Hamilton-Bates
Market Update

December 20, 2023

When Hawks Turn to Doves

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The Fed made us look really good by making a complete about face on rates this month, capping what has been a terrific two month run for stocks and bonds. Our role as investment manager is not to 'time the market's; and we don't try to predict every market wiggle in this Update. What we do is try to give context to the market's major movements and how we as investment managers are reacting to them and what we see for the main market trends. To that end we can say we have done pretty well for 2023. Contrary to most after a brutal 2022, we felt 2023 would offer a respite—even if it was for just the first half—before rising rates bit the economy and market in 2024. We pivoted ourselves a bit as the year went along, thinking that 2023 would end up strong even as the summer peak turned to a Fall low—which we called as well. Our thoughts were that rates were peaking in our view in October, even if the Fed itself didn't realize it yet. With rate pressure relieved, both stocks and bonds were free to lift off the lows which they have done with gusto.

The Fed Pivots and Fed Hawks Turn to Doves
The Federal Reserve Chairman and his merry band gave investors an early Christmas present last week when they pretty clearly stated that rate hikes are likely over. The market rallied on this but the moves in the financial market's from the October low seemed to say that this was already being priced in. The interesting thing is that the Fed was talking pretty tough on rates in the weeks ahead of the pivot—so it seemed a shocking admission for the Fed to pretty much say it out loud that they were done with hikes.

Given that inflation is still pretty high—even though it is well off its peak—and the economy still seems pretty strong (both growth and the labor market seem pretty robust)-this move comes a little out of the blue and is something the Fed usually doesn't do. The usual Fed mode of operation is once they start hiking they do it until something breaks. We did see a bit of a banking crisis in March, but the Fed kept on hiking anyway. Maybe they have learned from the past and they are trying not to intentionally tip the economy into recession. Or could they simply be playing politics by pivoting in order to avoid a recession during an election year? All that matters is that the Fed is taking its foot off the break, and unless inflation comes roaring back the current rate hike cycle is likely done. Energy prices have come way off their peak, so that is certainly helping with inflation, but housing, food, and auto prices remain stubborn. The Fed seems to be willing to tolerate higher inflation than their 2% target in order to avoid a recession.

We continue to see the economy as still ok—with the labor market really hanging in there. As long as Americans have jobs they will spend—and so far this Holiday Season they are spending. <u>As long as the labor market holds up the economy will be fine.</u>

The Stock Market & Investment Outlook
As investment managers our job is both to find opportunity and limit risk. We try to smooth the market's bumps yet make hay when the sun shines. Largely we accomplish those goals. On balance our accounts lost less than the market in 2022 and have subsequently made up those losses in 2023. Furthermore we try to accomplish our goals with the least amount of movement possible in accounts—we are not day traders. We move in incremental fashion. We held course during the first half of the year and during the Fall weakness we have gradually put cash to work. Now that the market has rallied, we are waiting for weakness to add further to positions.

The outlook for stocks near-term and into 2024 is positive. The Fed pivot has now changed the game. While the stock and bond market's have moved enough to start pricing in rate cuts in 2024—that may be a bit of a move too far. Seasonal strength should continue to support the markets, and the Santa Claus rally kicks in next week. So the next week or so should see stocks hold up well. The first week of January normally sees a bit of selling as those that waited to sell for the turn of the tax year do their trimming. However, money flow into the market is strongest in January, so ultimately January tends to be a strong month. We would buy any early January weakness. As for our 2024 outlook, it has definitely changed from cautious to

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cautiously optimistic. One of the first and best lessons we learned as investment managers was ‘Don’t Fight the Fed’. In 2022 and for most of 2023 the financial markets struggled as the Fed pursued its rate hike regimen. Now that the Fed is potentially out of the way, financial assets have a huge weight lifted off of them. As long as the Fed does not restart its program the first half of 2024 looks favorable. We don’t think the fed will now resume hikes unless they see inflation really come back, and that will take time. They won’t easily make another about face after the most recent one.

2023 saw significant gains in large-cap tech stocks, which are truly great American companies. They have little debt, tremendous earnings growth and tend to buy/back a lot of stock. There is lot to like there and we would not be against them.

However we could see a bit of a sea-change in 2024 as overlooked and oversold segments of the market rebound. This is what has happened since the October low, and if it continues it is quite bullish. If 2023 was the year of big names, 2024 could end up being the year of the no-names, where ordinary and non-descript sectors get their time in the sun. For now, lets all enjoy the Holidays and the market’s rebound. Have a safe and happy Holiday Season!

Market Charts: S&P 500—Rally Strength Implies New Bull Market

S&P 500 Chart Above

Stocks and bonds (not shown) have surged off their October lows in a near-perfect ‘V’ pattern. Rates coming off their peak which occurred in October shows just how powerful interest rate moves are. The release of rate pressure lets stocks run and they have, surpassing their 2021 high in recent weeks. On a short-term basis we are a bit stretched, and our indicators are ‘overbought’, so it would not be a shock to see a pullback at some point. However, the outlook is now BULLISH.