Hamilton-Bates Market Update

August 23, 2023

Seasonal Pullback Should Lead to Another Rally

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Seasonal Pullback Blunts Bull Run
The financial markets entered the year with negative sentiment in the wake of a tough 2022 for stocks and the worst year in over 200 for bonds. But rather than continue last year's malaise, stocks vaulted out of the gate and ran bullishly for the first 7 months of the year into late July. Things got a bit too exuberant at that point, and August has seen the market back off those peaks and into what has been so far a very normal correction.

So far what we are seeing has been a very orderly decline, and so far this looks more like a 'buyers' strike' than a hurried rush to the exits. The market rallied more than 10% in the first half of the year—in past years where that has occurred the second half of the year has been positive the rest of the way. In 10 cases since 1980 the second half has been positive 10 times. The average second half gain is about 10%. In our opinion this pullback is setting things up for a year-end rally and we will be putting money to work. Choppiness could continue into September with strength most likely to develop in Nov-Dec.

The Economy, the Fed, and Interest Rates
The economy is still growing as are earnings but there are some clear signs of fraying around the edges. The jobs numbers are ok but not great, and retailers are starting to note across the board softness developing in some demographics. Rising interest rates are pushing credit card rates to record levels and mortgages well into the 7% area. Homebuying has dropped to 1995 levels as demand has really softened. Home price affordability has become a big issue.

Inflation has dampened a bit but we are not sure how much lower it will go unless we do see a recession, but we do not see that happening before 2024. We think the economy will do ok into year-end and inflation will stay stable, allowing the Fed to declare 'mission accomplished'. That should boost sentiment and send stocks moving higher into early 2024. It is then that we fear the delayed effects of rising rates start hitting the broad economy.

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. But even we are a bit stunned by the strength of the rally in the first half of the year. We sat tight and added to some areas that we expect to do well in the months to come but we kept a good deal of powder dry. We'll be putting that to use in the next month as the correction we are seeing continues to unfold. We think it could be bumpy into September, the years seasonally weakest month, but then things will firm into year-end.

We remain invested, with a diverse portfolio of equities along with some fixed income although we remain underweight bonds. We are only buying some select bond sectors right now, as we don't see the peak in yields just yet, but better things are coming for bonds and bond investors. If 2023 sees a weak bond market AGAIN after the worst year in 200 for bonds in 2022; it would tell us 2024 could be the year for bonds.

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—that has indeed what has played out. We could see a little more pullback to reset sentiment and set the stage for another run higher.

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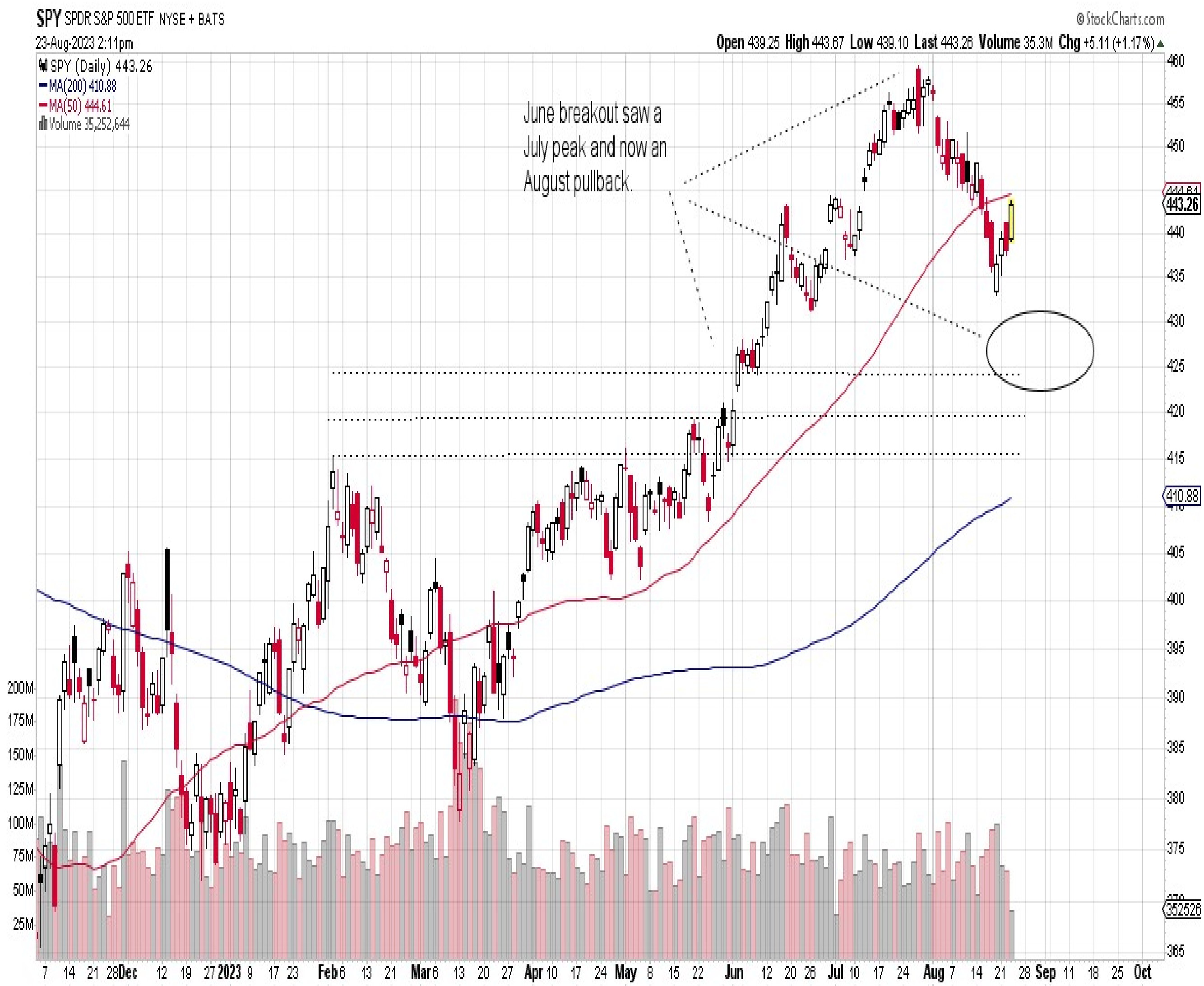
Market Charts: S&P 500—A Pause After a Five Month Rally



S&P 500

The long-term chart of the S&P 500 shows the bottom in October 2023 at the very far left, followed by some choppiness into March of this year. From there stocks rallied through May, breaking some long-term bearish trendlines and finally making a bullish price breakout in June. Bullish fireworks lasted throughout July when the rally finally exhausted itself. We think this pause will be temporary but could last into September. From there we think buy/backs and year-end seasonality will kick in and push stocks higher.