HUDSON ADVISOR SERVICES, INC

OUR VIEW OF THE MARKETS

By William N. Hudson, Jr. & David D. Burrows **Volume 51** **April 2012**

So, okay, we just came off the best first quarter for the stock market since 1998. Pretty impressive. Nonetheless investors remain quite apprehensive. The big question is: How will 2012 be different than 2011 – and how might it be the same? The concern is understandable. Last year started off with a good first quarter and then went deeply negative for the rest of the year.

At Hudson Advisors, we are optimistic this year will not be a repeat of 2011. Last year the market was traumatized by macro events: the crisis of sovereign debt in Europe, the specter of renewed recession, and the natural calamities in Japan. By contrast, we are in a relatively "placid sea" right now. The Europeans have stabilized some of the economic problems. The U.S. economy is growing, albeit slowly, but still growing. We do not foresee major bad news events in 2012. Thus, the stock market should not go off the cliff again this year.

That said, we do acknowledge what the commentators like to call "headwinds" in our relatively placid sea. Europe is looking at a recession, the Asian economies are slowing, high oil prices are troubling, and the Federal Reserve is taking a pause from its quantitative easing. The market has reacted negatively to some of these issues in early April. On balance, therefore, we see some retreat from the strong gains of the first quarter. But we expect the market to remain more positive than negative for the year overall.

Our long-time clients know that we do not fluctuate wildly in our investment strategies. We like large cap stocks with good dividend policies. We look for long-term growth opportunities and we pay attention in the short-run to preservation of capital and cash flow. We do not go bargain hunting. In a year like 2011, this strategy can be frustrating when the overall market declines so steeply. But we counsel our clients to be patient. Given the broad outlook for 2012, we think our strategies and the counsel that goes with them will have rewards.

MARKET TRENDS

The accompanying chart summarizes stock and bond market results for the first quarter of 2012. Equities rose pretty steadily to register strong gains and market volatility was subdued compared to the last half of 2011. Meanwhile, the fixed income markets finally were hit with a dose of reality and prices declined as investors sought opportunity in other asset classes.

Equity Markets: Absent the fixation on big picture worries, investors were able to concentrate on fundamentals. The result was a stock market that rose steadily in the first quarter. There was a noticeable lack of volatility. The S&P 500 index did not have a single trading day where it moved more than 2% -- a sharp contrast to 2011. The S&P ended the quarter with a 12.6% gain. The Dow Jones Industrial had its best first quarter performance in 15 years – closing with an 8.8% gain. The Nasdaq Composite was ahead 18.7% for the quarter – a highly positive sign for the technology sector. The Russell 2000 index of small company stocks grew 12.4% for the quarter.

The early part of April has seen a modest retreat from this advance. Both the Dow and the S&P 500 declined slightly in the first week of the new quarter. The market seemed to want time for reappraisal when the Federal Reserve said it would take a pause from quantitative easing and when Spain was back in the news with debt problems.

Fixed Income Market: At Hudson Advisors, we have been persistently confounded by the strength of the bond markets in recent years. Thus, we were somewhat gratified when other investors embraced our skepticism in the first quarter. The yield on the 10-year Treasury note, which moves inversely to prices, was 1.88% at the start of the quarter and 2.22% at the end. The fascination with high-quality, low-yielding government -- the perceived safe haven of recent years -- seems to have ended for now. Investors did show appetite for higher yield by taking on a large volume of lower quality corporate debt.

MAJOR MARKET INDEXES

	YTD Total Return
Dow Jones Industrials Average	8.84
S&P 500	12.59
*Russell 2000	12.44
*NASDAQ Composite	18.67
*Barclays Capital Aggregate	0.30
*MSCI EAFE Index	9.98

*Total return *excludes* reinvested dividends.

THE OUTLOOK

The Economy: Our view of the economy remains as expressed in the last quarterly commentary. The projected growth of 2% in the U.S. economy is certainly not exciting. We would be much happier to see something in the 3% to 4% range. But we see the current trend is sustainable and

real. This is not the 1990's with growth led by a technology bubble – or the mid 2000's with growth fed by the housing bubble. We think the slow growth now can be sustained and gradually improved.

Job creation in recent months has been steady – even though the March numbers were somewhat disappointing. Unemployment is creeping down slowly. Consumer confidence has improved and retail sales have risen. The housing market appears to have reached bottom – even though recovery will take a long time to achieve. The Federal Reserve seems to be sending some mixed signals about the future direction of monetary policy. But, looked at positively, the Fed no longer seems concerned about the need to prevent renewed recession.

National elections always create a sense of economic uncertainty. But here we also choose to be optimists. We do not see anything in the Presidential election process that will derail the slow economic gains. Following the November election, regardless of the outcome, we see some hope for easing the political gridlock that has gripped Washington. We like to believe the President and Congress in 2013 could start to make progress on long-term fiscal policy.

The Market: We are grateful for the strong first quarter. We expect the rest of the year to be less exciting. The reasons are twofold. First, we do face the economic headwinds of high oil prices and weakened export demand from Europe and Asia. Second, these economic headwinds dampen the outlook for corporate profits. Earnings have been healthy in the last year. In January, analysts predicted that overall U.S. earnings would grow by over 3% in 2012. That forecast is now revised for a basically flat earnings tend.

Given this outlook, we do not expect the equity market to make significant further advances this year. It will not retreat from the 1Q gains – but neither will it add much to the current price levels. We expect the Dow and S&P 500 in remain pretty much in their current trading range. There may be somewhat more upside potential for technology stocks.

OUR STRATEGIES

Asset Allocation: For clients investing new money, we continue to recommend 60% allocation to equities and the remaining portion to cash, bonds with maturities under two years, and alternative investments.

Equities: We remain focused on large cap companies with strong balance sheets, sustainable cash flows, and credible business models. Companies that pay attractive dividends are central to our strategy. We use covered call writing to improve upon dividend payments.

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

CONSUMER STAPLES: Companies that provide the necessities of life are good dividend payers in the current market.

ENERGY/UTILITIES: Gas and electric companies are a conservative stock pick that also pay good and regular dividends. The U.S. dependence on fossil fuels will remain for some years ahead.

TECHNOLOGY: The performance of the Nasdaq index tells the story. Businesses need to maintain and upgrade their technology platforms. Consumers are fascinated with newly innovative products. Technology companies will do well.

FINANCIALS: Certain regional and super regional banks have good value as the result of low risk profile and conservative balance sheets. The prospect of slowly rising interest rates will help these institutions.

Fixed Income: We are gratified to see other investors embrace our consistent aversion to long-term bonds. The interest rate and inflation risk to bond prices is simply too great. We prefer to keep the non-equity portion of client portfolios in cash, short term bonds, and some alternative investments.

Dow Jones U.S. Sectors (Percent Change for YTD, Ending March 31, 2012)			
Oil & Gas	**4.75**	**Consumer Services**	**14.00**
Basic Materials	**9.97**	**Telecommunications**	**3.54**
Industrials	**12.84**	**Utilities**	**-0.17**
Consumer Goods	**8.89**	**Financials**	**19.82**
Health Care	**9.94**	**Technology**	**22.13**

William Hudson, Jr. & Jeremy Hudson
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) 852-7628
William Hudson, III CFP ®
Potomac, MD • (301) 840-2071 • bhudson3@hudsonadvisors.com
David Burrows & Elizabeth Kisken CFA ®
29 Hillside Drive • Greenwich, CT 06830 • (203) 302-3530
www.hudsonadvisors.com • **(888) 275-1621**