Hamilton-Bates
Market Update

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Stocks Holding Up Despite Fears of a Hard Landing

In contrast to a brutal 2022, 2023 has seen surprising strength. Bonds have recovered a bit, as interest rates have stopped rising at an astronomical rate. Rate hikes have continued but the end of the rate cycle appears to be near. This release of extreme rate hike pressure has seen the battered tech sector surge off the mat; with 2022's worst sector now leading in 2023.

We were optimistic heading into this year, believing that the extreme negativity would give way to a relief rally early in the year. That relief has lasted longer and gone farther than most expected, and it could continue. 2023 could continue to be an interlude of bullishness in the wake of a tough 2022 and ahead of what could be a turbulent 2024.

Economy, Interest Rates, & the Fed

The economy continues to chug along, with GDP growth in the 1.5-2.5% range over the past 2 quarters. The economy has come off the rapid 8% reopening rate of late 2021 but has so far avoided the hard landing. Leading Economic Indicators, and Purchasing Managers Index data, along with regional Fed surveys show and economy clearly deaccelerating; but a strong labor market has so far kept consumers employed and spending. This factor has been what has delayed the hard landing many expected given how fast the Fed has hiked rates.

Speaking of the Fed, after hiking rates at the fastest page in decades, the current rate-hike cycle seems to be nearing an end. We could see one or two more quarter point hikes but we expect that the majority of the movement is behind us. Goods inflation has moderated, led by energy and commodity prices. Housing has come down led by lumber. What has remained sticky has been services inflation led by airlines, travel and restaurants. Given the strength of the consumer this is not surprising, but it could be in the early stages of changing. Why? Because of details in the Debt Ceiling Agreement. A tentative agreement has been reached that avoids a U.S. default on its debt. This is what we expected and avoids what could have been some needlessly turbulent markets.

Student Loan Deferment Program Ends

A covid era program of student loan payment deferment will end on June 30, 2023, and payments are expected to resume by Sept. 1, 2023. This was a big program no one really talks about. According to data we read, 64% of the $1.7 trillion in student loan debt has been in forbearance the past three years, amounting to $1.1 trillion. Many of the 25 million Americans who have deferred payments for student debt are aged 18-44 years old, one of the most important demographic groups that drive consumer spending. **For consumers taking advantage of the program, they have deferred 39 months worth of payments, resulting in more than $15,327 in additional discretionary income during the period,** much larger than the amount most received from other COVID stimulus programs. Starting in September payments will resume, with a New York Fed study indicating the average student loan payment is $393 per month. This is money that will come out of the economy, and be a net reduction in consumer spending in the fall.

The Fed—the Inflation Pickle

The seeds of the current inflation battle the Fed is fighting (and we are suffering with) go back to the decade plus of zero and near zero rates that the Fed undertook in the wake of the Great Recession in 2008. When a decade of artificially low rates met a deluge of fiscal stimulus during Covid and combined with the supply constraints of that period—it was the perfect storm for inflation. We went from near zero inflation to close to double digits—in no time flat. Wages had to rise to meet the demand for labor—adding further to inflation as consumers spent this

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newfound income. Inflation cycles can become self feeding as rising demand for wages create rising prices which create more demand for rising wages. This is a tough cycle to break and this is where the Fed finds itself now.

Parts of the economy are already slowing, led by energy prices and materials. Commercial real estate is under pressure. A regional banking crisis threatens a small group of bank stocks but also threatens to tighten credit. The real area of strength remains solid wage growth and a strong labor market. Consumers are showing signs of buckling under inflation but as long as Americans have jobs we will spend. But if the Fed hikes too much it risks running the entire economy into a recession. Slowing the economy enough to handle inflation without causing a hard landing is a balancing act on an ever-shrinking balancing beam.

The Stock Market & Investment Outlook
The financial markets have 'recovered' somewhat in 2023 as interest rate pressures have come down. But the gains have been very narrow and the average stock hasn't done all that much. Outside of the technology sector everything else is largely unchanged on the year. A small group of large-cap tech names have helped the S&P to a decent gain, but we'll need to see more stocks participate to show a truly healthy market. A glance at the data below will show the divergences.

Russell 2000 Small Cap Index	YTD	-0.5%
Dow Jones Industrial Average	YTD	-0.1%
S&P 500 Index	YTD	9.1%
S&P 500 Index Equal Weighted	YTD	–0.7%
Technology Index	YTD	34.4%

So far in 2023 the bond market has made back some of the losses of 2022, and we believe that with the rate cycle likely ending this year bonds will soon become the portfolio stabilizer we expect them to be. Should the economy slow into 2024 bonds could act as ballast and provide stability and income. We just have to get to the end of the cycle—that should be soon.

The stock market has been very narrow, with nearly all the gains coming from a handful of large-cap technology names. These stocks, such as Microsoft, Meta, Amazon, Google, Tesla, and Nvidia are growth names benefitting from a number of current tailwinds. The first is the end of the hike cycle—large cap growth does well when rates are stable or falling. Second, these companies are large with large moats to competition and strong balance sheets with plenty of cash. This makes them difficult to compete against and resilient in the face of a slowing economy. They don't need bank loans to fund their business like many small businesses and capital intensive sectors like industrials and manufacturing do. What we want to see is a broadening of the market, so that more gains come from an increasing number of stocks and sectors. A healthy market and economy is not just one sector. It can carry on for some time, but a tech only market brings back memories and shades of 1999-2000 and the tech bubble of that era.

Portfolio Strategy
We haven't done too much trading this year as there simply hasn't been too much to do. We did add to 'tech' relatively early on by adding the NASDAQ 100 to our fund holdings. The majority of our stock holdings remain blue-chip dividend paying names. We remain underweight in bonds but we are looking to add to this area when the opportunity arises. Cash remains a strong option with money market yields around 5%. We can bide our time. We could see a lull in June after a strong May for stocks, but we continue to see upside in 2023. Next time we'll cover our thoughts on Artificial Intelligence and investing.

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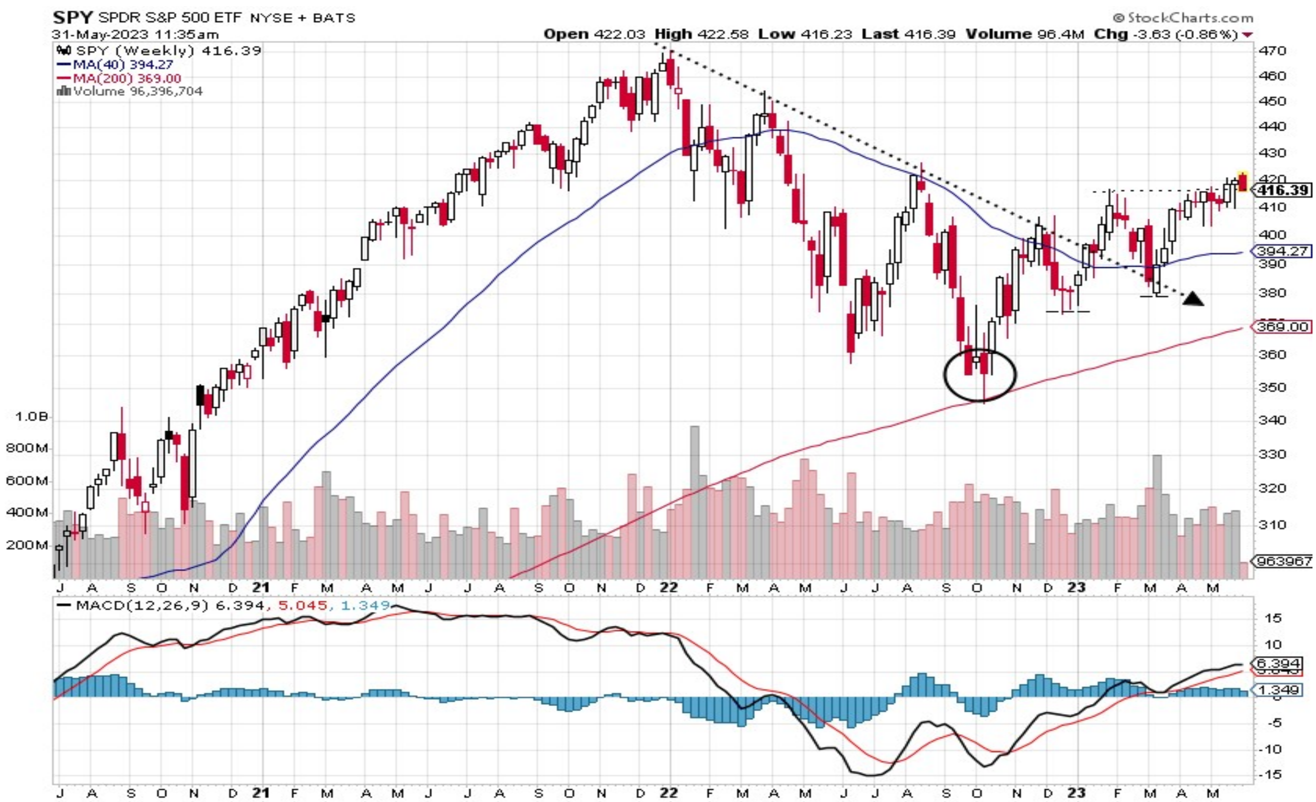
Market Charts: S&P 500 Continues to Grind Higher



S&P 500

The chart above shows the S&P 500 Index over the past few years. 2022 saw a broad decline that bottomed in October of 2022 right around the 200 week average (circled area in chart). From there the index has ground its way higher, managing to beak the downtrend in March-April of 2023 (the move above the downward sloping arrow). The market has managed a series of higher lows, stair-stepping higher in 2023. After a pause around 4200 the market seems to want to try a push higher. If we can get above 4200 and hold there, a further run through the summer could push the market to even more 'surprising' gains. A rally in 2023 while the majority expect a recession would catch the majority off guard and this remains our base case.