Hamilton-Bates
Market Update

April 14, 2023

Spring has Sprung and the Financial Markets are Trying to as Well

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2023 has so far been a better than expected year, with stocks and bonds continuing to gain after last year's washout. January's breakout was tested in February, but the market held where it had to and stocks once again turned higher. We are not testing the early February peaks once again. We think the strength can last another few weeks at least and so upside potential remains.

The Economy, Interest Rates, and the Fed

At this point everyone is expecting an economic slowdown if not outright recession. Even the Fed's base-case is a mild recession. The Fed has been hiking, and coupled with inflation and now a banking crisis it seems pretty clear a slowdown is in the economic cards. We would agree with this and in fact our work with the yield curve and its 'inversion' some time back was a sign that something was amiss and would be coming down the tracks. The problem is that just as a 'watched pot never boils', a well anticipated market decline or recession never seem to happen either. Once everyone 'knows' something the value of that knowledge is lost.

The financial markets can be a sneaky snake, trying to get you off guard and out of position. We have felt that that trick for 2023 may be that the recession everyone expects doesn't come—and the market remains stronger than people expect and for longer. That then hooks the most people in for a recession that is hiding around the corner in 2024.

The economy is showing signs of slowdown, especially in housing—and now retail sales which came out worse than expected. But employment is holding up, and jobs seem easy to get. As long as American consumers have a job they will spend. And given how hard its been to get workers when you need them, employers may be very unwilling to let workers go until they absolutely have to do it. This hoarding of labor may be what delays any recession until next year.

One last indicator for the economy that we look at are 'junk bonds'. These are high-yielding bonds from companies that don't qualify for a rating and are very at risk of going under in an economic slowdown. This segment of the bond market acts like an early warning of an imminent slowdown. So far this sector has held up well. When and if this group of bonds starts to weaken, it will be a warning that a slowdown is truly coming.

Stock Market Outlook

The bond rally in 2023 has helped interest rates peel back from peak levels, which takes a lot of pressure off of stocks. This is one reason why stocks have held up so well even in the face of some signs of economic slowing. Falling rates act like a tailwind to help offset some of this slowdown.

With the bond market holding up well this has given a tail wind to stocks, which have also continued to benefit from corporate buy-backs. Many investors and hedge-funds came into the year historically under-invested and that positioning in the market remains at very low levels. So many big sellers have already sold and there is now an absence of sellers. This has allowed corporate buy-backs and short-squeezes to push stocks to successively higher levels on each rally.

How the market acts over the next few weeks will tell us much. If we continue to see higher S&P highs this could attract a lot of sideline cash back into the market. We are allowing our holdings to ride this wave higher, and we'll wait for our models to tell us when to lighten up. When we see signs that economic weakness is charging down the tracks we'll step aside. Now that money market funds yield near 4.5% cash is no longer 'trash' as it was when rates were 0%.

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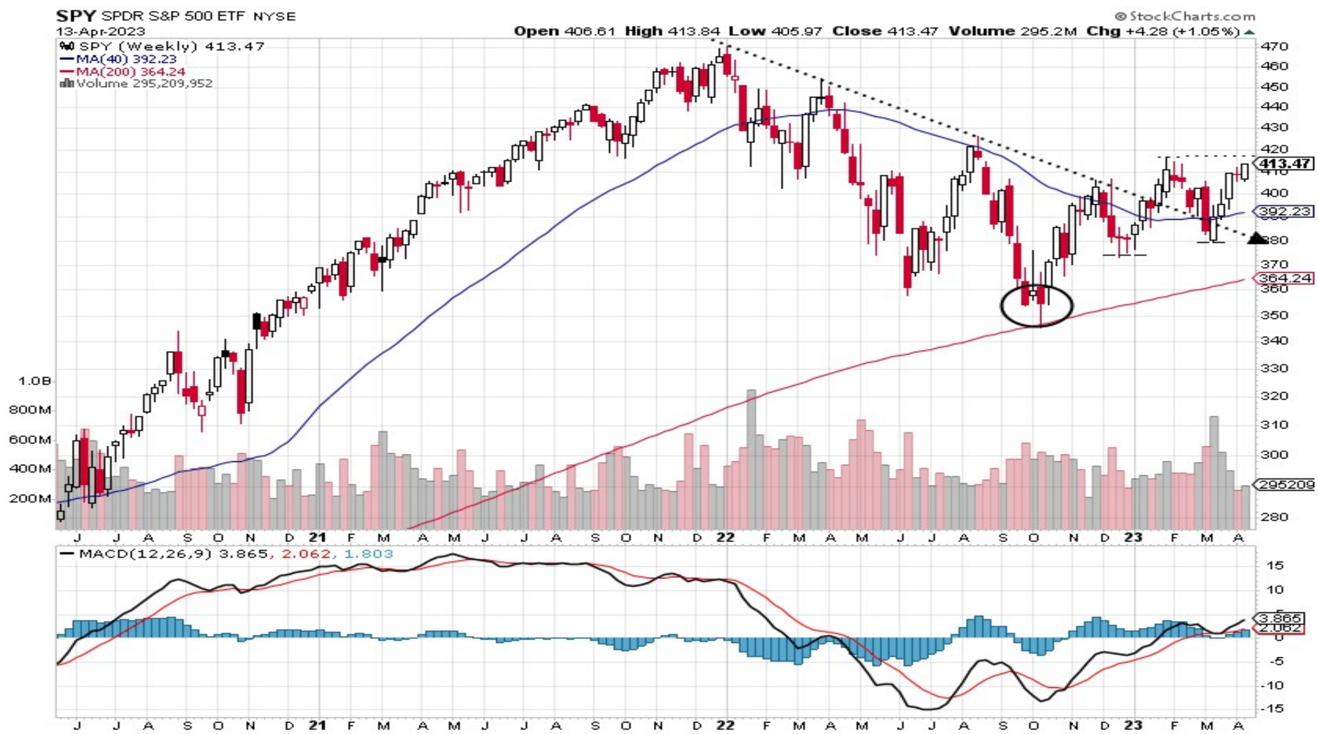
Market Charts: S&P 500 Breaks Old Down-Trend : Can it Hold the New Up-Trend?



S&P 500

The long-term chart of the S&P 500 shows the US equity market in a cautiously bullish position. The main low was made in October 2022 (circled), followed by a choppy rally that has so far managed a sequence of higher highs and higher lows. A push above the February high would continue that trend. Furthermore, the move in early 2023 broke the long-term downtrend back to the 2021 high (this downtrend is shown by the dotted arrow moving down to the right).

As long as we continue to see the market make higher highs and hold above the trend of higher lows 2023 can continue to be surprisingly strong-in spite of the fact that a 'recession' looms over our heads. The much anticipated economic slowdown may actually hold off until 2024.