HUDSON ADVISOR SERVICES, INC

OUR VIEW OF THE MARKET

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The election dueling between Clinton and Trump is all over the place. But both seem happy to bash Wall Street for the economy's problems. The effect is to undermine further the already eroded public confidence in our major financial institutions. Some people joke about renaming that famous actual street in lower Manhattan to Main Street.

Confidence! The issue now is confidence. It seems beleaguered everywhere we look: our financial institutions, our political election process, the situation in Europe with instability in the banking system and the fallout from the Brexit vote. Plus, we have the turmoil in the Middle East and the emerging dominance of China in Asia. All these confidence issues are intertwined in ways that make us cautious and concerned about the markets.

We believe the U.S. remains the best and safest place to invest. Nonetheless, our outlook for the stock market in 2016 was always restrained. We did not believe that economic and earnings performance would be strong enough to push stock prices much higher during the year. We actually are pleased with the third quarter performance. Investors seemed intrigued with the potential for technology stocks and there was a positive ripple effect across the broader markets indexes.

But that bit of gusto for technology is not enough to offset all the other forces that are holding back the market. We have the huge uncertainty of the U.S. Presidential election. We have the new uncertainties about the stability of the banking system in Europe. We also have the ongoing uncertainties about corporate earnings performance and Federal Reserve policy. All of these uncertainties put the market into a huge "holding pattern."

Looking to the fourth quarter, do not see much upside opportunity. We will be happy to maintain the year-to-date gains already achieved. Our posture with client portfolios is defensive and we are avoiding major new commitments. .We will wait until 2017 to see if more clarity can emerge with regards to future market performance.

MARKET TRENDS

The accompanying chart summarizes stock and bond market prices in the first three quarters of the year. Lead by technology, the stock market had a reasonably good quarter that contributed to the year-to-date gains. Meanwhile, U.S. Government bond prices took a slight retreat from their advances in the first half.

Equity Market: The star of the quarter was the Nasdaq Composite Index which posted a 9.7% gain in the period and was ahead 7.5% for the year. Investors seemed impressed with product innovations in technology. The impact was felt in the broader market indexes. The S&P was up 3.3% for the quarter and 6.1 % for the year. The Dow Jones Industrial Average increased 2.1% for the quarter and 5.1% for the year. The Russell 2000 index of small cap stocks was also a good performer. It moved ahead 9.9% ahead for the quarter and was up 10.2% for the year.

Fixed Income Market: Given all the global uncertainties, investors had literally scoffed up U.S. Treasury bonds in the first half of the year. The yield on the 10-year Treasury was 1.47% at the end of June -- down from 2.27% at the end of 2015. (Yields move inversely to prices.) This phenomenon showed slight reversal in the third quarter. The yield was 1.60% on September 30. It had reached an historic low of 1.36% in July. The consensus view is that yield numbers on the 10-year Treasury will trade between 1.5% and 1.75% in the fourth quarter. The range is still low by historic standards. Many investors seem to prefer the perceived safety of U.S. Government bonds and ignore the huge risk that long-term bond prices can fall significantly if interest rates were to take an unexpected rise.

MAJOR MARKET INDEXES

	3Q 2016 Return	YTD Return
Dow Jones Industrials Composite PR	1.93	7.47
S&P 500 Index PR	3.31	6.08
Russell 2000 Index PR	8.66	10.19
NASDAQ Composite PR	9.69	6.08
EAFE Index NR	6.43	1.73
Barclays Aggregate Bond Index TR	-0.28	5.07

THE OUTLOOK

The Economy: U.S economic performance in the first half of 2016 – expressed candidly – was a bit of a dud. The economy grew at an annual rate of only 1.1% – even weaker than the anemic post-recession average of about 2%. Yes, the official unemployment rate is now under 5% --but that number masks the problem of the "hidden" unemployed. Both consumer and business spending on the domestic side are sluggish and international demand is stymied by all the problems in Europe and Asia. Most economists expect an uptick in the second half of the year.

Nonetheless, the last forecast from the Federal Reserve is for GDP growth of 1.8% for full-year 2016.

As explained in our last two quarterly commentaries, a major cause-and-effect drag on the economy is laggard corporate earnings. The companies in the S&P 500 have been negative for the last five quarters. It is the first time since the 2008-2009 period that we have seen five consecutive quarters of earnings decline. The trend is expected to continue as third quarter earnings are reported – with an expected year-over-year drop of 2.1%. The hopes for a rebound in earnings seem muted.

The Market: Here are reasons we expect the market to be in "watch and wait" for the rest of the year.

- Stocks are highly priced right now. The S&P 500's price/earnings ratio has a forward 12 month forecast of 19.9 – compared to the 10-year average of 15.7. It will take better earnings to improve this P/E ratio.
- The current U.S. Presidential election is one of the most bizarre in our history. Investors are nervous. A Clinton victory will calm some of those jitters in the short-term, but the long-term impact is cloudy.
- The Federal Reserve will likely impose a small interest rate hike in December. The market will absorb that event – but may gyrate a bit at first.
- The problems with Deutsche Bank create anxiety about the stability of the European banking system that comes on top of the unknown economic impact of the Brexit vote.

So, all that said, we have limited expectations for the stock market in the fourth quarter and will be happy to see it hold on to the current year-to-date gains.

OUR STRATEGIES

Asset Allocation: For clients investing new money, same as last quarter, we recommend 55% allocation to equities and the remaining portion to cash, bonds with maturities under two years, and alternative investments. We stagger the time period in which we reach that 55% level. For fully invested clients, we recommend to trim equities to 55-65% depending upon time horizon and objectives.

Preferred 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. Some of the sectors we are like are similar to those indicated last quarter:

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- HEALTH CARE: We are attracted to some pharmaceutical companies because of new products coming to market and because of the needs of an aging population.
- ENERGY: We like the big stable names which show potential as oil prices will begin gradually to move higher.
- TECHNOLOGY: There is still good value in this sector despite the recent buying trend – and the opportunity for growth in stock prices is good.
- CONSUMER DISCRETIONARY: We expect consumer spending to improve and there is opportunity here with the affluent and wealthy segments.

Fixed Income: Our repeated aversion to bonds with long maturities remains firm. We still believe the risk of a sharp decline in prices is too great a risk for our clients. We prefer to find vehicles such as municipal tax liens and other alternative investments. .

Dow Jones U.S. Sectors (Percent Change for YTD, Ending September 30, 2016)			
Oil & Gas	17.85	Consumer Services	2.76
Basic Materials	13.59	Telecommunications	17.95
Industrials	12.86	Utilities	16.49
Consumer Goods	7.28	Financials	3.50
Health Care	1.36	Technology	12.69

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Top 25 Stock Returns for US listed Stocks with a market cap greather than $1 Billlion			
RIC	**Company Name**	**Market Capitalization (USD, Millions)**	**Total Return, YTD (Compounded) (%) As Of: 9/30/16**
GMCI.PK	GMCI Corp	1,794,797,841.54	517.2%
CDE.N	Coeur Mining Inc	1,790,882,166.71	377.0%
NERO.PK	Neuromama Ltd	35,443,124,943.75	332.7%
CLF.N	Cliffs Natural Resources Inc	1,305,959,403.32	270.3%
FMSA.N	Fairmount Santrol Holdings Inc	1,864,366,788.72	260.9%
ACIA.OQ	Acacia Communications Inc	3,312,230,102.50	233.7%
HL.N	Hecla Mining Co	2,084,168,533.00	202.1%
QUAD.N	Quad/Graphics Inc	1,300,461,915.89	201.7%
CC.N	Chemours Co	2,815,765,059.36	201.6%
CWEI.N	Clayton Williams Energy Inc	1,063,495,751.04	188.9%
RMR.OQ	RMR Group Inc	1,185,416,725.00	168.5%
NAV.N	Navistar International Corp	1,900,039,360.08	158.9%
WB.OQ	Weibo Corp	11,880,716,605.90	157.1%
TROX.N	Tronox Ltd	1,075,901,875.20	154.3%
CCO.N	Clear Channel Outdoor Holdings Inc	2,100,629,094.00	150.9%
YRD.N	Yirendai Ltd	1,640,340,000.00	150.6%
SLCA.N	U.S. Silica Holdings Inc	3,115,582,729.00	150.2%
OCLR.OQ	Oclaro Inc	1,476,486,851.10	145.7%
CNX.N	CONSOL Energy Inc	4,648,365,397.82	143.4%
AMD.OQ	Advanced Micro Devices Inc	6,121,800,000.00	140.8%
RICE.N	Rice Energy Inc	5,378,033,639.52	139.5%
X.N	United States Steel Corp	2,972,775,302.85	139.1%
WPX.N	WPX Energy Inc	4,404,052,272.84	129.8%
AVXS.OQ	AveXis Inc	1,350,857,068.64	128.3%
EXEL.OQ	Exelixis Inc	2,904,407,594.01	126.8%

Bottom 25 Stocks Returns for US Listed Stocks with a market cap greater $1 Billion			
RIC	**Company Name**	**Market Capitalization (USD, Millions)**	**Total Return, YTD (Compounded) (%) As Of: 9/30/16**
UMAXD.PK	Umax Group Corp	1,298,800,000.00	-75.0%
SPWR.OQ	SunPower Corp	1,185,332,628.48	-70.3%
AEEX.PK	Asia Equity Exchange Group Inc	1,432,500,000.00	-69.5%
KBSR.PK	KBS Real Estate Investment Trust Inc	1,056,523,656.60	-67.2%
ENDP.OQ	Endo International PLC	4,718,198,451.84	-67.1%
CVI.N	CVR Energy Inc	1,293,782,645.00	-62.0%
SCTY.OQ	SolarCity Corp	1,964,233,233.42	-61.7%
RH.N	Restoration Hardware Holdings Inc	1,364,640,161.44	-56.5%
PTLA.OQ	Portola Pharmaceuticals Inc	1,239,632,422.68	-55.9%
PCRX.OQ	Pacira Pharmaceuticals Inc	1,331,951,193.63	-55.4%
CVRR.N	CVR Refining LP	1,323,972,000.00	-53.7%
MYGN.OQ	Myriad Genetics Inc	1,304,570,864.37	-52.3%
XTNY.PK	Xiangtian USA Air Power Co Ltd	2,647,868,160.00	-50.4%
INFN.OQ	Infinera Corp	1,351,700,988.16	-50.2%
ROGP.PK	Royale Globe Holding Inc	1,611,487,500.00	-50.0%
FIT.N	Fitbit Inc	3,087,939,960.60	-49.8%
CYH.N	Community Health Systems Inc	1,217,051,798.76	-47.2%
QUNR.OQ	Qunar Cayman Islands Ltd	4,230,163,232.68	-45.0%
ESV.N	Ensco PLC	2,603,555,974.08	-44.6%
IPXL.OQ	Impax Laboratories Inc	1,773,362,345.23	-44.6%
SHLD.OQ	Sears Holdings Corp	1,211,437,250.10	-44.3%
LC.N	LendingClub Corp	2,362,544,351.08	-44.1%
PAY.N	Verifone Systems Inc	1,764,468,251.40	-43.8%
CXW.N	Corrections Corp of America	1,580,678,136.10	-43.8%
HTZ.N	Hertz Global Holdings Inc	3,147,860,104.96	-43.6%