Hughes Investment Advisory Service

January 4, 2018

Dear Clients and Investors,

Happy New Year to all of you. All I can say right now as I sit down during a brutal winter storm to write this Year-End Investment Outlook letter is Wow! The DJIA just crossed the 25,000 mark for the first time and the markets are celebrating the new-year in a very big way. I'm actually quite excited as I sit to write the Outlook letter. Sometimes, like I assume many, I search for relevant investment themes to write about. Today, the investment thoughts running through my brain are many and I will need to trim them down to keep this letter to my self-imposed two page limit.

US stocks closed out trading in 2017 on a positive note. The S&P 500 was up +6.1% in the 4th quarter and rose +21.8% for 2017. Each year at this time I like to reflect back on last years predictions to see how they turned out.

Where was I correct in 2017?

- The S&P 500 rose +21.8% not close but above my prediction of +14%.
- GDP Growth looks like it will finish the year at approximately 2.7% close to my +3% call with the last 3 quarters all above +3%.
- Consumer confidence rose strongly as predicted from the 100 level to a 17 year high of 122.1
- Inflation did move above 2% as predicted ending 2017 at 2.2%
- Oil rose to just above $60.00 per barrel and traded inside my range of $45-$65 all year.

Where was I off the mark in 2017?

- Unemployment dropped to 4.1% well below my 5% prediction.
- The US dollar did not strengthen as predicted versus the Euro ending at .83 versus the 1.00 predicted. It fell nearly 10% versus a basket of major currencies.
- The 10 year T-Note ended the year at 2.47 well below my 3.5% prediction.

The good news about my incorrect predictions is that though they were off the mark, the actual levels were all stock market friendly which resulted in a more positive S&P500 number than I expected for 2017 – so we will take it!

What lies ahead for the US and World economies in 2018? The current economic expansion turns 10 years old this summer making it the 3rd longest in US history. At this point, and with my current outlook, I believe that there is now a good chance that this recovery could become the longest on record. The combination of a deep recession and an initially slow recovery plus recent very pro-growth fiscal policy initiatives from Washington have set us up for an unusually long economic expansion cycle. For the record, the longest expansion on record was 120 months (1991-2001), this expansion is now 95 months so that would mean an additional 2 plus years of growth if we were to exceed the old record. It's probably also appropriate to add one of my favorite old Wall Street proverbs, "It's never as good as you think when it's great and never as bad as you think when it's bad! I'll be keeping that in mind as we move through 2018.

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Looking at my big 3 economic indicators I continue to see strength or stability rather than recession, these are Housing, Auto Sales and the Yield Curve. The Yield Curve deserves it's own discussion page and I will probably do that during Q1 but for now suffice to say that despite a flattening of the curve, I still do not see recession warnings coming from this tried and true indicator.

Before I get into my 2018 predictions I wanted to touch on some big picture macro ideas that I have written about in the past and I see developing further as we enter 2018. The US is on the cusp of enjoying "Energy Superpower" status. The unprecedented oil and gas boom, driven by shale and technology is allowing the US to join Saudi Arabia and Russia as one of the worlds leading energy powerhouses. The US, already a military and economic superpower is now also a growing "energy" superpower. This is occurring while Saudi's role is diminishing and Russia's is stagnant. Currently the US is on pace to become the worlds largest exporter of liquefied natural gas by mid 2020's and in late 2020's the US should begin to ship more oil to foreign markets than it imports! The implications of these shift are not only important in the energy markets but also results in a positive shift in the geopolitical arena as well. The bottom line is that the old petrodollar system, in existence since the 1970's is being undermined by exponential growth in energy technology and shifting geopolitics, which will result in a meaningful Paradigm shift.

The other related
Paradigm shift underway involves Alternative Energy Sources as in EV's (Electric vehicles), solar power, wind and battery. The current growth rate of these new technologies roughly doubles every 2 years EV's currently represent about 1.5% of the car market however with a doubling of this rate every 2 years should lead to an auto market that primarily consists of EV's in approximately 12 years! The implications of this shift to EV's for gasoline demand and international oil revenue are extraordinary and in my opinion have not been truly understood by the markets. The fact that US energy production will grow robustly at the same time that alternative energy usage will explode will have profound effects on our economy, markets and World in the next 2 decades.

Some predictions for 2018:

- The S&P 500 will rise 12%. GDP Growth of 3.25% Unemployment dips below 4%.
- Interest rates will finally rise – 10-year T- note goes over 3%. 4 rate hikes by FED
- Consumer Confidence remains very strong 122 now.
- Inflation moves higher towards 3% by year-end.
- Oil prices hit $75.00 and average over $60 for the year.
- Dollar remains strong relative to most currencies, finally strengthens versus Euro 1.00
- Corporate profits hit another record high S&P 500 earnings at $155

At this time I continue to favor large-cap, dividend paying, international corporations with strong balance sheets, Japanese equities and Asian markets in general. Risk/reward continues to favor equities over fixed income. Select MLP's, REIT's and specialized bond funds continue to look good as income producers.

Sincerely,
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