Hughes Investment Advisory Service

October 1, 2017

Dear Clients and Investors,

The third quarter was a slightly positive one for equities with the S&P 500 rising 4% placing the index ahead by 12.2% YTD. This was the best September since 2013. The S&P 500 has now risen for 8 straight quarters! Again, the markets have remained remarkably stable with minimal volatility and no official corrections for stocks since the first quarter of 2016. It was not a quiet news quarter no matter how you look at it: North Korean aggressions, 2 Hurricanes, Fed Reserve meetings all during a historically negative period (Sept/Oct) for stocks and yet the market was still positive. What's happening here?

Real Gross Domestic Product (GDP) for the 2nd quarter reached +3.1%, a number that many in Washington and Wall Street have been hoping for. 3rd quarter GDP estimates as of today stand at +2.1%. The market has clearly responded favorably to the election of Donald Trump last November. Aside from his pro-growth agenda, he promised to bring a more business friendly attitude to Washington. His failure to get any of his major initiatives passed through Congress has, so far, been a disappointment and one would think the markets response would be negative. What has neutralized the lack of legislative progress on his agenda is the better current performance of the economy itself, notwithstanding any boosts it might get from tax reform, decreased regulation and infrastructure spending. The key looking forward rests on whether or not GDP growth can approach and remain around the 3% level rather than the 1.5-2.0% level post the 2008-2009 financial crisis. Justifiably, this question regarding 3% GDP growth lies at the heart of pretty much everything happening in Washington and on Wall Street today.

So where do we stand on the new administrations plans for achieving this consistent GDP growth of 3%? On the negative side we have Health Care reform. It is stalled and looks unlikely to pass. Although I truly believe that Health Care reform is necessary, we have not seen an actual solution to the Health Care dilemma from either party over the last several years. It has been easy to say that a problem exists, more difficult is to propose an actual solution to this very complicated issue. I can sum up my view on the Health Care dilemma: The US has the best Health Care system in the world, witness the worlds best discovery and delivery science thanks to our leading edge educational and technology leadership. The problem is that our science and technology leadership has enabled us the ability to heal and help people in so many ways leaving the ultimate question of "how will we pay for it"? I have not seen an answer to this basic question. Ironically, the cost of Healthcare is so high due to the achievements of some of the companies that we own!

In the neutral camp is Infrastructure Spending, which always sounds good during the election campaign period but always seems to stall when the rubber hits the road in Washington. My belief is that mother-nature just handed Washington an Infrastructure Spending boom free ticket with the re-building required after the recent hurricanes. The hurricanes are likely to reduce 3rd quarter GDP growth by at least one half of one percent , but demand driven by rebuilding should be reflected positively in the fourth quarter and first half of 2018. A massive spending boom should result out of necessity in Texas, Florida and the US Caribbean Islands.

On the positive side we have De-Regulation and Tax Reform. De-regulation is well under way and providing a major tail wind to the current spurt in economic growth. Tax Reform will be the main driver of economic growth and higher stock prices as we move forward into the last quarter of 2017 and into 2018. Can Congress pass Tax Reform? I believe that they can and this question will be the primary focus in the months ahead since so much depends upon the outcome and there are many bi-partisan aspects to tax reform that both sides can support. The administrations tax reform plan was finally announced this week and the policy debates will now ensue.

Equities bottomed in March 2009 and the economy began to strengthen in June of that year, so we have been in a favorable period for investing for more than eight years. Cycles do not usually last this long. We all know that it can't go on forever, but I do believe that we can continue on a positive course for both the economy and the markets for several more years since I currently see very few warning signs of a recession. What would really concern me would be an inverted yield-curve and excessive optimism on the part of retail investors. Another important warning signal is the Leading Economic Indicator Index, which has been climbing steadily since 2016 – currently 128.8. Corporate earnings are still rising and there has never been a recession while this is happening. Strong business activity exists not only in the USA, but throughout the world: Europe is growing at 2% this year and so will Japan. The growth rates for China and India are at 7%. The US and our international companies will benefit from continued strength in these major economies.

The Federal Reserve: although the hurricanes have put the Fed on hold in terms of increasing interest rates, we will likely see some hikes next year. The combination of a better economy, a rising stock market, and a tighter Fed should mean a stronger dollar, but that is not how the currency has performed so far this year.. There are, however, some benefits from the dollars decline. The ECB is less likely to taper, American exports benefit and foreign earnings of American companies are worth more. I expect the dollar to strengthen against the Euro over the near term.

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,

J. Britt Hughes
Registered Investment Advisor
Britthughes2@icloud.com www.hiasllc.com