Hamilton-Bates
Market Update

July 11, 2023

Still Grinding Higher

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Not What Was Expected

We are halfway through 2023 now, and we can honestly say the market's resiliency has shocked even us—even as we were expecting to see more strength than most others. Last year's beaten down tech stocks are leading the way, carrying the major averages to solid returns through the halfway mark. The average stock and broader indexes are lagging behind, but all in all most portfolios are up in the 6-10% range which is pretty good given the environment we had to start the year.

They say that the thing that the Market does best is confound the majority of investors. To that end it has been succeeding fabulously. Since 2022 the Fed has undertaken a rapid series of rate hikes, one of the fastest in history, to put a brake on inflation.

Throughout 2022 rates moved up and stocks moved down. Stocks and bonds fell together as the financial markets scrambled to price-in rising interest rates. The yield curve quickly inverted, which happens when short-term rates are pushed above long-term rates, and investors braced for an imminent slowdown. 2022 ended up being one of the worst years for stocks and bonds since 2008. By year's end most institutional and retail investors had 'battened down the hatches' and were prepared to face the gathering storm of 2023.

But the market simply doesn't do what most expect, and with everyone positioned very defensively—it meant there were few people left to sell, everyone had already sold out. That left the market with no place to go but up, as long as the economy didn't fall apart. And it didn't. Far from it.

The Economy, the Fed, and Interest Rates

Rapidly rising rates had everyone expecting an economic slowdown if not a recession. The economy did slow, but we seem to be in more of a rotating recession or slowdown rather than a broad contraction. Certain sectors are weakening then recovering, while other remain strong, so that the economy as a whole stays afloat.

We have thought that as long as the employment situation stayed strong the economy would as well, and so would stocks. The job market has stayed strong and wages have grown nicely, but have not kept up with inflation. Inflation has moderated, but not to the extent the Fed has hoped for. Materials prices have come down but services inflation remains high. The Fed is planning 2 hikes before year-end and then to hold rates steady until inflation tames.

We think inflation will indeed come down, and the economy is showing signs of slowing. Commercial real estate is an area of weakness, and student loan deferment is ending and debt repayments will begin in late September. Employment, the key cog in the economic machine, showed its first signs of cracks as the employment showed the weakest job growth since 2020. Beneath the surface there was more concern as hours worked declined, continuing a trend that portends economic slowing.

The Fed may end up hiking two more times, but the majority of fed moves are likely behind us. We believe this makes fixed income more attractive in late 2023 into 2024. It is 2024 where we expect the economic slowdown to finally arrive.

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AI—Rise of the Machines
Artificial Intelligence has been a hot topic of late, with companies falling all over themselves to say how they are using it in their business. It's the latest buzzword—but is it buzzworthy? We think it is, but the runway will be long and winding.

We see AI as helpful in things like healthcare and surgery—where robotics is already playing a role, and in the area of a super personal assistant–where your smart phone gets even smarter and talks to you like Iron Man's suit 'Jarvis' talks to him. It sounds crazy but so did the idea of 'smart phones' in 2000. The growing AI trend benefits chip stocks and data storage companies, sectors we already know and like. We'll share more in upcoming issues but we believe AI is here to stay.

The Stock Market & Investment Outlook
We were positive on stocks coming into 2023, thinking that we were in the eye of the storm and that 2023 would be a period of relative calm after a rough 2022. That has indeed been the case except that some stocks have been stronger than even we expected.

We remain invested, with a diverse portfolio of equities along with some fixed income although we remain underweight bonds. Cash remains relatively high since we still see an economy that will slow in the second half, and with yields greater than 5% cash is no longer trash.

The trend is still up for stocks, and we could see this rally lasting into year-end, but the third quarter is usually a soft spot. We could see a little pullback to reset before another run higher.

Market Charts: S&P 500 Continues to Grind Upward

S&P 500
The long-term chart of the S&P 500 shows the decline in 2022, bottoming in October at the 200 week average in red (circled area in chart). From there stocks rebounded, finally breaking the down trend in May (by pushing above the downward sloping trendline ending in an arrow).

Since then stocks have pushed upward sucking money off the sidelines back into stocks. Most of this money has gone into large-cap tech stocks like Apple, Microsoft, Tesla, NVDIA, and Meta—but recently small-caps and the broad market have started to show signs of life. As long as the market holds trend, and key sectors like banks and retail (not shown) hold up, the rally will continue.