Hughes Investment Advisory Service LLC

October 1, 2020

Dear Clients and Investors,

For the 3rd quarter the S&P 500 was up over 8% and is now up about 4.1% YTD. The DOW Industrials are down 2.7% YTD

The Federal reserve has recently lowered hopes for a V-Shaped economic recovery. In a statement issued following the September FOMC meeting, the Fed stated that the ongoing Covid-19 crisis is weighing on the prospects for economic growth, jobs and inflation. Importantly, the Fed also stated that it remains committed to using its full range of tools to support the economy during these challenging times.

Additionally, as I write this, Congress and Treasury Secretary Mnuchin are hopefully on the verge of announcing a new stimulus proposal which could total approximately $2.2 trillion.

So, what we will have as we enter the last quarter of 2020 is continued monetary and fiscal stimulus. Why the economy continues to need this massive stimulus is obvious, Covid-19 and its impact on the US and world economies. The central bank's stance reflects the tenuous nature of the business upturn with recent economic data painting a rather mixed picture of the overall recovery. For example, surveys on existing home sales, retail spending, industrial production, and the leading indicators all suggest that the recovery is intact, but that the gains are moderating. It should also be noted that the activity levels continue to be well below the levels in place before the Covid-19 related lockdowns.

Despite the continued headwinds we are tentatively still headed in the right direction, though it will probably take another year or two to get fully back on track. This timetable explains well why the Fed took the multi-year commitment to keeping interest rates at historically low levels. As outlined 3 months ago, my base-case scenario assumes that Covid-19 is something that Americans will need to live with for an extended period of time = still true. Second, that the Federal Reserve will continue to support the economy and markets = still true as evidenced by last week's FOMC meeting and announcements. Third, that Congress will pass additional aid for households and businesses of approx. 1 trillion dollars = now likely boosted to 2 trillion. Four, that a vaccine will achieve FDA approval sometime before year-end 2020. Along with these assumptions we continue to have a gradual lifting of the lockdown restrictions on a State by State basis.

Meanwhile, Wall Street sentiment is not uniform. Recent concerns center on the drawn-out process of the business recovery. The slower the recovery the longer it will take for corporate earnings to recover to pre-crisis levels. And with P/E multiples already reflecting a richly valued equity market, especially for high-profile tech names, this choppy economic recovery will keep pressure on stocks as we settle into the 4th quarter. Additionally, there is the uncertain political outlook, with the outcome of the November election still very much in doubt. The next 30 days should see elevated market volatility.

So, with everything that is happening both here in the US and overseas what else am I paying attention to in addition to what's mentioned above? Some long-term trends have been accelerated by Covid-19. We have reached the point of no return on the technology cold war. What was a top risk is now a reality. There are two technology superpowers in the world, China and the US. The pandemic is showing more clearly than ever that the technology space is increasingly critical for a larger and larger part of the world economy. We're not just talking smartphones-5G but anything with a chip in it: Smart homes, smart cars, smart cities, clean energy and the entire cloud data ecosystem of human-kind. The US versus China competition is on steroids because of the pandemic. On pretty much every front, the relations between the two largest economies are getting worse and the Phase 1 trade deal is now essentially on hold and a Phase 2 looks unlikely.

The potential downside of a deterioration of the China/US technology cold war plus a second or third wave of the virus would be a lengthy global recession or depression. A depression of global scope would be more dramatic and bigger than the recession in 2008. Would this mean something like the Great Depression 1929-1941? No because the US and World are a lot wealthier now versus 1929. This potential crisis would be transformative, with a technological displacement that would be great and permanent for wide sectors of the population. Being an optimist, and because of the dynamism of the US economy and most companies there will continue to be winners and losers with the least innovative being hit the hardest.

On the plus side the new US/Mexico/Canada trade deal is proceeding. Breakthrough Middle East peace deals are being completed between Israel, Bahrain and the Emirates and hopefully soon many more Arab countries and Israel. The US is still the most powerful country in the world. We're an exporter of energy and food. We've got the world's reserve currency. We have the biggest, strongest and most powerful banks. Our tech companies are by far the strongest and becoming vastly more important. It could be argued that because of the pandemic, the US is becoming asymmetrically more powerful compared with our allies than before.

So, what do we do from an investment standpoint? Continue to differentiate between the winners and losers in the pandemic and post-pandemic economy. Where do I find winning industries and companies today? Defense, technology, financial technology, medical technology and pharma. The utility and consumer staples sectors stand out as income producers in a zero-rate environment.

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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