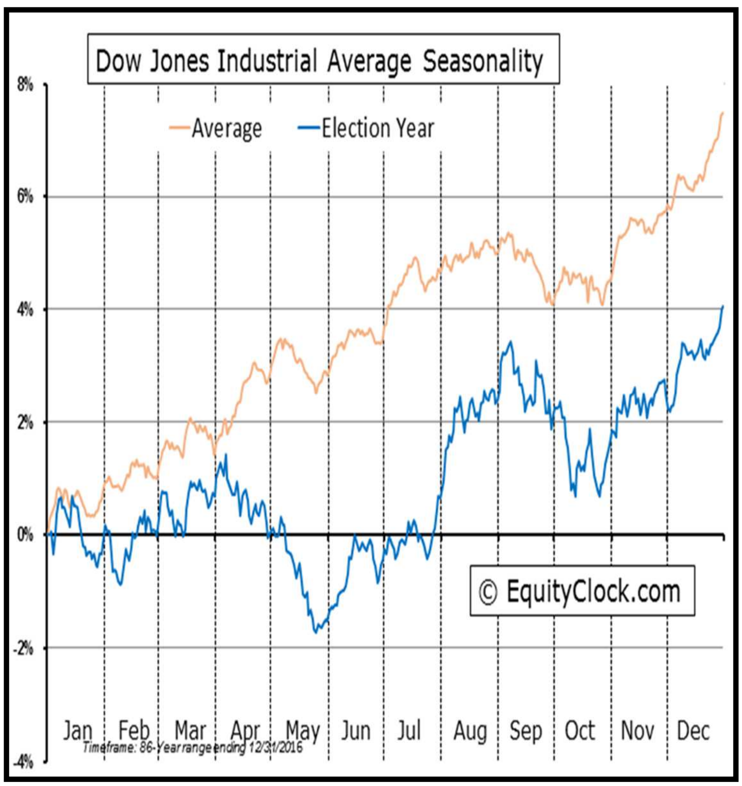
Notable Charts

S&P 500 Chart (Monthly)
The long-term trend remains intact, with the S&P 500 trading well above its 10-month average. The key level to watch is 3000 on the S&P 500, which we would expect would contain any correction that would develop.



The DJIA and Election Year Patterns
The bottom chart shows the average pattern of the average year in yellow– with the key features of the seasonally weak Sept-Oct period followed by the year-end rally pretty clear.

Election years are similar but more pronounced on the downside, with more early year choppiness and a pretty big mid-year pullback. We then see a rally, dip around the election then a bigger move up. We could see 2020 following a pattern of sideways to down into May, followed by a rally once the Democrat challenger is known (the markets hate unknowns). From there we could see generally higher prices into year-end with just a minor dip around the election, especially if its Trump vs. Biden, as Biden removes a lot of the market concerns over a progressive Democrat on the ticket.