Hamilton-Bates

Market Update

April 15, 2021

April and May Should See Higher Stock Prices

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The economy is reopening, and as it does demand for nearly everything is growing. We are seeing that flow into supply chain strains as everything from commodities, to lumber, to plastics has suddenly become strained. Job openings have also risen, as many industries now are in desperate need for employees. The key will be weather the economy can reopen and handle the demand surge without triggering inflation that eats into profits.

Earnings, and the Economy

The latest jobs report showed a whopping 900K jobs created in March, with unemployment falling to 6%. These are strong numbers but we are still 6 million jobs short of where we were before Covid-19. With the economy in re-open mode nearly all sectors are starting to really move, especially housing where prices are rising (lumber costs have soared) and housing supply is tight. Nearly every where we go now we are seeing 'hiring signs'. Agriculture prices are also up a great deal, and farmers are finally getting a break. With so much good news going around some are concerned with inflation—the Fed is not. The Fed has stated that it is willing to let inflation run a little hot until the lost jobs from Covid are recovered.

Earnings are expected to be quite strong over the next few quarters, and comparisons are easy given that a year ago we were coming out of the depth of the Covid decline. Earnings growth of 25-50% is expected YOY for most sectors. So far so good this week as earning season kicked off with the financial sector delivering with gains above even recent lofty expectations. If strong earnings and outlooks hold up, it will temper fears of inflation and costs pressuring companies—giving a big boost to equities.

Still on Bond Watch

Bond yields have risen from the ultra low levels of 2020, that is expected. However, the bond market has moved a bit more than we would have liked, and seems destined to test the Fed and its willingness to tolerate inflation and higher long-term rates. Yields have peaked around 1.75% and have moderated, but a push above 1.75% toward 2.0% would put negative pressure on stocks and the economy. A move above 2% would be a strong negative (in our opinion). We are watching yields closely even as we expect stocks to rise over the next several weeks.

Market Outlook

April has so far born out its historic tendency as a strong month, with solid gains across the indexes. But we are getting maybe a bit too much of a good thing, with the S&P up 12 of the last 14 days. A brief pause/pullback soon seems likely. So expect some late month consolidation.

The intermediate and long-term bullish trend remains intact, so as long as the economy continues to build steam without overheating inflation, a rising tide of earnings should lift stocks this quarter. We remain concerned over elevated bond yields, but as long as yields stay out of the 'danger zone' (see chart page 2) the stock market can adjust to current yield levels.

Investment Strategy

Over all we remain positive on stocks since the economy remains solid, and the economy should handle the rise in yields easily as long as we don't see another big yield spike. Earnings could be much better than the expectedly strong levels, and if so stocks could get a really big fundamental boost. Corporate bonds have acted much better, and high-yield bonds continue to fare well. This mix seems to be coming together to provide a strong boost for the financial markets in the second quarter.

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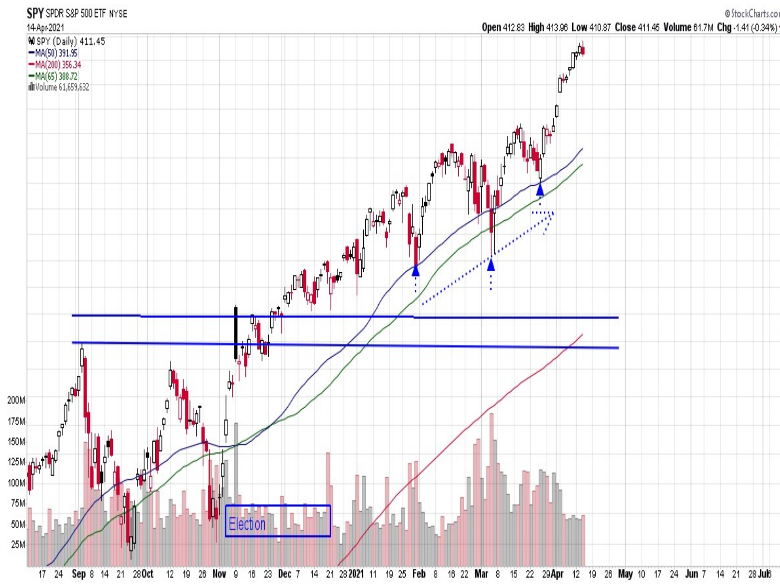
Market Charts

Market Remains Bullish but Overbought

The past few quarter have been pretty good for stocks, as we thought they might. The market bottomed right around the Election which told us that was likely the low—and it was. The S&P has now rallied to new highs, although the past few months have been choppier (rising interest rates make things more volatility in general) but the up-trend has remained intact. In the short-term the S&P is overbought and a bit extended, so a 2-3% pullback seems likely to us. **The bigger trend should remain positive into early Summer at the least.**



Bond Yields at Key Levels

Bond yields have risen sharply since the Covid Crisis lows of last year, when the 10-year note bottomed at 50bps (0.50%). Some rise in rates is natural and healthy, as it shows the economy getting back to business as usual. However, if rates rise too quickly, it can put a good deal of negative pressure on the financial system, so we don't want to see rates go up to much from here. It looks in the near-term that rates are stabilizing and even coming down a bit, but we will keep and eye on our cautionary levels shown in the chart at right.