Hamilton-Bates
Market Update

July 16, 2021

July Strength Materialized as Expected—but Pullback Looms

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July Starts with a Bang

With the third quarter now three weeks old, there is little sign on the surface of change from the market trend that took hold in the middle of June. Bond yields have moderated, despite another round of much higher than expected inflation data, and this in turn has supported a return of flows towards growth stocks. This has propelled the indexes to new highs as we head into the dog days of summer. The only change is that the current move now favors mega-cap technology over the more speculative portions of the sector, with the early-year high flyers once again showing signs of rolling over. July could remain strong but like a summer thunderstorm—clouds are forming on the horizon.

Earnings, and the Economy

So far so good. The economy is open, vaccine rates are up, and the economy seems to be hitting on all cylinders. Covid variants are spreading, but the good news is that the vaccines seem effective and serious Covid cases remain quite low.

Companies across the spectrum still seem to be having trouble hiring works, but this will likely resolve itself over the next few months as special unemployment benefits for most states have or will be ending. Those who are on the sidelines will be forced to get back in the workforce, easing most or all of that workforce tightness.

Our big view remains the same—the overall economy remains solid, with a strong consumer and favorable labor markets supporting spending and earnings. Unemployment remains low and the employment reports continue to show firms hiring. Earnings season is upon us and the news should be good. We'll be gauging the market's response to the earnings as that is what matters. Our concerns for the economy will come when the labor market weakens, or interest rates rise enough to threaten the economy. <u>Neither show signs of happening right now.</u>

Market Outlook

June gloom led to July 'fireworks' as stocks rebounded to make slight new highs. However, while the indexes are at their peaks, we are seeing some trouble 'under the hood', as market breadth and volume aren't confirming this move. What is happening is more money is moving into fewer stocks, pushing the indexes to highs but leaving many stocks struggling. Furthermore, small-cap stocks are really lagging now, which is an early 'risk-off' sign for us.

The first 7 months of the year have been very strong, and the history of strong first halves has seen that strength continue into year-end. The average has been another 10%. However, the third quarter, which we are in now, has been the weak link. We could face sort of a 'mid-cycle' correction here, with August and September seeing the market taking a respite from the strong move seen so far this year. It doesn't have to occur, but what we are seeing under the market's hood suggests the odds are good for a pullback. <u>Maybe 3-6%</u>? We don't believe the long-term upside is over just yet– and any weakness will be an opportunity to add to equity holdings.

Investment Strategy

Over all we remain positive on stocks since the economy remains solid, and <u>yields haven't risen enough to hurt the economy, nor have they fallen significantly to signal an impeding slowdown</u>.

Like the summer weather, markets too can be volatile, and a summer thunderstorm or correction is very possible over the next few weeks. We'll tread carefully and look to add to holdings on that weakness, as we believe the next act of the market rally is still to come.

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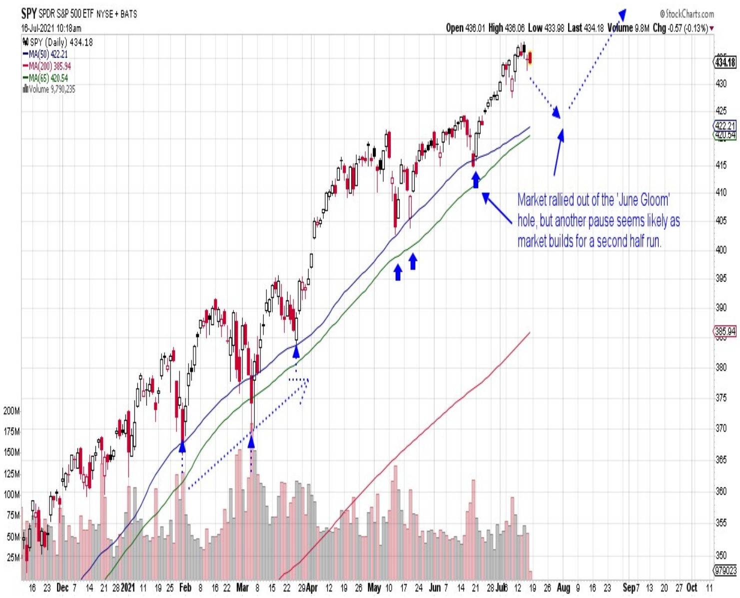
Market Charts

Market Remains Bullish but is now Consolidating
2021 continues to be bullish but Choppy, with alternating periods of strength followed by consolidation. We are not seeing deep pullbacks, but they have been regular. After a strong four week move from the June lows- we expect some softness in the week(s) to come. Don't get too concerned with such a move as solid fundamentals suggest the bull still has room and time yet to run.



Bond Yields at Key Levels
Stocks may be the beating 'heart' of the financial markets, but interest rates represent the economic 'blood pressure'. Like our own, we don't want to see <u>high</u> blood pressure, nor do we want it too <u>low</u>. The same is true with interest rates. Rates moving too high to soon hurt the economy, rates moving too low suggest an economy heading into recession. We like to see yields/ rates moderate in a 'just right' zone. Sort of where they are now. Yields have backed up the May peaks which coincided with the high in many commodities, which is a positive. Now we'd like to see yields settle in the 1.20 -1.50% range suggesting a normal, healthy conditions. So far so good here.