HUDSON ADVISOR SERVICES, INC

OUR VIEW OF THE MARKET

By William N. Hudson, Jr. & David D. Burrows

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We were amused by a commentary written by a 72 year-old money manager with 40 years of investment experience. He said: "Hey young Turks on trading desks, up-and-coming money managers, and Wall Street jockeys. You want the truth about global markets today? You can't handle the truth. This is no market for young men. At least we old men remember what a real bear market is like, and you young guys have not got a clue."

At Hudson Advisors, we enjoy our interaction with young investment professionals. But, like the commentator above, we are grateful lately for our grey hair and long memories. The commentator went on to describe the interconnected complexities of today's global financial markets. Yes, it is hard to sort out all the pieces: crisis in the Eurozone, political gridlock in the United States, economic slowdown in China. Any one event now seems capable of putting financial markets globally into either tailspin or temporary giddiness. That was the story of 2011 – one of the most volatile in stock market history.

But our seasoned commentator had this to say. The world now is more about risk management than investing. Forget the home runs. Guard against the really big losses, and go for singles and doubles. Do not react too quickly to a stock market that seemingly goes up and down at random. Develop your strategy and stick to it. You will win more games than you lose.

We quote from this commentary – not just because of the age affinity – but because we embrace that basic philosophy. We cannot predict or respond to all the news that drives the market. So, at Hudson Advisors, we stand by our basic strategy: pick stocks from fundamentally sound companies with diversified business plans, attractive valuations, and good dividend policies. They will weather bad news and, over time, remain strong investments for our clients. From this perspective, we expect 2012 to be a better year than 2011.

MARKET TRENDS

The accompanying chart summarizes stock and bond market results for full year 2011. The decline in equity prices began in the second quarter, accelerated in the third quarter, and then improved in the fourth quarter—leaving the indexes by year-end pretty much at their starting point. Meanwhile, the fixed income markets did extremely well. Bond prices, especially U.S. Treasuries, soared to near historic levels. Investors were driven by fears that drove them to perceived places of safety.

Equity Markets: The year 2011 was indeed both paradoxical and frustrating: market activity was turbulent, but in the end not much really happened. Coming off the healthy gains of 2010, the first quarter was positive. Starting in April, however, the market became traumatized by the "macro" events of sovereign debt crisis, government paralysis, natural calamities, and the specter of renewed recession. The third quarter was one of the worst in stock market history. Major indexes were all in negative territory on September 30. The fourth quarter was a rocky story – but turned positive enough to return the indexes to their position at the start of the year.

The Dow Jones Industrial was the best performer – closing the year with a 5.5% gain – driven by several dividend-paying, blue chip companies. The story was worse for the other major indexes. The S&P 500 ended up dead even for the year. The Nasdaq Composite was 1.80% down for the year – its first negative performance since 2008. The Russell 2000 index of small company stocks took a beating – a drop of 5.5% for the year. International equities took the worst beating of all, off 15% to 22% depending on the underlying region.

Fixed Income Market: At Hudson Advisors, we were continually confounded by the strength of the bond markets. As expressed last quarter, the flight from equities seemed driven by a sentiment that just said get somewhere safe and live to fight another day. Despite the long-term issues of fiscal policy, and the credit downgrade by S&P, investors perceived U.S. Treasuries as the safest place to be at this time. The yield on the 10-year Treasury note, which moves inversely to prices, began the year at 3.31 % and fell by December 30 to 1.88% -- a historic decline of over 40%. The yield on the 30-year Treasury bond went from 4.69% to 2.91%. Investors also seemed willing to accept the investment grade debt of the same companies whose stocks they were shunning. U.S. corporations were able to issue over $1 trillion of debt with good credit standing at attractive rates -- up more than 10% from 2010. Investor appetite for high-yield, or junk bond, debt was more subdued.

MAJOR MARKET INDEXES

	YTD Total Return
Dow Jones Industrials Average	5.5
S&P 500	2.11
*Russell 2000	-5.5
*NASDAQ Composite	-1.8
*Barclays Capital Aggregate	8.2
*MSCI EAFE Index	-14.82

*Total return *excludes* reinvested dividends.

THE OUTLOOK

The Economy: The confidence in our preference for equities is rooted in our view of the U.S. economy. We recognize that conditions are not robust But nor are things entirely dismal. We are encouraged by positive signs. Unemployment is slowly declining and hiring is on the upswing. Job growth has averaged about 150,000 in the last

four months. Measures of consumer confidence have improved. Pending housing sales in November were the highest in 19 months. Trends in business investment are positive. The Federal Reserve will keep interest rates low. The economy grew 1.2% in the first three quarters. We agree with those economists who see 2% growth in 2012.

So, okay, we know that everyone would feel better if economic growth was 3% to 4%. But we view the current growth trend as stable and real. This is not the 1990's with growth led by a technology bubble – or the mid 2000's with growth fed by a housing bubble. We think the slow growth now can be sustained and gradually improved.

We understand the deep concerns about the situation in Europe. We are not confident that political leaders there will find a fundamental solution any time soon. But, as expressed last quarter, we believe they will patch together temporary fixes that will forestall any meltdown in the global financial system. With regards to the U.S., political gridlock will continue throughout 2012. Following the fall elections, however, we see the opportunity for reasonable progress on the U.S. debt problem.

The Market: Given this economic viewpoint, we are positive on corporate earnings. Before tax corporate profits are up an average of 4% in the last year. Most big companies have healthy balance sheets and strong cash positions. They were stress tested by the events of 2008 and survived. Provided there are some remedies applied in Europe, we believe U.S. companies can withstand the negative forces blowing across the Atlantic.

The large U.S. companies in the S&P 500 now have stock prices that average 12.5 times earnings. These attractive valuations are a buying opportunity for all the investor assets now parked in cash. We think it entirely possible for large cap companies to have equity market growth of 5% to 8% in 2012.

OUR STRATEGIES

Asset Allocation: For clients investing new money, we continue to recommend around a 60% allocation to equities and the remaining portion split between cash, short term bonds, and alternative investments.

Equities: We remain focused on large cap companies with strong balance sheets, sustainable cash flows, and credible business models. Given the economic and market uncertainties, we are defensive in our equity selections. We look for companies that can withstand the current turbulence. Companies that pay attractive dividends are central to our strategy. We use covered call writing to improve dividend payments. We note that our regular sector preferences were good performers within the S&P 500 during 2011: notably health care, consumer staples, and utilities.

HEALTH CARE: 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.

INDUSTRIALS: This sector was weak overall lat year – but we did well with certain auto and aviation stocks.

FINANCIALS: Interestingly, certain regional and super regional banks have good value as the result of low risk profile and conservative balance sheets. We are avoiding larger international firms that may have exposure to the Eurozone problems – which has hurt this sector overall.

STRUCTURED PRODUCTS: To assist return, we have been putting some monies into instruments which have upside potential linked to performance of the equity markets – albeit with a cap that allows a guarantee of the principal invested.

Fixed Income: It is hard to find new language to express our aversion to long-term bonds. The day of reckoning is coming and all those buyers will take a large hit to their portfolio values when the economy and inflation do pick up. We prefer to keep the non-equity portion of client portfolios in cash and ultra-short term bonds.

Dow Jones U.S. Sectors (Percent Change for YTD, Ending December 31, 2011)			
Oil & Gas	**-2.29%**	**Consumer Services**	**-5.23%**
Basic Materials	**-16.35%**	**Telecommunications**	**-0.45%**
Industrials	**-2.76%**	**Utilities**	**14.18%**
Consumer Goods	**-5.93%**	**Financials**	**-14.56%**
Health Care	**-9.22%**	**Technology**	**-1.07%**

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