

HUDSON ADVISOR SERVICES, INC

OUR VIEW OF THE MARKET

By William N. Hudson, Jr., David D. Burrows, William Hudson III, Evan Coppola, & Jeremy Hudson

We are reading what our competitor firms have predicted for 2016. Much of it is pure “mush”. That is our word for what you tell clients to keep them happy and appeased. For instance, the consensus forecast of 10 top Wall Street analysts says the S&P 500 Index will end 2016 at 2,220. That is an 8% rise over 2015. We, on the other hand, were not wildly optimistic about the market’s performance in 2015, and our outlook for 2016 remains cautious.

At Hudson Advisors, we are not alarmists. But we are realistic and we want to be candid with our clients. Our outlook for 2016 is **neutral**. That means the market may bounce around – but remain basically flat to 2015. We might get fortunate and see a slight gain. But we will not be surprised to see a modest decline.

There are many counter-veiling forces at work. We have our list of positive forces and negative forces. The list of negatives is longer. The global economy is stagnant at the same time the U.S. dollar is strong. Export demand is extremely weak. The market got hammered in the year’s opening week over concerns about the Chinese economy. We always assumed that China could wield the policy levers to manage their growth rate. That assumption is shaken. Evidence suggests that policymakers are stumbling around and not in control of events.

That said, we do not agree with views expressed recently by George Soros. He seemed to suggest that our current situation is a crisis like the fiscal meltdown of 2008. We do not have that fear. The structural problem of too much bad debt in the financial sector does not exist now.

MARKET TRENDS

So, we will move into 2016 with this tone of candor in our commentary – and caution in our approach. We will be defensive in our investment of client monies with the goal to preserve assets for a future period when the investment climate is brighter and clearer. The accompanying chart summarizes stock and bond market prices in 2015. Confronted with the weakened global outlook, the stock market was lackluster. Meanwhile, in the bond market, U.S. Government and investment grade corporate bond prices were steady. Junk bonds got hammered.

Volume 66

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Equity Market: Stock prices were stable in the first half of the year, took a pounding in August and September over concerns about the global economy, and recovered ground in the fourth quarter. Overall, it was the worst year in the market since 2008. The Dow Jones Industrial Average was down 3.58% for the year. The S&P 500 Index declined 0.73%. As a matter of fact, on average, the S&P 500 stocks were down 22% from their highs reached in the spring of 2015. Small cap stocks were hit the hardest. The Russell 2000 index was down 5.71% for the year. The only bright spot was technology. The Nasdaq Composite Index was ahead 8.38%.

But the overall indexes do not tell the whole story. There is a deeper technical problem in the market. On its face, the 1.38% in the S&P 500 would not seem too terrible. But the 10 largest contributors to the index provided 250% of the total return. The rest of the companies in the index had a total return of negative 2.1%. To have a few stellar performers and a majority of serious losers is not a good sign for the market.

Fixed Income Market: Bond prices were a mixed story. The yield on the 10-year Treasury note – which is inverse to prices – might have been expected to rise considerably in a year when the Federal Reserve finally moved to raise interest rates. But the yield ended the year at 2.27% -- barely higher than where it began at 2.17%. The perception of Treasuries as being a safe place remains. The same can be said of investment grade corporate bonds which held their value.

By contrast, junk bonds took a serious beating, especially at the end of the year, as oil and commodity prices fell. The S&P U.S. High Yield Corporate Bond Index was down nearly 30% for the year.

MAJOR MARKET INDEXES

	4Q Return	2015 Return
Dow Jones Industrials	6.67	-3.58
S&P 500 Index	6.45	-0.73
Russell 2000 Index	3.20	-5.71
NASDAQ Index	5.73	8.38
EAFE Index NR	4.37	-3.30
Barclays Aggregate Bond Index	-1.26	-2.12

THE OUTLOOK

The Economy: The December jobs report for the U.S. was strong – as it has been for most of 2015. But the overall economic expansion is tepid. The GDP growth rate for 2015 was forecast to be over 3%. It was actually closer to 2%. The Federal Reserve says GDP will increase 2.4% in 2016. But many economists are skeptical of that number and believe the Fed will have to back off its plan for four interest rate hikes.

The U.S. is clearly hurt by the global picture. Confidence in China is waning. Other emerging markets are weak. Europe and Japan are stagnant. The steep decline in oil and commodity prices creates havoc and weakens other currencies relative to the dollar. The combined effect is to cut demand for U.S. exports and hurt the sales of U.S. companies with substantial operations abroad.

Some positive forces are at work. U.S. consumers are saving money on energy and that potentially creates more confidence and purchasing activity. The balance sheets of most large corporations are solid. The economy historically has done well during Presidential election years. Also, we believe the Federal Reserve will act with restraint and may modify its announced interest rate hikes if the economy appears too weak.

The Market: Corporate earnings will be the key to what happens in the stock market. Therein lies the explanation for our neutral stance on the market. Companies will soon start reporting fourth quarter earnings. A few companies will do well, but the majority will be negative. The forecast is for an aggregate decline of 6%. Unfortunately, we do not see the economic fundamentals that will generate much earnings improvement in 2016.

This situation comes when the average stock in the S&P 500 has a price/earnings ratio of 17.4 – versus a 10-year average of 15.7. Given the earnings outlook, we see limited opportunity for those prices to move higher. We think the

overall market will be fortunate to eke out a 2% to 3% gain for the year. It may just stay flat to 2015 and perhaps even experience a small percentage decline. Again, our viewpoint is neutral and we are not going to spread the “mush.”

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 short maturities, 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:

- **FINANCIALS:** The stocks of insurance companies and some regional banks have stable valuations.
- **TECHNOLOGY:** As in 2015, we expect technology to show strength – especially those companies that appeal to consumer interest in new and imaginative devices.
- **HEALTH CARE:** We are attracted to some pharmaceutical companies because of new products coming to market.
- **ENERGY:** Despite the overall problems in this sector, some companies are interesting such as those involved in propane distribution.

Fixed Income: Our repeated aversion to bonds with long maturities remains firm. We are surprised the Treasury market held up as well as it did in 2015. But the risk of a sharp decline in bond prices is too great a risk for our clients. We prefer to find alternatives such as municipal tax liens.

Dow Jones U.S. Sectors (Percent Change for YTD, Ending December 31, 2015)			
Oil & Gas	-22.03	Consumer Services	6.60
Basic Materials	-12.43	Telecommunications	3.52
Industrials	-1.69	Utilities	-4.61
Consumer Goods	6.05	Financials	0.09
Health Care	6.59	Technology	4.10

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Top 25 Stock Returns for US Listed Stocks with a market cap greater than \$500 Million

Ticker	Company Name	Market Capitalization (USD, Millions)	Total Return, YTD (Compounded) (%) As Of: 0M
TYMI.PK	Tyme Technologies Inc	\$ 946.84	121758.75%
EGRX.OQ	Eagle Pharmaceuticals Inc	\$ 1,343.07	472.06%
ROGP.PK	Royale Globe Holding Inc	\$ 1,450.34	455.56%
EXEL.OQ	Exelixis Inc	\$ 1,247.42	291.67%
ANAC.OQ	Anacor Pharmaceuticals Inc	\$ 4,997.04	250.29%
PRTA.OQ	Prothena Corporation PLC	\$ 1,961.35	228.08%
ITCI.OQ	Intra-Cellular Therapies Inc	\$ 2,307.30	204.76%
DYAX.OQ	Dyax Corp	\$ 5,533.49	167.57%
SRPT.OQ	Sarepta Therapeutics Inc	\$ 1,723.48	166.62%
HRTX.OQ	Heron Therapeutics Inc	\$ 901.43	165.41%
RARE.OQ	Ultragenyx Pharmaceutical Inc	\$ 3,955.70	155.65%
NBIX.OQ	Neurocrine Biosciences Inc	\$ 4,512.39	153.22%
LOXO.OQ	Loxo Oncology Inc	\$ 524.01	142.13%
GLOB.N	Globant SA	\$ 1,270.08	140.14%
W.N	Wayfair Inc	\$ 3,717.56	139.90%
ABMD.OQ	Abiomed Inc	\$ 3,615.67	137.20%
NFLX.OQ	Netflix Inc	\$ 46,995.62	134.38%
TXMD.A	TherapeuticsMD Inc	\$ 1,744.69	133.03%
SWHC.OQ	Smith & Wesson Holding Corp	\$ 1,270.12	132.10%
STMP.OQ	Stamps.com Inc	\$ 1,781.58	128.40%
IMGN.OQ	Immunogen Inc	\$ 1,114.27	122.46%
CBM.N	Cambrex Corp	\$ 1,400.29	117.81%
AMZN.OQ	Amazon.com Inc	\$ 298,596.71	117.78%
COCP.OB	Cocrystal Pharma Inc	\$ 548.56	111.90%
CBPO.OQ	China Biologic Products Inc	\$ 3,769.42	111.90%

Bottom 25 Stock Returns for US Listed Stocks with a market cap greater than \$500 Million

Ticker	Company Name	Market Capitalization (USD, Millions)	Total Return, YTD (Compounded) (%) As Of: 0M
SNETD.PK	SourcingLink.net Inc	\$ 652.62	-98.61%
AJGH.PK	AJ Greentech Holdings Ltd	\$ 683.42	-91.24%
TK.N	Teekay Corp	\$ 740.15	-79.68%
APOL.OQ	Apollo Education Group Inc	\$ 820.62	-77.51%
CHK.N	Chesapeake Energy Corp	\$ 3,292.10	-76.76%
CNX.N	CONSOL Energy Inc	\$ 1,962.99	-76.50%
HLX.N	Helix Energy Solutions Group Inc	\$ 569.96	-75.76%
DNR.N	Denbury Resources Inc	\$ 716.37	-74.33%
SWN.N	Southwestern Energy Co	\$ 2,964.33	-73.95%
SUNE.N	Sunedison Inc	\$ 1,821.15	-73.91%
NAV.N	Navistar International Corp	\$ 785.28	-73.60%
DDD.N	3D Systems Corp	\$ 1,101.73	-73.56%
TRGP.N	Targa Resources Corp	\$ 1,501.30	-73.36%
TOO.N	Teekay Offshore Partners LP	\$ 676.26	-73.05%
JOY.N	Joy Global Inc	\$ 1,229.00	-72.36%
MNKD.OQ	Mannkind Corp	\$ 621.56	-72.20%
EAPH.PK	Easton Pharmaceuticals Inc	\$ 3,544.37	-71.97%
SSYS.OQ	STRATASYS LTD	\$ 1,277.31	-71.75%
SDRL.N	Seadrill Ltd	\$ 1,725.92	-71.61%
GPRO.OQ	GoPro Inc	\$ 2,570.32	-71.51%
WLL.N	Whiting Petroleum Corp	\$ 1,945.48	-71.39%
CEQP.N	Crestwood Equity Partners LP	\$ 1,426.99	-70.74%
FCX.N	Freeport-McMoRan Inc	\$ 7,570.95	-70.11%
X.N	United States Steel Corp	\$ 1,190.67	-69.83%
CNV.OQ	Cnova NV	\$ 1,050.77	-69.53%

Hudson Advisors Core Buy List

Ticker	Company Name	Sector	Ticker	Company Name	Sector
NKE	Nike Inc	Consumer Discretionary	ZTS	Zoetis Inc	Health Care
TIF	Tiffany & Co	Consumer Discretionary	GD	General Dynamics Corp	Industrials
foxa.o	Twenty-First Century Fox Inc	Consumer Discretionary	TYC.N	Tyco International PLC	Industrials
CMCSA.o	Comcast Corp	Consumer Discretionary	SWK	Stanley Black & Decker Inc	Industrials
DIS	Walt Disney Co	Consumer Discretionary	DE	Deere & Co	Industrials
sbux.o	Starbucks Corp	Consumer Discretionary	BA	Boeing Co	Industrials
tjx	TJX Companies Inc	Consumer Discretionary	UTX	United Technologies Corp	Industrials
UA	Under Armour Inc	Consumer Discretionary	LLL	L-3 Communications Holdings Inc	Industrials
cbs	CBS Corp	Consumer Discretionary	LMT.N	Lockheed Martin Corp	Industrials
VFC	VF Corp	Consumer Discretionary	UPS	United Parcel Service Inc	Industrials
MCD	McDonald's Corp	Consumer Discretionary	LUV	Southwest Airlines	Industrials
TSN	Tyson Foods Inc	Consumer Staples	GOOG.o	Google Inc	Information Technology
SJM	J M Smucker Co	Consumer Staples	AAPL.o	Apple Inc	Information Technology
STZ	Constellation Brands Inc	Consumer Staples	AVGO.o	Avago Technologies Ltd	Information Technology
HAIN.o	Hain Celestial Group Inc	Consumer Staples	mbly.n	Mobileye NV	Information Technology
CVS	CVS Health Corp	Consumer Staples	fb.o	Facebook Inc	Information Technology
PM	Philip Morris International Inc	Consumer Staples	MA	MasterCard Inc	Information Technology
PG	Procter & Gamble Co	Consumer Staples	msft.o	Microsoft Corp	Information Technology
TAP	Molson Coors Brewing Co	Consumer Staples	INTC.o	Intel Corp	Information Technology
PEP	PepsiCo Inc	Consumer Staples	STX.o	Seagate Technology PLC	Information Technology
MO	Altria Group Inc	Consumer Staples	CE	Celanese Corp	Materials
CL-N	Colgate-Palmolive Co	Consumer Staples	lyb	LyondellBasell Industries NV	Materials
VLO	Valero Energy Corp	Energy	DD	E I du Pont de Nemours and Co	Materials
XOM	Exxon Mobil Corp	Energy	IP	International Paper Co	Materials
KMI.N	Kinder Morgan Inc	Energy	SHW	Sherwin-Williams Co	Materials
AIG.N	American International Group Inc	Financials	MPW	Medical Properties Trust Inc	REIT
gs	Goldman Sachs Group Inc	Financials	SSS	Sovran Self Storage Inc	REIT
MET	Metlife Inc	Financials	PSA	Public Storage	REIT
MTB	M&T Bank Corp	Financials	AMT	American Tower Corp	REIT
COF	Capital One Financial Corp	Financials	NLY	Annaly Capital Management Inc	REIT
C	Citigroup Inc	Financials	VOD.I	Vodafone Group PLC	Telecommunication Services
JPM	JPMorgan Chase & Co	Financials	VZ	Verizon Communications Inc	Telecommunication Services
GILD.o	Gilead Sciences Inc	Health Care	t	AT&T Inc	Telecommunication Services
CELG.o	Celgene Corp	Health Care	APU	Amerigas Partners LP	Utilities
BMJ	Bristol-Myers Squibb Co	Health Care	SPH	Suburban Propane Partners LP	Utilities
ABBV.n	AbbVie Inc	Health Care	D	Dominion Resources Inc	Utilities
BAX	Baxter International Inc	Health Care			