

HUDSON ADVISOR SERVICES, INC

OUR VIEW OF THE MARKET

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We have been writing this newsletter for 20 years. We always try to give our best guess of how the market will behave in the immediate period ahead. Three months ago we said the market would retain its impressive first half gains – but would move sideways for the rest of 2019. That was a prediction when, yes indeed, we were right on the mark.

So what happens next? There are so many questions and issues: 1) The potential for the slowing global economy to drag down the still healthy U.S. economy. 2) The completely unpredictable outcome of trade battles and trade talks with China. 3) And, of course, the unprecedented situation of an impeachment process running concurrent with an election process.

Let us be certain on one point. We do not mix investing with politics. Historically, the economy and the markets mostly do things *despite* what happens politically. We are not obsessed with scary media narrative about financial fall-out from impeachment and the elections.

We are watching the economic and market fundamentals. We predict the market will remain in its volatile but sideways trend for the rest of 2019 and well into 2020. We do not intend to trade around based upon short-term news. As always, we will tell our clients to stay near their long-term asset allocation and re-balance as necessary if volatility unsettles their portfolio strategy. Our job is to keep our clients' assets safe and growing despite the uncertain investment terrain.

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Equity Market: The third quarter saw the market bounce around considerably. Investors were happy in July in anticipation of the Federal Reserve decision to ease monetary policy and cut interest rates. The S&P 500 moved above 3,000 and reached an all-time high point. The market then retreated in August over concerns of an escalating trade conflict with China. As those concerns abated somewhat, September was a stable month.

The Dow Jones Industrial Average was up 1.87% for the quarter and 16.22% for the year-to-date. The S&P 500 gained 1.9% in the quarter and 18.74% for the year. The Nasdaq Composite index was down 0.09% in the quarter and up 20.56% for the year. The Russell 2000 index actually lost 2.76% in the quarter as investors were concerned about the debt situation of small companies. It was still ahead 12.96% for the year.

Fixed Income Market Bond prices rose over concerns about the global economy. When investors get nervous, they buy government bonds. The yield on the 10-year Treasury was 1.675%% at the end of September versus 2.0% at the end of June. (Yields move inversely to prices.) That was the biggest quarterly decline on yield in 7 years.

MAJOR MARKET INDEXES

	YTD Return
Dow Jones Industrials Composite PR	16.22
S&P 500 Index PR	18.74
Russell 2000 Index PR	12.96
NASDAQ Composite PR	20.56
EAFE Index NR	12.80
Barclays Aggregate Bond Index TR	7.71

source: Morningstar® as of September 30, 2019

MARKET TRENDS

The accompanying chart summarizes stock and bond market prices for the first three quarters of 2019. Equities swung up and down throughout the third quarter. They ended slightly positive and contributed to 2019 being the best year, to-date, for stock market performance since 1997. Meanwhile, the bond market rallied because of investor perception of its “safe haven” status in uncertain times

THE OUTLOOK

The Economy: The U.S. economy continues to look fundamentally strong. The consensus forecast is for annualized growth of 2.25% in 2019. While job expansion fluctuates by month, the unemployment rate is still historically low at less than 4%. Consumer confidence is also relatively strong.

But warning signs do exist. The World Trade Organization has slashed its forecast for trade growth this year and next. They say international trade flows will expand only 1.2% this year – the weakest year since 2009. The reason seems to be both the overall slowdown in the global economy and the fallout from the trade conflicts. The U.S. economy is feeling the impact. Reports in early October say the indexes that measure U.S. manufacturing activity are at their lowest in 10 years. The indexes that measure service sector activity are at their lowest in 3 years.

The “good news” in this scenario is that weakening economic measures increase the likelihood the Federal Reserve will act to stem wider downturn. Most observers expect the Fed to cut interest rates in late October and then again before the end of the year. The consequence will be to stave off the possibility of recession in 2020. What happens in 2021 and beyond is almost impossible to predict.

The Market: Of course, corporate earnings are critical to the stock market outlook. Most companies are now reporting or predicting earnings for full year 2019 that are lower than last year. This trend appeared in the second quarter and is expected to be the same for the third and fourth quarters. It will be the first year since 2016 that corporate earnings are lower than the previous year.

The run-up in the market this year has made stock prices rich by historical standards. The price-to-earnings ratio is now about 18 times this year’s expected earnings – up from about 15 at the end of last year. The earnings outlook does not offer much promise to lower that ratio again.

With no prospect of imminent recession, we are not concerned about a major retreat in the market during the fourth quarter or the early months of 2020 – even though we will see some volatile trading days. But with rich stock prices, and longer-run economic concerns, we do not think the market can move much higher than its current level.

OUR STRATEGIES

Asset Allocation: Normally, for clients investing new money, we recommend 60% allocation to equities and the remaining portion to cash, bonds with maturities under two years, and alternative investments. But in this environment, we may recommend a lower allocation to equities until the market direction is somewhat clearer.

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. We are mindful that value stocks are getting attention over growth stocks in the current market. The sectors getting our interest are similar to last quarter.

HEALTH CARE: The larger uncertainties regarding national health care policy make us cautious about much of this sector. But we like select names in bio-technology and medical devices.

TECHNOLOGY: We are cautious about this sector – especially given the various issues in the big tech names – but areas such as communications equipment and semi-conductors have our interest.

FINANCIALS: Our focus is upon regional banks and non-bank financial services. Prices are reasonable for many of these stocks.

Other Equity Approaches: We like Minimum Volatility Exchange Traded Funds as a part of client portfolios. Minimum Volatility strategies don’t just target the least-volatile stocks. They also consider how stocks interact with each other, which allows reduction in volatility at the portfolio level by mitigating exposure to concentrated sources of risk.

Fixed Income Investments: Our repeated aversion to bonds with long maturities remains firm. We prefer to find higher yielding alternative investments such as municipal tax liens.

Dow Jones U.S. Sectors Total Return (Percent Change for YTD, Ending September 30, 2019)

Source: Morningstar®

Oil & Gas	4.66	Consumer Services	20.40
Basic Materials	11.90	Telecommunications	26.64
Industrials	25.25	Utilities	24.51
Consumer Goods	21.20	Financials	23.05
Health Care	5.82	Technology	28.90

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Top 25 Performing Stocks 2019 (09/30/19) - US Listed companies with a market cap above \$5 Billion. Source: Telemet ®

Issue	Name	Last	Mkt Cap	Net Pct YTD (%)	Industry Group
FNMA	Fannie Mae	3.63	20,800	242.45	Thriffs and Mortgage Finance
ROKU	Roku, Inc. Class A	103.73	12,057	238.55	Household Durables
SNAP	Snap Inc	15.67	21,344	184.3	Communications Equipment
SE	Sea Ltd ADR	31	13,794	173.85	Software
PAGS	Pageseguro Digital Ltd.	46.25	14,513	146.9	Health Care Providers & Services
ASMIY	ASM International N.V	93.16	5,754	139.3	Semiconductors and Semiconductor Equipment
SHOP	Shopify Inc.	315.84	35,378	128.13	IT Services
ACAD	Acadia Pharmaceuticals	36.7	5,303	126.96	Biotechnology
NVCR	NovoCure Limited	74.16	7,280	121.49	Health Care Equipment & Supplies
AVLR	AVALARA INC	67.34	5,084	116.18	Software
COUP	Coupa Software Inc	133.9	8,415	113.01	Software
PODD	Insulet Corp	162.69	9,806	105.11	Health Care Equipment & Supplies
PPC	Pilgrims Pride Corp	31.67	7,906	104.19	Food Products
EDU	New Oriental Education & Techn	110.71	17,498	101.98	Diversified Consumer Services
GNBT	Generex Biotechnology	1.96	12,019	94.33	Pharmaceuticals
CMG	Chipotle Mexican Grill	834.22	23,127	93.2	Hotels Restaurant & Leisure
FND	Floor & Decor Holdings, Inc	49.86	5,227	92.51	Specialty Retail
VSM	Versum Materials	52.99	5,790	91.16	Semiconductors and Semiconductor Equipment
MANH	Manhattan Associates, Inc.	80.97	5,208	91.1	Software
MELI	MercadoLibre, Inc.	554.35	27,557	89.29	IT Services
TER	Teradyne Inc.	58.04	9,864	84.96	Semiconductors and Semiconductor Equipment
CY	Cypress Semiconductor	23.39	8,638	83.88	Semiconductors and Semiconductor Equipment
STNE	StoneCo Ltd. Cl A	33.8	7,498	83.3	Health Care Providers & Services
AYX	Alteryx, Inc	107.7	6,764	81.1	IT Services
CSGP	CoStar Group, Inc.	599.92	21,926	77.84	IT Services

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TW	Tradeweb Markets Inc. Class A	38.19	5,760	-70.27	Diversified Financials Services
AABA	Altaba Inc.	19.56	18,494	-66.25	Media & Services
PCG	PG&E Corporation	9.8	5,184	-58.76	Multi-Utilities
TEVA	Teva Pharmaceutical	6.83	7,458	-55.71	Pharmaceuticals
DXC	DXC Technology	28.31	7,613	-46.77	IT Services
ABMD	Abiomed Inc.	175.04	7,943	-46.15	Health Care Equipment & Supplies
SSL	Sasol Ltd ADR	17.14	10,676	-41.48	Oil Gas & Consumable Fuels
BMA	Banco Macro S.A.	26.02	70,644	-41.16	Banks
CTK	CooTek Inc	5.13	16,228	-38.34	Health Care Providers & Services
BRKMY	Braskem SA	15.35	5,577	-37.24	Chemicals
SWDBY	Swedbank AB Sponsored ADR	14.08	15,717	-37.11	Banks
KHC	The Kraft Heinz Company	27.53	33,590	-36.03	Food Products
BIDU	Baidu, Inc. ADS	101.78	35,625	-35.83	IT Services
HLF	Herbalife Nutrition Ltd.	37.92	5,735	-35.67	Personal Products
ESALY	Eisai Company Ltd	50.8	14,478	-35.08	Pharmaceuticals
CXO	Concho Resources Inc.	67	13,472	-34.82	Oil Gas & Consumable Fuels
MT	Arcelor Mittal	13.83	14,019	-33.12	Metals & Mining
GPS	Gap Inc.	17.28	6,494	-32.92	Specialty Retail
DOW	Dow Inc.	46.41	34,493	-30.37	Chemicals
DLAKY	Deutsche Lufthansa	16.06	7,459	-30.04	Airlines
MYL	Mylan N.V.	19.22	9,915	-29.85	Pharmaceuticals
HAL	Halliburton Company	18.65	16,336	-29.83	Energy Equipment & Services
SRPT	Sarepta Therapeutics Inc	76.81	5,710	-29.62	Biotechnology
MOS	Mosaic Co. (The)	20.57	7,937	-29.58	Chemicals
TRIP	TripAdvisor, Inc.	38.28	5,332	-29.03	Media & Services