Hughes Investment Advisory Service LLC

July 3, 2020

Dear Clients and Investors,

As of June 30th, stocks just posted their best 100-day period in more than 80 years. Not surprisingly, this follows the worst quarter (Q1 2020) in the stock markets history. For the quarter the S&P 500 was up over 20% and is now down about 4% for 2020.

To summarize, this economy and the markets are completely upside down and confusing to read due to the continuing covid-19 outbreak here in the US and worldwide. Daily we are blasted with contradictory news headlines that show evidence of positive and negative news on the virus and economic front. For example, the US economy added 4.8 million jobs in June yet nearly 20 million Americans remain out of work. Just in the last 6 months the virus has sickened 2.6 million Americans and killed over 128,000, brought sectors of the US economy to a virtual stand- still throwing the economy into recession, knocking the S&P 500 down 34% into a Bear market. The Fed and Washington then intervened allowing the stock market to recover before the economic data corroborated it with the S&P 500 re-entering a bull market and now within striking distance of pre-virus prices and all-time record highs. I know I'm not alone when I say that this has all been a lot to digest in 6 short months…So where does that leave us now as we enter the second half of a Presidential election year while still mired in the middle of covid-19? Talk about a lot of variables!

I spend most of my time trying to focus solely on the data and news that is pertinent, accurate, relative to the economy, markets and the companies that we own. This is a difficult task given the news flow and fast changing dynamics of todays world with covid-19 still raging. Honestly, I thought that by now, we would have had more clarity on the world's pathway towards a solution to the virus which would allow economies to re-open and life to return to normal. These new outbreaks, or 2nd waves around the country are a clear set-back. On the other hand, a vaccine may be forthcoming at any time. Clearly, despite no vaccine to date, our medical community has already developed a better way to treat covid-19 patients reducing the death rate relative to new cases.

Still, the economy is far from normal and will take a long time to absorb the millions of unemployed workers who will be holding down consumer spending (68% of the US economy), threaten corporate profits and weigh on state and local government budgets. The pandemics course and the response to it will determine what happens to the US economy over the next 6 months and beyond into 2021.

Will the recovery continue, and will it be shaped like a V, U or W? Since we can't know that answer without knowing the pandemic's future path my solution is to own strong, stable companies with the ability to prosper no matter the shape of the recovery. Overall, the unusual degree of uncertainty confronting consumers and investors will constrain economic activity for the rest of 2020 and probably prevent further upside for the stock markets overall. My outlook isn't disastrous but I'm not optimistic either. I can't help but believe that the virtuous cycle of capitalism and related benefits for the economy and markets will be disrupted for a period of time as a result of covid-19.

My base-case scenario first assumes that covid-19 is something that Americans will have to live with for an extended period. Second that the Federal Reserve will continue to support the economy and markets. And third that Congress will pass additional aid for households and businesses of approx. 1 trillion dollars. Along with these assumptions would come a gradual lifting of the lockdown restrictions along with the arrival of a vaccine or therapy by this fall with mass production of a treatment by mid -2021. The above scenario would allow for S&P500 earnings to improve by the end of 2020.

On this all-important earnings front, currently we are in irrational exuberance territory for equities with the forward price/earnings ratio for the S&P 500 at 22, near an all time peak. This is the result of the most recent market rally along with covid-19 related depressed earnings. To summarize the earnings picture, in January I was expecting 2020 S&P 500 record earnings of $180 but earnings will in fact come in much lower possibly as low as $120 and it could be 2022 before earnings are back up to pre-covid-19 levels. I would argue that markets probably will not move much higher until earnings catch back up to prior levels sometime in 2022. We're going to get through this, but how many jobs will come back, how many businesses will reopen and how long before we get back to pre-virus GDP and earnings per share will dictate future stock prices. Yes, a lot of factors effect stock prices but the underlying earnings of corporate America are what matter most.

What other factors? Well there's TINA – which stands for There Is No Alternative. TINA may not be a good reason to buy stocks but it's a reality when other asset classes like CD's, bonds, money markets and potentially real estate offer low or minimal returns. Then there is the Federal Reserve and their support for the financial markets and the strong possibility of more fiscal stimulus out of Washington.

Despite my cautious outlook for equities overall, opportunities always arise on a weekly basis due to the market's gyrations. Defense, Utilities, Consumer Staples and Financial stocks currently offer good relative value and yields. The big tech leaders such as Google, Amazon, Apple, and Microsoft on the other hand look expensive and overbought which is why I recently reduced exposure there. The companies that we own throughout the portfolios are still the best in the world at what they do.

At this time, I continue to favor large-cap, dividend paying, US based multi-national companies with strong balance sheets. We love businesses with irreplaceable brand names, high barriers to entry, wide margins, grow their dividends and have modest debt.   Risk/reward continues to favor equities over fixed income. A few select REIT's and specialized bond and income funds continue to look good as income producers. I will continue upgrading and adjusting portfolios accordingly. Please do not hesitate to give me a call to discuss the above analysis.

Sincerely,

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