HUDSON ADVISOR SERVICES, INC

Market Commentary

Volume 85 October 2020

We have seen increased volatility in the markets leading up to the Presidential election as the medical and scientific world is on the hunt for improved testing, treatment, and a cure for the novel coronavirus. There is a lot of uncertainty and emotions with less than one week to go, but no matter the outcome we will be keeping an even keel to weather any volatility. Some are concerned about a Biden win and a "blue wave," some worry about a Trump re-election, and others fear a contested election will send the economy back into recession. While such concerns are valid, there is not enough focus on the business cycle.

We are maintaining our long-term perspective while keeping in mind that politics will drive behavioral investing over this short cycle. History suggests investors should not be overly concerned about material asset return differences under different political administrations. A portfolio of 60% equities and 40% fixed income has produced an annual compound return of 8.2% in the 94 years since 1860 with a Republican president and an 8.4% annual compound return in the 65 years with a Democratic president (based on data from Global Financial Data through December 31, 2018. The 60/40 portfolio is 60% GFD US-100 Index and 40% GFD US Bond Index). A return discrepancy exists between presidential election and non-election years, but it is not statistically significant. Geopolitical selloffs are typically short-lived. While equity markets often react negatively to initial news, returns over the following 12 months are more in line with historical averages.

It is important to remember the 2020 recession was caused by a self-induced shutdown and not structural or cyclical imbalances. As such, and with the help of massive global fiscal and monetary stimulus, the economy was able to restart quickly. The U.S. has replaced 11.4 million of the 22 million jobs lost to the pandemic, and a number of other economic indicators have clawed back to pre-pandemic levels. Initial jobless claims continue to march lower, which is one key indicator that the economic recovery is on track.

The daily Covid-19 infection rate has held steady and relatively high for months, but the lower incidence of deaths may help explain the relatively muted market response to rising infections. We also believe the U.S. health system has seen significant improvement in its ability to handle and treat cases, which lowers the possibility of further of lockdowns. Many see additional fiscal stimulus as an unpredictable influence in the recovery. Should Congress and the White House remain at a stalemate over more stimulus, many temporary job losses could turn permanent, which would turn event-driven losses into cyclical ones. We see this as a risk, but only in terms of prolonging the recovery, not reversing it.

A month ago, we saw Fed Chair Jerome Powell announce a new approach, with changes in policy. Powell stressed the Fed's objective for maximum employment and concluded that inflation could temporarily run over its 2% target if more Americans join the workforce. Despite the cross currents, the prospect of further advance is strong in the short run, but investors have few attractive alternatives. Holding cash has no financial reward and bond prices are at risk if the Fed increases rates too soon. However, the Fed is indicating that rates will be lower for longer. Lower for longer is not just at the Fed level but a globally coordinated effort with other central banks.

Not all stocks will do well in the period ahead. Some companies will not perform to support their run-up of value in the last six months. The gulf between winners and losers may widen. Our job is to pick the winners and we believe our current sector preferences both protect our clients and give them the likelihood of respectable to attractive portfolio returns.

MARKET TRENDS

The accompanying chart summarizes stock and bond market prices for the first 9 months of the year. So far, 2020 is truly a historical year. The Dow Jones and S&P 500 recorded their best second quarter performance in over two decades. Both those indexes had their worst first half performances since the 2008 fiscal crisis but that was quickly muted with Fed intervention.

Equity Market: The market was strong in the first six weeks of the year, continuing the bullish trend seen in most of 2019. Then the coronavirus panic hit as business around the world came to a standstill. The overall market lost nearly 40% of its value in a five-week period. The low point for the S&P 500 was on March 23. Then investors regained confidence as the Federal Reserve and Congress responded with massive packages of monetary and fiscal stimulus. The market (S&P 500 TR) leaped back in April and May, leveled off in June, jumped in July and August, and finished September up 8.93% for the quarter and up 5.57% for the year.

The Dow Jones Industrial Average gained 11.45% in the third quarter, but had trouble turning positive for the year-to-date, down 0.35%. The Nasdaq Composite index was ahead 11.24% in the third quarter and 25.33% for the year. Its performance was driven by the continued strength of the large technology companies. The Russell 2000 index was up 4.93% in the third quarter and negative 8.69% for the September 30 year-to-date.

Fixed Income: The hunt for yield is on! Our caution on bond investing is now intensified. As indicated, the price of the federal stimulus of the economy is inflation in future years. At some point the Federal Reserve will switch monetary policy to fight inflation. This situation makes long-term bonds very risky.

MAJOR MARKET INDEXES

	YTD Return
Dow Jones Industrials Composite TR	-0.35
S&P 500 Index TR	5.57
Russell 2000 Index TR	-8.69
NASDAQ Composite TR	25.33
EAFE Index NR	-7.09
Barclays Aggregate Bond Treasury TR	8.90

Source: Morningstar® as of September 30, 2020

We encourage clients to consider closed-end municipal funds that are trading at a discount to their net asset value for enhanced yield and only invest in direct issue bonds with maturities of less than five years. Our municipal tax lien strategy offers a competitive yield as a fixed income alternative.

THE OUTLOOK

The Economy: The Fed has always had a dual mandate, trying to achieve "maximum employment", and "price stability" which, up until now, meant a target inflation rate of 2%.

As the Fed changes its approach, inflation will be allowed to run but hopefully in a good way. The central bank is moving to a mandate that will seek inflation that averages 2% over time. This is in response to inflation that has been below 2%. Currently, we are averaging about 1.4% since 2012 and the new policy will allow price pressures to run up after periods of weakness.

Some inflation is good for the economy. More raises, more consumption (which is the main input to the GDP calculation), and more profits are all outcomes of elevated inflation. Low inflation will put downward pressure on rates and if we are too low, the Fed has less policy levers to pull to ward off an economic downturn.

Policy makers will step in to lend support to the economy if unemployment is too high, but they will not hike rates just because unemployment is too low. We cannot rely on the economic theory that higher employment generates higher inflation (in the period leading up to the crisis, unemployment was at a 50 year low at 3.5% and inflation remained well below target).

If inflation is under control, the Fed will be less inclined to hike rates when the unemployment rate falls, which has the added benefit of helping to close inequality gaps.

The new approach of the Fed is uplifting and their reaffirmed commitment to 2% inflation has long been expected. This confirms that low Fed policy rates are here to stay. Even with the new policy, it is unlikely that inflation moves above 2% anytime soon. This should be praised by long-term investors. Monetary policy is about incentivizing people to borrow money (especially for big ticket items). At the same time, yield on cash is likely to remain near zero so there is an opportunity cost of holding on to too much cash. Monetary policy is one of the most important economic factors for investors to consider.

The Market: There always will be reasons to feel anxious about the outlook for markets but we continue to stress the value of looking at the longer-term picture. The U.S. is in recovery mode which historically looks good for risk asset returns. As mentioned before, the Fed will remain accommodative for the foreseeable future and we cannot underestimate the power of their policy changes to support financial markets. U.S. equities will emerge stronger than other equity markets around the world. The power of the large U.S. technology companies will be significant. The contrarian bearish view is that stocks will follow the pattern of the Great Depression: initial crash, partial rebound, and prolonged slump as the challenges of economic recovery are recognized.

STRATEGIES

Preferred Equities: As always, despite market conditions, we look for long-term equity opportunities. Our focus is on companies that can weather both the short-term period and flourish in a longer time frame. We want fundamentally sound companies with reasonable valuations and that pay dividends. In that context, we are looking at these sectors:

TECHNOLOGY/ TELECOMMUNICATIONS: Most technology companies have next generation products in development. Both consumers and corporations seem to recognize the need to keep their computer equipment and communications systems up to date. Select semiconductor companies offer promise as the 5g play gets expanded.

CONSUMERS: The consumer staple companies are a base in this situation. The discretionary companies have promise as more people go back to work. The trends look sustainable thanks to low interest rates, lower energy costs, and soft inflation giving the consumer some free cash flow.

INDUSTRIALS: Assuming the passage of an infrastructure bill next year – 2021 should create opportunity for certain industrial companies – such as those that enhance productivity and power management. The continued low relative price of energy is good for transportation industries.

HEALTHCARE: We are interested in companies with products and services for the demands of an aging population. – including certain pharmaceuticals.

OTHER ASSETS: Our aversion to long-term bonds remains. We like maturities under five years and cash and alternative investments such as municipal tax liens.

Dow Jones U.S. Sectors Total Return
(Percent Change for YTD, Ending September 30, 2020)
Source: Morningstar®

Oil & Gas	**-47.96**	**Consumer Services**	**16.51**
Basic Materials	**2.35**	**Telecommunications**	**-8.94**
Industrials	**0.99**	**Utilities**	**-7.50**
Consumer Goods	**14.15**	**Financials**	**-15.78**
Health Care	**6.84**	**Technology**	**30.15**

William Hudson, Jr., William Hudson, III CFP ®, Jeremy Hudson, & Evan Coppola
4445 North Hwy A-1-A, Suite 233 • Vero Beach, Florida 32963 • (772) 231-8101
237 Main Street, Suite 600 • Buffalo, New York 14203 • (716) 803-6587
David Burrows
29 Hillside Drive • Greenwich, CT 06830 • (203) 302-3530
www.hudsonadvisors.com • (877) 504-1964

Top 25 Performing Stocks 2020 (3rd QTR) - US Listed companies with a market cap above $5 Billion. Source: Telemet ®					
Issue	**Name**	**Last**	**Mkt Cap**	**Net Pct YTD (%)**	**Industry Group**
FPCG	First Physicians Cap Grp Inc	1,000.00	10,582	3,372.22	Diversified Consumer Services
NVAX	Novavax Inc	111.91	6,486	2,711.68	Biotechnology
ZM	Zoom Video Communications, Inc	472.03	140,269	593.75	IT Services
VSLR	Vivint Solar, Inc.	42.25	5,299	481.96	Commercial Services & Supplies
LVGO	Livongo Health, Inc.	142.53	13,941	468.74	Health Care Providers & Services
RUN	Sunrun Inc.	76.98	9,262	457.39	Electrical equipment
NIO	NIO Inc. ADR	21.31	22,110	430.12	Automobiles
TSLA	Tesla, Inc.	428	398,814	411.56	Automobiles
FSLY	Fastly Inc	93.75	9,360	367.12	Software
BVXV	BiondVax Pharmaceuticals Ltd.	38.91	16,868	318.84	Pharmaceuticals
GSX	GSX Techedu Inc.	90.26	22,725	312.9	Diversified Consumer Services
IMMU	Immunomedics Inc.	85.06	19,660	301.96	Biotechnology
SE	Sea Ltd ADR	156.31	72,246	288.64	Software
MRNA	Moderna Inc.	72.98	27,093	273.12	Biotechnology
IRTC	Irhythm Technologies, Inc	238.15	6,439	249.75	Health Care Equipment & Supplies
PTON	Peloton Interactive, Inc	99.17	23,745	249.2	Electrical equipment
W	Wayfair Inc Class A	295.5	28,188	226.98	Internet & Direct Marketing Retail
DTSRF	Digital Shelf Space Corp	0.45	23,806	221.87	
ENPH	Enphase Energy, Inc.	83.88	10,569	221.01	Semiconductors and Semiconductor Equipment
ZS	Zscaler, Inc.	141.21	18,768	203.68	IT Services
QDEL	Quidel Corporation	219.13	9,193	192.06	Health Care Equipment & Supplies
DOCU	DOCUSIGN INC	216.27	39,687	191.82	Software
DDOG	Datadog, Inc	106.23	35,144	181.17	Software
PENN	Penn National Gaming Inc.	71.44	9,832	179.5	Hotels Restaurant & Leisure
ETSY	Etsy, Inc.	122.79	14,652	177.17	Internet & Direct Marketing Retail

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OXY	Occidental Petroleum Corp	10.14	9,432	-75.39	Oil Gas & Consumable Fuels
ICAGY	International Consol. Airlines	4.15	9,097	-74.92	
CUK	Carnival PLC	13.07	7,851	-72.86	Hotels Restaurant & Leisure
CCL	Carnival Corporation	15.34	9,214	-69.82	Hotels Restaurant & Leisure
AZUL	Azul SA	13.13	16,525	-69.32	Airlines
OKE	ONEOK Inc.	26.76	11,885	-64.64	Oil Gas & Consumable Fuels
SU	Suncor Energy	12.32	18,790	-62.44	Oil Gas & Consumable Fuels
BBD	Banco Bradesco SA	3.42	32,569	-61.79	Banks
PSXP	Phillips 66 Partners LP	23.58	5,710	-61.75	Oil Gas & Consumable Fuels
SCGLY	Societe Generale	2.69	7,129	-61.49	Banks
LYG	Lloyds Banking Group plc	1.3	91,564	-60.73	Banks
SLB	Schlumberger Ltd.	15.92	22,097	-60.4	Energy Equipment & Services
BSBR	Banco Santander Brasil SA	4.87	36,334	-59.85	Banks
UAL	United Airlines Holdings, Inc.	35.48	10,324	-59.72	Airlines
RDS/B	Royal Dutch Shell Cl B	24.38	189,876	-59.35	Oil Gas & Consumable Fuels
RDSXB	Royal Dutch Shell Cl B	24.38	189,876	-59.35	Oil Gas & Consumable Fuels
NTTYY	Nippon Telegraph & Telephone	20.64	85,117	-59.13	Diversified Telecommunication Services
BDORY	Banco Do Brasil SA Spns ADR	5.31	14,791	-59.03	
MOMO	Momo Inc. ADS	13.82	6,251	-58.76	Software
RDS/A	Royal Dutch Shell CL A	25.35	98,736	-57.02	Oil Gas & Consumable Fuels
RDSXA	Royal Dutch Shell CL A	25.35	98,736	-57.02	Oil Gas & Consumable Fuels
ITUB	Itau Unibanco Banco Hldg S.A.	3.97	38,877	-56.67	Banks
EOG	EOG Resources Inc	36.29	21,130	-56.67	Oil Gas & Consumable Fuels
SPG	Simon Property Group Inc.	64.71	19,794	-56.56	Equity Real Estate Investment Trusts (REITs)
ET	Energy Transfer LP	5.62	15,129	-56.24	Oil Gas & Consumable Fuels