Hamilton-Bates Market Update

Calm On The Surface Turbulence Below

August 20, 2026

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It is August, the dog days of summer when the heat and humidity tend to slow the pace of things down. In the stock market August tends to be more sleepy than usual too—with traders and investors away on vacation. The major averages have also been tame, essentially trading around the level (give or take) of three months ago. However, beneath the surface there is much going on, both in the equity AND bond markets—with some especially big news this week on bonds that absolutely can and will affect the financial markets.

Earnings, Economy, Energy and Interest Rates
The economy remains solid, with GDP growth coming in above trend. Nothing wrong there. Earnings have been absolutely gangbusters—with S&P earnings expected to growth 30% this year. The market is up, but would need a big move the rest of the year to match the gain in earnings. Its possible, but we would not expect that. There is some skepticism that this years earnings are boosted by AI spend and tariff rebates, and these gains are not durable. Maybe, but only time will tell. What is true is that the breadth of earnings gains suggest the economy is pretty solid right now. We don't see any red lights on earnings yet. The July Jobs Report came in much weaker than expected, with a loss of 23K jobs. This is worth noting, and a few more negative numbers stacked up in coming months would not be good. Whether this was just a giveback or hangover from the World Cup, or something more, is too early to tell.

The Fed and the Bond Market
Inflation data have been coming in cooler than expected, seemingly reducing the pressure on the Fed to hike rates this year to confront inflation. The problem is that the conflict with IRAN seems to have gone into a stalemate mode—where combat drops but the oil doesn't flow like it did before. This has kept oil prices elevated, although well off the peaks of early in the summer. The problem is that its not just the price of Oil, but the refined products that matter. Gasoline, Diesel, and other products refined from crude remain high and stockpiles depleted. Continuing draws from the SPR are not really possible (its near rock bottom) and diesel prices are at crisis highs. This has been rough on the bond market—where yields have been rising reflecting the flow through inflation pressure from energy and refined product prices. The 10-year yield hit 4.80% last week, nearing the highest levels in 20 years. Rising yields with rising energy prices put a double squeeze on the consumer.

As a result just this week the Fed/Treasury announced they will double the size of the buy backs of long dated bonds, while essentially increasing the issuance of short-term bonds. What this theoretically does is help cap or reduce long-term interest rates while keeping short-term rates where they are. Bonds rallied, but the move was also supportive to stocks and precious metals which soared. This move means the powers that be don't like yields where they are and are going to try to get them under control. <u>Short-term this is possible. Long-term it has other connotations that will affect portfolio strategy. We are putting out a Special Update on this topic next week</u>.

Stock Market Outlook and Portfolio Strategy
While the stock market has been relatively stable, beneath the surface there have been big moves in sectors and individual stocks– with big declines in one sector masked by big gains in another. There has been a lot of jockeying around beneath the surface. Adding to the chop is the fact that we are staring down the barrel of the worst two months historically in the mid-term year. <u>A pullback seems likely here, so don't' be shocked or panicked. A 5% or so dip would be ok and healthy, and in our opinion set the stage for an even bigger rally into 2027. We used the recent chop to add to International holdings recently, and we'll add to other positions on any decline</u>.

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A Pullback Would Not Be a Bad Thing

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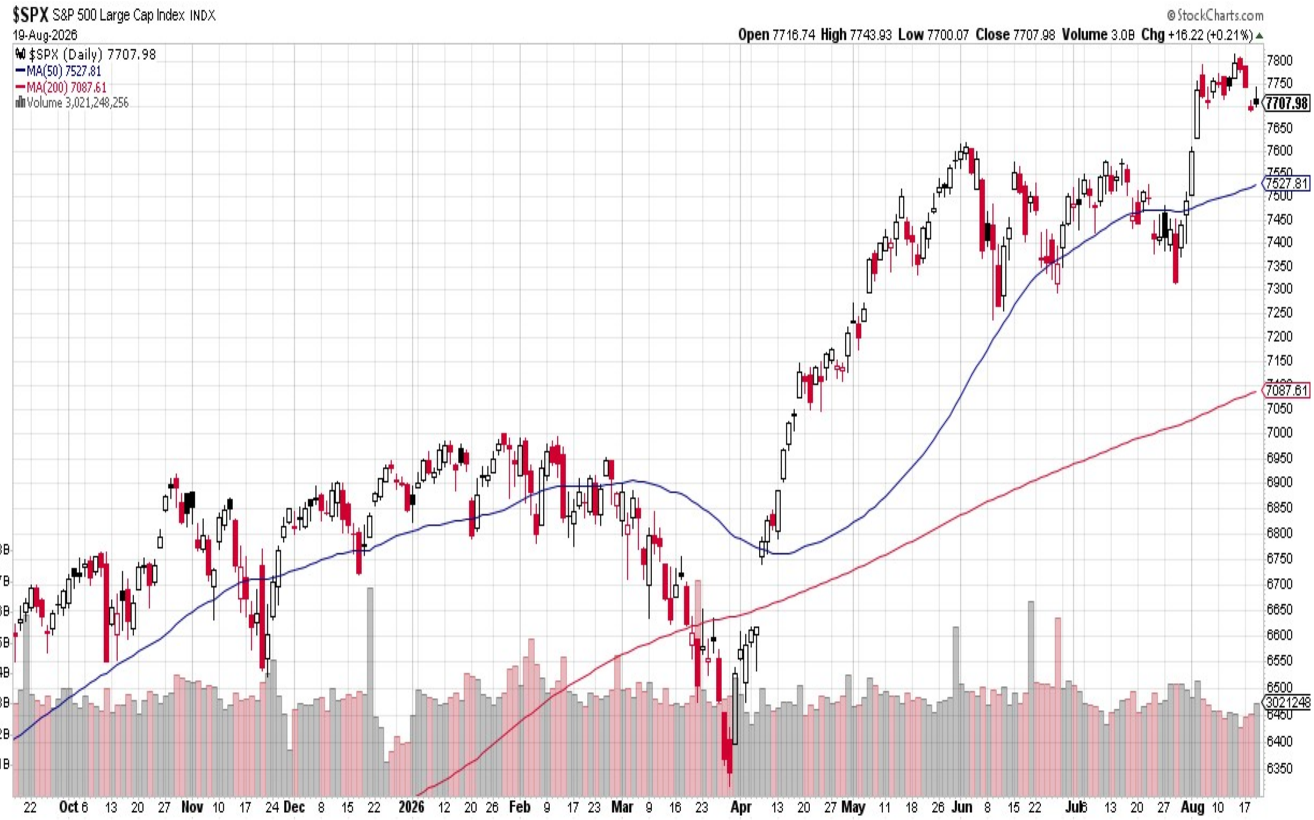
S&P 500 Market Chart



S&P 500 Chart—Bullish But...

The relative calm of this chart the past few months cant describe the sector chop beneath the surface; or the fact that even with the S&P 500 recently hitting a new high above 7800 that the number of individual stocks making new highs has dropped. This is not normally healthy behavior. With weak historical trends given the upcoming mid-term elections, a pullback should not shock anyone.

This is especially true given the bond yields have been rising most of the year. Yields have moved to the 'uncle point' for stocks—where rising yields begin to depress stock prices. <u>We believe a correction in the August to early October time window, whether its 3, 5, or 7%, would ultimately prove healthy and set the stage for an even bigger rally into 2027</u>.