Hamilton-Bates

Market Update

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Hanging In But Not Going Anywhere (Just Yet)

The market continues to buy itself time and sidestep a meltdown, with rallies coming each time key support levels are tested or threatened (see charts on page 3). Still its close enough that one or two more bad days could still push key indices over a technical edge and kick off a painful pullback that we've been lucky to avoid thus far.

With the trend still intact, stocks could blast through their recent ceiling and muster a bullish May, but that's certainly a tougher road to navigate as it stands right now with overhead resistance and negative seasonality taking over. The bulls remain in control though, and this market has earned the benefit of the doubt. The good news is, the make-or-break levels are pretty easy to spot here (again see page 3), and the market sure seems as though it doesn't want to sell off– even with so many reasons lately to do so.

Economy, Earnings, and Interest Rates

Things have been pretty busy in the middle of earnings season, and earnings haven't disappointed—70% of companies have beaten earnings and this quarter's earnings gains will be the highest in many years. The 'fear' however, is that peak earnings are in—and that rising rates will slow earnings growth moving forward. Oh the Fed—they are definitely not our friend any longer. Economic data has been pretty strong too, existing and new home sales up more than expected. That suggests buyers haven't been put off by rising mortgage rates yet. GDP remains solid too—as the first quarter's GDP growth rate looks like it was stronger than expected. The first of three readings on Q1's GDP growth says it was up 2.3% versus expectations of only 2.1%. Anything above 2% should help support corporate earnings growth. The Labor Report came out this morning, once again coming in below estimates—but strong enough to keep the 3-month average 190K jobs per month. Interestingly, the report was a return to 'goldilocks'- strong enough to support growth but not too hot to force the Fed to keep its foot on the rate hike pedal.

With the economy at full employment, we're not likely to see a lot of progress in terms of people getting jobs - they've already got them. The litmus test going forward will be wage growth. Economists are calling for hourly earnings growth of 0.2%, though note that by other measures, employment costs during the first quarter grew the most they had since the last quarter of 2010.

There's a lot to be said for the cumulative benefit of broad economic growth (as it allows companies and consumers to be confident enough to make bigger investments). Lets hope the Fed doesn't kill the bull again by raising rates too quickly. Its clear the 3% level on the 10-year is the pain point– where much above these levels right now would be a threat to the economy and the stock market.

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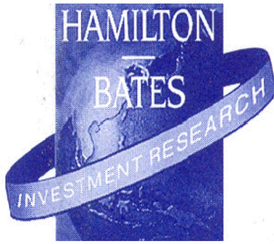

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Market Outlook and Investment Strategy
We continue to be encouraged if not impressed at the market's ability to rebound from key support levels. Each time they absolutely need to, the bulls come in for a pushback. The problem is that the rallies after the lows don't seem to be adding up to much.

So we have a market that has peaked in late January, has made 3 lows since and had two successively weaker rebounds (see charts on next page—a picture is indeed worth many 1000's of words here). A look at those charts tells the tale. Right on cue the 200-day moving average line (yellow) turns into the technical floor we expect it to. But, the index is still below lower highs of March and April, and this string of lower highs needs to be broken.

The importance of the 200-day average and the nearby support levels at the January, March, and April lows cannot be overstated. On the one hand the persistent resilience is clear. On the other hand, the market needs to hold above these levels and start to bounce or risk of a rollover and break down grows. While we don't yet want to presume a more meaningful correction is inevitable, we do want to be prepared for it if and when it happens. So, should the 200-day line end up failing as a floor, the most plausible downside target from there is the 2300-2400 area, which is the most 'natural' area for a bigger pullback to find support.

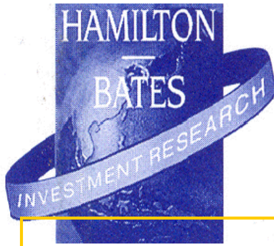
Again, we're not yet saying it's going to happen. The market has tested, and so far held its 200-day average 3 times now—3 times may indeed be the charm and we could be setting the stage for an advance. If the rally begun late this week holds up, we could see the major averages punch through the falling trend-lines and unleash a new uptrend. A break of the down trend and series of lower highs may well incite a wave of buying and set-off a very strong Summer.

This week's late rally was a start, but the market needs to follow through. This is a time to be patient rather than force moves. We have gotten some minor 'buy' signals that have had us putting some money to work this week—lets hope for the bulls that trend builds.

Investment Strategy
We continue to see the glass as 'half full' and are encouraged by the market's ability to hold in the face of many, many, reasons to decline. The negative signals that has us raising some cash in March are starting to reverse course. It sure seems like the market wants to rally. Earnings have been good, it seems like its interest rates and the fears of the Fed hiking too much that's been holding the market back—perhaps that's why the market rallied so strongly on today's 'goldilocks' employment report—ok but not too strong– enough to support the economy but just maybe keep the Fed at bay.

The NASDAQ and technology sector remains strong, this helps the bullish case. We are also seeing strength in small-caps, also a 'risk on' area. Strength in NASDAQ and the Russell 2000 could be early indications that the market is finally preparing to move higher. On the interest rate front, 3% has so far been the cap on yields, and bonds could have finally found a level where the overdue bounce can begin. If yields have peaked for now, it would be a big boost for stocks.

We are now getting some long-awaited buy signals and are now doing selective buying, particularly in small-caps, with the market holding key support once again.



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Market Charts : Key Levels Both Short-term and Long-term

S&P 500 Daily Chart—The 'W' pattern we referred to back in February sure looks to be coming into form now. We highlighted a model 'W' in red in the chart to make it even clearer. If the pattern holds true, the next long-term move is another rally leg higher.

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NASDAQ Daily Chart—On the long-term chart all the recent 'volatility' looks like a little blip—that's why this big picture view can be so helpful—it puts things into perspective. The market broke below the 10-month average (red line) early on, but has so far held above this key level on a monthly closing basis. A monthly close below the 10-month would be an early sign that something was amiss. As you can see prior closes below the 10-month average coincided with pretty sizable corrective periods.

10-Year Bond Yields (Interest Rates)-