Hughes Investment Advisory Service LLC

January 1, 2024

Dear Clients and Investors,

Happy New Year! Both the stock and bond markets performed well in Q4 and for the full year 2023. As usual however, it was not so straight forward as the final numbers would suggest. As far the numbers go: the S&P 500 was up 12% in Q4 and 24% for the full year 2023. The AGG or Total Bond Market Index was up 5.6% thanks to a good final quarter of 2023. For perspective, the S&P 500 is sitting just under it's all time high however it is also exactly where it stood 2 years ago. The AGG was on its way to a record 3rd straight down year until the huge rally in bonds in the final quarter of 2023. The equal weight S&P 500 was only up 11.7% all of which also occurred in the final quarter.

Key 2023 economic data points:

- Estimated final 2023 Real GDP growth 2.4%
- Estimated final 2023 Inflation +3.2%
- Estimated final 2023 S&P 500 Earnings $225

The above data is, after all, what matters most in calculating how the economy is doing which directly effects corporate earnings and the performance of investment classes across the board.

Looking back at last year's predictions: GDP Growth was double what I expected. I was spot on with my inflation and earnings forecast which both went against the consensus at the time. As far the S&P 500 return prediction I again went against consensus. 12 months ago, the consensus was for a recession in 2023 and along with-it lower S&P 500 earnings and consequently another down year for the markets! My prediction for S&P 500 returns was +14% which in the end proved too low thanks to the outsized returns from the Magnificent 7 Big Cap Tech Stocks thankfully many of which we count as long-term holdings. They are Apple, Google, Microsoft, Amazon, Meta, Nvidia and Tesla.

For 2024 I'm forecasting:

- GDP growth of 2.2%
- PCE Inflation of 2.8%
- S&P 500 Earnings of $245 or +9%
- S&P 500 Return of +10%
- A lower year-end Federal Funds rate of 4.75%

So where do we stand as we head into 2024? The economy has remained resilient throughout 2023 and as we enter 2024. Inflation is dropping according to the Federal Reserve's plan so far. By all appearances it looks like the desired soft landing may in fact be in the cards as employment remains strong, GDP steady, and inflation continues to cool. Can we call this scenario a done deal? Stay fully invested? Well, we all wish it was that easy but as we know the consensus is usually wrong and as is always the case, we will have surprises hitting us left and right throughout 2024. I believe that the biggest risk for 2024 continues to be the possibility of a recession as the last 2 years of interest rate hikes have their catch-up effect on the US economy. Federal Reserve Fed Funds interest rate moves lag and generally take 12-24 months to be felt by the economy. For that reason, I will remain vigilant, assume little, stay focused and continue to follow the investing tenants that we know through experience generally work in the medium to long term.

Where do I see economic and investment risks as we enter 2024? As previously mentioned, a recession remains the primary risk. As I have written about for some time the US government debt burden has expanded to an alarming level and we will need to see how this affects the economy going forward. Interest expense on the debt is now a major expense item in the annual federal budget squeezing other necessary budget categories. The wars in Ukraine and Gaza have a high financial and human cost on the US and World economies. These wars both seem "contained" currently but could potentially spiral at any moment due to the nature of war. The Presidential election is also a complete wild card from a political viewpoint with the polls once again suggesting a difficult and potentially disruptive election season which could lead to political and potentially economic paralysis ahead.

The Chinese economy, #2 by GDP, is in crisis. Having never really recovered post-covid and now in the middle of a property bubble. Youth unemployment is skyrocketing. Recent figures show Chinese bank loans at $33 trillion dollars double the 2016 figure. This debt exceeds US bank loans of $21 trillion. China's financial system seems at risk of contagion from the property market crisis and slowing economy. Chinese real estate represents 1/5th of overall economic activity. We will need to understand the Chinese economic slowdowns effects on both US companies with Chinese operations and the effects of slower Chinese GDP and what that means for the world economy.

Where am I optimistic and see opportunities in 2024 and beyond?

- Strong consumer purchasing power thanks to continued strong job creation and wage growth.
- Record Household net worth thanks to Baby Boomers. Total American household net worth stands at a record-high 151 trillion.
- Onshoring with increased factory construction, jobs and foreign FDI coming into the US.

- Strong corporate earnings and cash flows enhancing investments and shareholder returns.
- Productivity enhancement because of AI and the continued and growing dominance in the technology space by US firms. We seem to have entered a new era of technological advancement and productivity growth resulting in a new technology productivity boom mostly dominated by US corporations.
- Record US energy production and our continued increase in liquified natural gas and oil exports to our allies overseas.

For example, Apple's market Capitalization at $3.066 trillion means the company's valuation is larger than the GDPs of all but six of the world's biggest economies. The 6 are USA (26T), China (18T), Japan (4T), Germany (4T), India (3T) and the UK (3T). How about Russia, the market capitalization of the entire Russian stock market is 60 billion meaning that Apple is worth more than 50 times more than all Russian stocks combined! You can see where that math leads when you include the next 9 biggest US corporations by market cap never mind the entire US stock market.

Equity market returns last 5 years in dollars:

S&P500	+92%
Europe	+33%
Latin America	-5%
China	-38%

Here are two other examples, one financial the other political that caught my eye in articles in the Wall Street Journal this month: 1. A 1% increase in NATO defense spending is the equivalent to a 24% increase in Russia's total defense budget. 2. The SpaceX Falcon last week successfully launched the Boeing X-37B Spaceplane. SpaceX had 96 successful launches in 2023 compared to 61 in 2022. For context, the rest of the world launched more than tripling the rest of the worlds launch payload combined!

Why do I point these numbers out? Because with financial dominance like the above items suggest it seems clear that US corporations will continue to lead the world in innovation and business for as far out as one can currently see and hopefully the US can maintain ours and our ally's military technology lead over our adversaries as well. These two topics are in fact joined at the hip as I read the headlines today explaining how the US Navy is keeping the Red Sea and Suez Canal clear of modern-day Houthi pirates/terrorists to keep the worlds shipping lanes open.

Specifically, given the above observations where do I find attractive investments today? Higher rates are giving us opportunities to re-establish positions in the bond market. The Tech/Cloud buildout continues, Defense, Medical/Pharma/Bio and Energy including Nuclear and Hydrogen. These are the growth areas where the US will play an important leading role in the years ahead. The utility sector, a big disappointment in 2023 should prove to be a winner for us this year.

Overall, 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 now seems equal between equities and fixed income – the 60/40 portfolio is back! REIT's, MLP's and specialized bond/income funds look good as income producers. I believe that our portfolios are well positioned to produce consistently attractive long-term risk adjusted returns while preserving capital. Please do not hesitate to give me a call to discuss the above analysis.

Sincerely,

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