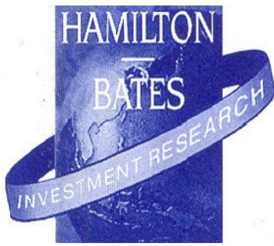

Hamilton-Bates

Market Update

December 6, 2021

An old market phrase (dating back to the 1900s) is this: "**The bears have Thanksgiving, but the bulls have Christmas**."

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US stocks have traded lower since mid-November as investors reacted to a new virus variant (Omicron), and strong business sentiment surveys (leading to a more hawkish Fed), which has professional and retail investors alike contemplating how to position into a suddenly volatile year-end.

As we leg further into the last month of 2021 and the post-pandemic era, the past two weeks has many raising the question: are we starting to see what the 'new normal' looks like? Maybe, but we don't think its COVID that is the issue at present.

It's not unreasonable to look at the Omicron variant as an anomaly that 'surprises' markets and represents a left tail risk. But after enduring the original COVID-19 outbreak followed by waves from the Beta and Delta variants, investors may be determining that COVID waves are becoming a regular thing -- seasonal like the flu the perhaps. In fact, Omicron has many features that make it much like the common cold—primarily it does not seem nearly as deadly as DELTA.

We believe that what may be jarring the markets right now are a combination of technical and seasonal factors (fund distribution season), combined with some good old tax selling ahead of year-end. <u>We also believe there is some concern building over the Fed and their Taper</u>.

The Economy, Rates, and the Fed

The Economy continues to move along, with GDP back into its normal 2% range for growth. Employment remains strong, with jobs both easy to come by and better paying. The scales are finally tipping back towards LABOR after 40 years of falling real wages. As long as the job market remains robust the economy will be on solid footing.

The Fed for its part, has finally begun the long-awaited TAPER. They will begin to pull back on the massive money printing infusion that began in 2008. They are gradually cutting asset purchases back and will be down to ZERO by Feb/Mar of 2022. They have not talked about rate hikes, but the market expects two next year (we are not sure about that).

The financial markets have been major beneficiaries of Central Bank largess and the elimination of the money spigot could be a significant issue for the financial markets in the months ahead. Can the market stand on its own two feet? As long as the economy holds up we think it can, but without monetary supports we could see more volatility in 2022.

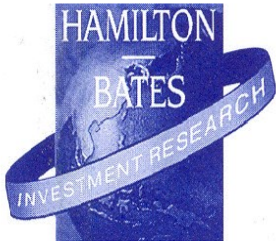
Market Outlook

The November rally smashed into a Covid Wall (Omicron), which killed short-term sentiment around Thanksgiving and exacerbated the selling. Short-term seasonal pressures are also weak, as this is mutual fund distribution season. So the first 10 days of December are generally soft. We are seeing that weakness magnified right now.

The good news is that the speed of the selling and the severity among many individual stocks—has taken sentiment and technical measures to very oversold conditions. Normally readings like those we are seeing historically lead to sizable gains over the subsequent month. We expect the market to regroup and rebound in the second half of December, especially since pretty much everyone who wanted to sell likely has done so. We'll gauge the nature and quality of the bounce to hone our expectations for the first quarter of 2022. We'd look for the market to hold recent lows, and attempt to build momentum into year-end. Given the amount of selling we have seen, a short-squeeze/equity chase to the upside is possible over the next few weeks.

History of the Santa Claus Rally

The fourth quarter is historically the strongest part of the year– typically seeing solid gains. The 'Santa Claus Rally' however, while typically lumped in with this year-end strength, <u>actually only refers to the last 5 trading days of the year and the first 2 trading days in January</u>. This period is noted for gains a large majority of the time. It also serves as an indicator of sorts in that should the market NOT rally over this last part of the year it typically is a harbinger of negative trading the following year. We expand that thought a bit when we look at the year end period, and if the market doesn't



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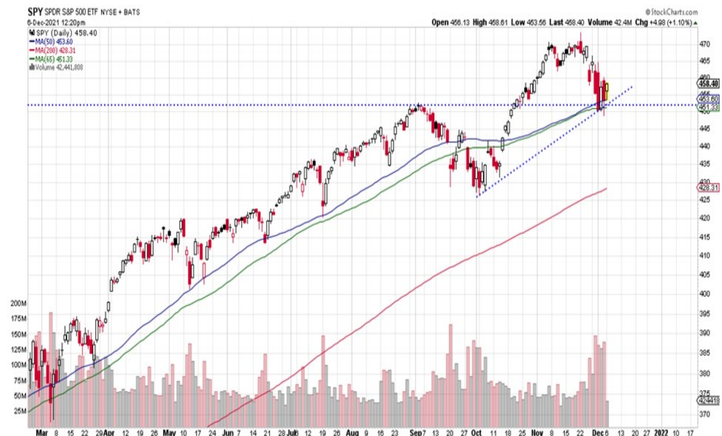
act well for most of the year-end period we become very concerned about the following year. Yale Hirsch from the Stock Trader's Almanac said it best when he set it to rhyme in 1971 - "Should Santa fail to call, bears may come to Broad and Wall".

We expect that flows will turn positive as Buy-Back Programs and traditional year-end flows combine with oversold conditions to boost stocks. Our focus will be on large-cap dividend paying stocks, as these 'growth at a reasonable price' names plus 'value' stocks could be set to lead. Interest rates remain low and despite the threat of inflation yields have not pressured the high end of their recent range, suggesting to us that there is some risk of a slowing of growth after the holidays. So it will be an interesting tug of war between positive seasonality and money flow trends versus a slowing of growth in the wake of supply-chain stress.

Market Charts

S&P 500
The recent correction took the S&P 500 back to test the breakout level above the prior high and short-term trend (shown by blue lines). Key moving averages are also in this area. **As long as this level holds stock can build toward a year-end rally that lasts into early 2022**.



Interest Rates—10 Year Bond Yield
The bond market has been surprisingly tame given the talk of inflation. Yields have not gotten to prior highs around 1.80-2.00%, and have in fact dipped a bit during the recent stock decline. As long as yields bounce between 1.3%-1.80% things will be ok. A move above 1.8% (would suggest overheating) or below 1.3 (things cooling too quickly) would likely unsettle the financial markets.

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