Hamilton-Bates Market Update

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Can the Market Hold Its January Gains?

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2023 has seen a continuation of the strength we saw at year-end. Seasonal strength in December led to a Santa Claus rally into the New Year, and money flows into beaten down stocks propelled the market to its best January gain in some time. Battered tech stocks had their best January in 10 years, and the typical 60/40 portfolio had its best January since 1987. It was a welcome start after a brutal 2022.

The Economy, Interest Rates, and the Fed

Strong money flows that are typically seen to start the year were part of the reason for the strong start, but the Fed was easily just as important. After ramping up rate hikes in 2022 to tamp down inflation, the Fed has finally started to take its foot off the break. Rate hikes are nearing their end, and at the very least the 75bp mega hikes are long over. Rapidly rising rates put a great deal of negative pressure on financial assets, so even a lessoning of the magnitude of hikes is an enormous negative pressure removed from the financial markets.

The economy remains strong even in the face of the rate hikes undertaken so far. We thought that for the Fed to pull off a series of rate hikes without killing the economy they would effectively have to 'thread the needle' as there was little room for error. *So far* they have seemed to have done just that. GDP growth remains solid, and the labor market remains strong. Unemployment just hit its lowest level in nearly 5 decades. Inflation has started to come down and some investors are talking about a return to 'goldilocks' - a period of slow growth and low inflation returning.

We are not so sure we are ready to go that far, but certainly the economy has handled the rate hikes better than most expected. Largely it has to do with the labor market. Because companies have had such a hard time finding workers, they are now loathe to let them go. In the past cutting workers was one of the *first* things companies did to cut costs, now it's the *last.* As long as the labor market holds up the economy is likely to continue to surprise to the upside. **If the labor market weakens it would be a big red flag**. We will be watching the weekly unemployment claims for signs of a big jump as well as looking for weakening job creation figures in the monthly labor market report.

Stock Market Outlook

We thought that December would be a strong month, and that its strength would carry over into January. We even said that we thought the strength of the move might catch many investors off-guard, and indeed that has been the case. There has been a good deal of short-covering as well as new money coming into the market to start the year, and many hedge funds remain under-invested if the market is to continue higher.

Some bears have pointed out that the current rally looks like the August and October rallies of 2022 that failed an rolled over to new lows. In our opinion this one is a little different. Market breadth, the number of stocks moving up versus the number of stocks moving down has been very, very strong. In this regard this is a big change from 2022. This does NOT guarantee a new up-trend, but along with the break of the prior down trend it does mean we should give the market the benefit of the doubt as long as the key levels mentioned in the charting section on page 2 are held (spoiler– its around 3900 on the S&P 500).

The yield curve remains very inverted (which means short-term interest rates are above long-term rates) - which only happens ahead of a recession. We have our eye on this. One is out there—but if it holds off until 2024, we can see further strength in stocks, and a continuation of the markets surprising strength to start the year.

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Market Charts: S&P 500 Breaks Old Down-Trend : Can it Start a New Up-Trend?

S&P 500

The major averages have broken the long-term down trend back to the 2021-2022 peaks, and are attempting to start a new long-term upward trend. The extent they can hold onto the January gains will go a long way toward determining whether this new bull trend can grow or wither on the vine. The down-trend noted by the dotted line has been broken. As long as the major averages can hold above this line, and the key average (blue), will tell us what we need to know. The key level we are watching is right around the 3900-3950 level where the trendline and moving average now reside. Some consolidation after a strong month is normal—a break below these noted levels would not be and suggest more weakness before a new up trend can take hold.