Hughes Investment Advisory Services LLC

July 6, 2017

Dear Clients and Investors,

The second quarter was another positive one for equities with the S&P 500 rising 2.7% for the last 3 months placing the index ahead by 8.2% YTD. The S&P 500 has now risen for 7 straight quarters. The markets have been remarkably stable/positive with very little volatility and no corrections for stocks since the first quarter of 2016.

The final reading for Q1 GDP growth was +1.2%. Second quarter GDP growth estimates are looking much better with the latest GDP NOW estimate currently at 3.0% The current trend for GDP growth seems to be higher at the moment. The new administrations goal is for annualized 3% plus GDP growth. Trumps plan for 3% GDP growth rests on four policy initiatives: 1. De-Regulation has been the order of the day in Washington since Trump entered the White House and is having a positive effect on business, which should continue. 2. Infrastructure spending which is progressing slowly. 3. Health Care reform is currently stalled in the Senate and represents a threat to faster growth. The Senate will hopefully remain in Washington by-passing their summer break in order to find a solution to America's health care insurance nightmare. 4. Tax Reform is the other crucial ingredient for faster GDP growth and is also currently stalled in Washington.

Without the last two policy initiatives being implemented in the near future the markets are at risk. I am expecting one very significant policy change from Washington that is not frequently discussed, it is called a "reconciliation instruction" which allows the Senate to pass tax reform with just 51 votes rather than the traditional 60 votes. Without this "reconciliation instruction" change I doubt that Health Care and Tax reform will occur. Since the two sides in Washington are more divided than I have ever seen, I believe the republican Senate will enact this measure. I think the balance of 2017 will be a tortuous back and forth negotiation in Washington with the accompanying media uproar however I do expect Health and Tax policy reform to be passed in late 2017 for implementation in 2018. These reforms are absolutely critical to the nations future and have been ignored for way too long so I hope that our representatives are able to persevere and get to a market friendly, fiscally responsible taxpayer beneficial solution! Current odds for passage of both reforms are 60/40 in favor of passage.

There is an important structural change that has been taking place in the equity markets since the beginning of the 21st century that gets no attention but I have been studying and fascinated with – a shrinking stock market! What is a shrinking stock market? The data are striking. Globally, the number of publicly listed companies has fallen from 10,853 in 1996 to 5,985 last year, a 45% decline! In the US the trend is even greater with US listed stocks falling by 50% from 7,322 to 3,671 last year. The number of IPO's (Initial Public Offerings) in the US has declined by almost 90% annually in the past 20 years. Public companies are also choosing to exit the public marketplace by choosing to go private. Private companies now have unprecedented access to capital and have a choice between being a public or private corporation. By going the private route they can bypass the burdens of dealing with the regulatory and investment pressures of the public marketplace.

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Moreover, and most importantly, the decline in the supply of stocks has coincided with a surging demand for stocks. For example, over the past 40 years, assets in mutual funds have grown from 40 billion to more than 8.7 trillion, a huge 21,710% increase. What this shrinking supply of stock means for investors has yet to be fully determined however I have some theories. From very early on in my investment career I learned that corporate stock splits and equity issuance dilutes share earnings by creating more shares per dollar of earnings. By contrast, reverse stock splits and company buybacks increase each dollar of earnings on a per share basis.

Interest rates remain at near record low levels, which decreases the attractiveness of bonds resulting in another large demand loop for equities. Record household net worth, increased pension fund demand and larger investor populations also serve to increase demand for equities. Alternative investments such as gold, commodities, Bitcoin etc. are too small to absorb all of this increased demand. The net result of the above factors may mean that the average P/E ratios from previous decades need to be increased resulting in higher overall average stock prices in the decades ahead.

In summary, I believe that, absent a geo-political crisis, we are looking at a continuation of an improving economic backdrop with growing corporate earnings as we head into the second half of 2017. The solid, synchronized global recovery appears to be gaining traction. Eurozone confidence just hit a post crisis high with the ECE Sentiment indicator jumping to 111.1 – its highest level since 2007. The ECB is now discussing ways to curb the economic stimulus measures in place since mid-2014. Our Federal Reserve has now increased rates 2 times in 2017 and is in discussions to trim their balance sheet by reversing QE measures. On the cautionary front, auto sales continue to slide with sales down 2% in the first 6 months versus 2016 and the yield curve has been flattening, usually an indicator of slowing economic growth.

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

Sincerely,

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