Hamilton-Bates
Market Update

March 25, 2021

Still Bullish for Q2 Despite the Current Volatility

P.O. BOX 270 Newtown Square, PA 19073 877.768.4247 www.hbir.com

The first quarter of 2021 is coming to an end with the market suffering modest volatility in response to rising bond yields. We say 'modest' because the net effect on the major averages has been relatively small, with the NASDAQ down just 2% for the year. However high-growth names are down 20-30-40% from their peaks, and many are down 10-20% year to date. It has definitely been a bi-furcated market. The good news is Q1 is ending and Q2 should be much better.

Blame it on the Bonds

Much of the consternation and concern this year has come from the bond market, where yields have risen sharply from last August's lows. The yield on the 10-year note was 0.50% at that time, and it rose to a high of 1.74% a week ago. That is a 1.25% rise in 6-7 months– that's a lot. In fact we have 'suffered' through one of the worst bear markets in government bonds since WW2. We say 'suffered' because we have been underweight/out of this asset class, and correctly so.

The move in yields puts lots of pressure on growth stocks, as the current value of their future growth is worth less as rates rise. When rates rise companies that pay dividends generally perform better, since you are getting cash in the hand vs some potential future growth. Cyclical and economically sensitive stocks have also done ok, as these companies benefit from an economy on the upswing.

The good news is that to us the rise in yields looks over or nearly so. We could see a bit more of a rise, possibly as high as 1.9%, but we don't think we'll see further runaway yield rises over the next few months. We see yields peaking and dropping back toward 1-1.25%. This rise in yields has actually made bonds moderately attractive hear, and municipal bonds especially so. Furthermore, should rates stop spiking and begin to moderate, it will turn the headwind to a tailwind for stocks in Q2.

Market Outlook

We expected volatility during the first quarter and it finally came, with a slide into quarter-end that has undone the January gains. This is ok, and in fact the market has followed its historic post-Election pattern to a 'T'. Once we get through March things historically have gotten much better in post-Election years.

Seasonal factors favor the market as well, as the Stock Trader's Almanac states that April is historically the market's strongest month, since 1980 its been up an average of 1.5%. We would have thought it would be been December and we probably weren't alone there. Seasonal strength should be a big boost to the start of Q2.

Investment Strategy

Over all we remain positive on stocks since the economy remains solid, and the economy should handle the rise in yields easily. A reopening economy will boost earnings, which we believe will be much better than expected. Combined with a rebound in bonds, this mix should come together to provide a strong boost to stocks in Q2.

We have not deployed new capital so far in 2021, and other than move from growth to a DJIA index a few weeks ago, we have allowed the market to correct and come to us. We could see a bit more volatility into quarter-end for technical reasons, as some expect stocks to be sold and bonds bough as pensions rebalance.

We expect to add to stock and bond holdings over the next week or two and will look to take advantage of this volatility. **We think the second quarter will prove to be a good one, perhaps surprisingly so after such a sour end to the first quarter.**

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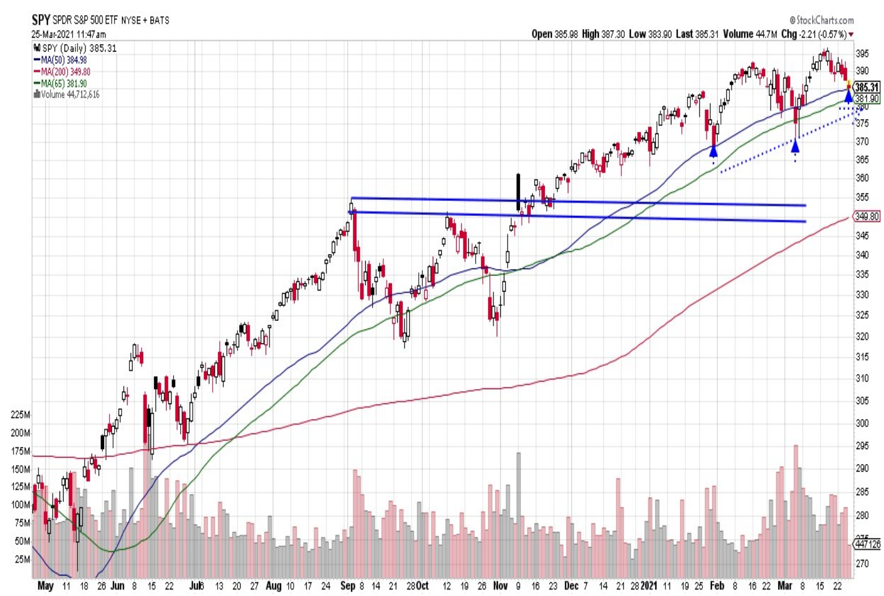
Market Charts

Bond Yields Hurt Growth Stocks

The top chart shows the Growth Oriented NASDAQ 100 (red-black line), along with 10-year bond yields (solid black line). It shows how the spike in yields that started in January caused Growth stocks to peak and roll-over in Feb. Since then the NASDAQ is down 9%. We see signs the yield rise is nearly over so growth stocks should be set for a rebound in Q2.

S&P and DIA Remain in Bullish Trends

Growth has taken it on the chin, but the broader indexes like the S&P 500 and DJIA have held up ok, since they have a good deal of value and cyclical stocks that have held up during the correction in growth stocks. The S&P's advance has been choppy, seen by the three pullbacks so far this year (noted by blue arrows), but the market has held its upward trend. We expect a solid Q2 with a target of 4100, a move of 5-7%.



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