Hughes Investment Advisory Service LLC

July 1, 2021

Dear Clients and Investors,

For Q2 the S&P 500 was up 8.4% and is up 14.4% YTD. The US economy has begun the second half of 2021 in generally good shape, with GDP growth in the just-ended second quarter likely having surpassed the 6.4% growth registered in Q1. Powering the economy has been the Covid-19 relief packages, continued low interest rates, rising consumer confidence, declines in jobless filings and strong economic growth particularly in housing and durable goods orders. All this as a result of continued progress with the vaccine rollout and reduction of the Covid-19 virus. This good economic news should continue into the 2nd half with a further lift from the anticipated 1.2 trillion-dollar bipartisan infrastructure agreement nearing completion.

What about the concerns I expressed earlier this year, have they passed? Hardly, and I will address these next but at least the economy is growing strongly, and key economic numbers are positive as mentioned above.

Inflation continues to rise with the PCE (personal consumption price index) recently rising at the fastest rate in 30 years! For now, the Fed suggests the inflation spike is transitory and will fade as the economic expansion moves onto a slower track and supply bottlenecks ease. I have my doubts on this and so do more members of the Fed as they are now moving slowly towards a more hawkish stance, and this has not gone unnoticed by Wall Street. Crude oil is up 56% YTD and notched a new multi-year high just last week. If oil prices run hot enough, that could raise inflation to a level that – if sustained – could cause inflation to overshoot the Fed's desired outcome and also stress the American consumer. Because of this, stocks initially backed off from their June highs but have subsequently reversed course and closed once again at news highs last week. This is always a precarious time for markets when the Fed shifts gears to a more hawkish stance. The stock market has benefited immensely from the Fed's accommodative monetary policy but if the Fed signals that interest-rate increases are coming sooner than expected the markets could stumble.

Federal Reserve miscommunications about upcoming policy changes and/or raising interest rates too aggressively is a major risk. Remember when in late 2018 over a few months the market dropped 19% as the Fed raised rates. Despite the recent new highs set by the S&P 500 the market is clearly on soft ground from an interest rate perspective.

Investors seem to have put taxes and debt on the back burner for the time being, but these two macro issues will rise to the forefront as the Biden Administration continues to roll out their plans for more deficit spending and tries to convince a reluctant split Congress to compromise and raise taxes to at least partially pay for all the increased spending plans. My guess is that the longer these issues stall in Washington the less likely it is that anything will be enacted. Despite seeming progress at last month's G-7 meeting on the idea of a 15% minimum worldwide corporate tax rate, I still have my doubts that this policy will come to pass. Gridlock in Washington can be a good thing for Wall Street. We will need to see what happens when Congress returns from summer recess and the next election season begins to heat up.

What about corporate earnings? Currently, this is a bright spot! I continue to be pleasantly surprised by the overall earnings picture. Yardeni Research currently projects 2021 S&P 500 earnings to reach $195, up 40% from 2020 which gets us to that record earnings level a full year earlier than I had been expecting just 6-9 months ago. Yardeni Research is expecting 2022 S&P earnings of $205, again another record, but only modest growth of 5% year over year. If we do achieve 2022 S&P 500 earnings of $205, despite being another record, 5% earnings growth is not anything to write home about if P/E ratios are in the high teens or 20% level – so we are potentially looking at peak earnings for this cycle in 2022 possibly giving equities a reason to stall or drop.

The next few months will be critical as economic numbers roll out providing further direction on where inflation is headed which will in turn help guide the Fed and investors response. Despite the risks, exposure to equities remains appropriate at this time.

Where do I find winning industries and companies today? Technology, Industrial, Defense, Pharma, Med Tech and Biotechnology. The US continues to expand our leadership in the medical/pharma arena, and I'm excited about the breakthroughs that will come in the next 5 years in biotechnology and genetic testing which should produce continued new breakthroughs in cancer and Alzheimer treatments amongst other currently untreatable diseases. The Utility and Consumer Staples sectors stand out as income producers in a low-rate environment. I am expecting the Utility sector to be a surprise winner from the EV and green energy revolution with required infrastructure investments needed throughout the system.

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, wide moats, high 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 and look for special situations as conditions on the ground change. Please do not hesitate to give me a call to discuss the above analysis.

Sincerely,

J. Britt Hughes
Investment Advisor Representative
Bay Colony Advisory Group, Inc.
britthughes@hias.com
www.hiasllc.com