

# HUDSON ADVISOR SERVICES, INC

## OUR VIEW OF THE MARKET

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

We admitted in our October newsletter that we failed to predict the stock market surge of 2017. We take consolation in two thoughts. First, 9 out of 10 Wall Street prognosticators also did not foresee the dynamism of the market. Second, to borrow from Yogi Berra, it is tough to make predictions, particularly about the future. On many levels, 2017 was especially difficult.

But, excuses aside, we owe our clients explanation of what did occur in 2017 and what we think about the outlook for 2018. This assignment is challenging. The Dow Jones passed the 25,000 mark on January 4 – only 23 trading days after passing the 24,000 mark. *The New York Times* was prompted to write this headline: “After Dow 25,000, the Party Has to End. But When?”

We are more positive than a year ago. We do not think the party will end in 2018. The party may quiet down – but not come to an end. The fundamentals of economic and corporate earnings growth are extremely strong. These fundamentals temper the argument that stock prices are overvalued. Plus, we accept the concept of “market melt-up” – referring to the momentum of investors rushing to catch the rising tide.

Our clients know we are active managers who focus on stock selection. We help clients to define risk tolerance and then achieve market gains. In that context, we are cautious but optimistic about 2018. We anticipate a market environment where we can find stocks with reasonable value and potential for our clients.

Volume 74

January 2018

**Equity Market:** Driven by the fundamentals of the economy and corporate earnings, U.S. stock indexes moved steadily upwards in 2017. Volatility was at an historic low. The domestic story was aided by the international markets – which finished the year at or near record levels. The star of the market was the Nasdaq Composite Index which posted a 6.8% gain in the fourth quarter and was ahead 28.2% for the year. Investors were attracted to the product innovations in technology. The impact was felt in the broader market indexes. The Dow Jones Industrial Average increased 7.77% for the quarter and ended the year with a 20.40% gain. The S&P 500 was up 6.12% for the quarter and 19.42% for the year. The Russell 2000 index of small and mid cap stocks moved ahead 2.99% for the period and was up 13.14% for the year.

**Fixed Income Market:** In contrast, the bond market has been essentially flat. The Barclays Aggregate Bond Index which posted a 0.05% gain in the fourth quarter and was ahead 2.31% for the year. The yield on the 10-year Treasury was 2.40% at the end of December – versus 2.44% at the end of 2016. (Yields move inversely to prices.) The certainty of gradual rate increases from the Federal Reserve should keep bond prices subdued. There is greater likelihood in the future for declines than for increases.

### MAJOR MARKET INDEXES

	YTD Return
Dow Jones Industrials Composite PR	20.40
S&P 500 Index PR	19.42
Russell 2000 Index PR	13.14
NASDAQ Composite PR	28.24
EAFE Index NR	25.03
Barclays Aggregate Bond Index TR	2.31

source: Morningstar®

### MARKET TRENDS

The accompanying chart summarizes stock and bond market prices for the full-year 2017. Lead by technology, the stock market moved steadily higher throughout the year to record levels. It was the second best year for the market in the last decade. The boom continued into the new year when the market surged past that 25,000 mark – the best yearly start for the market in 50 years. In contrast, the bond market was flat.

### THE OUTLOOK

**The Economy:** The U.S. economy is performing extremely well. The annual growth in the GDP was nearly 3% in 2017 and the prediction is for the same in 2018. It seems that a decade of low interest rates is finally firing up

all the cylinders. New job creation averaged over 200,000 per month in 2017. The unemployment rate is down to 4.1% -- considered “full employment” by historic standards. Many companies report labor shortages and hiring difficulties. Wages growth is slower to take hold – but signs indicate that employers are prepared in 2018 to increase pay for workers.

Other key indicators are positive. Retail sales and industrial production are at their strongest level in years. The housing market is tight. Capital spending by corporations has picked up sharply – spurred in part by the anti-regulatory philosophy of the Trump Administration.

The U.S. economy is also assisted enormously by the renewed strength of the global economy. All 45 countries tracked by the Organization for Economic Cooperation and Development are projected to grow in 2018. This synchronicity in the global economy is historically uncommon.

**The Market:** Economic growth boosts corporate earnings. In 2017, earnings per share in the S&P 500 rose by 11%. The technology sector was a stand-out – with 80% of tech companies beating expectations. The growth in 2018 is forecast at 8%-10%. Many analysts believe the cut in corporate taxes will add another 5%-8%.

Healthy earnings alleviate some of the concern about stocks being overvalued. Through most of 2017 the price/earnings ratio on the S&P 500 had a forward 12 month forecast of about 18 – compared to the 10-year average of about 15. Now, however, many analysts believe strong earnings will reduce that P/E ratio to between 16 and 17.

As consequence, we believe that growth of between 5% to 10% is possible for the major equity indexes in 2018. Our major caveat is the Federal Reserve response to a burst of new inflation. The Fed is expected to raise rates 2 to 3

times in 2018. If they respond more aggressively, to combat inflation, the impact on the stock market could be chilling.

## OUR STRATEGIES

**Asset Allocation:** 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. We stagger the time period in which we reach that 60% level. For fully invested clients, we recommend to trim equities to 60-70% depending upon time horizon and objectives. Some clients will need to re-balance portfolios after the equity gains of 2017.

**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 getting our attention:

**TECHNOLOGY:** We are cautious about this sector – where many stocks are rich – but areas such as bio technology and semi- conductors have our interest.

**INDUSTRIALS:** We are giving renewed attention to manufacturing companies – especially in the small business sector – which lagged the market run-up in 2017.

**FINANCIALS:** Rising interest rates will make banks more attractive – and our focus is upon regional banks.

**HEALTH CARE:** Opportunities exist in this sector because of medical innovations and the needs of the aging baby boomer population.

**INTERNATIONAL:** The recovery in the global markets maintains our interest in international exposure for our clients.

**Other Investments:** 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 alternative investments such as real estate limited partnerships, demand notes, and municipal tax liens.

### Dow Jones U.S. Sectors Total Return (Percent Change for YTD, Ending December 31, 2017)

*Source: Morningstar®*

Oil & Gas	-1.56	Consumer Services	20.36
Basic Materials	25.09	Telecommunications	-0.28
Industrials	24.54	Utilities	12.44
Consumer Goods	17.03	Financials	20.03
Health Care	22.84	Technology	37.29

**William Hudson, Jr., William Hudson, III CFP®, Jeremy Hudson, & Evan Coppola**

4445 North Hwy A-1-A, Suite 233 • Vero Beach, Florida 32963 • (772) 231-8101

237 Main Street, Suite 600 • Buffalo, New York 14203 • (877) 504-1964

**David Burrows**

29 Hillside Drive • Greenwich, CT 06830 • (203) 302-3530

[www.hudsonadvisors.com](http://www.hudsonadvisors.com) • (877) 504-1964

**Top 25 Performing Stocks through YTD 12/31/17 - US Listed companies with a market cap above \$5 Billion. Per Telemet.**

Issue	Name	Last	Mkt Cap	Net Pct Q	Industry Group
NKTR	Nektar Therapeutics	\$ 58.88	9271.698353	346.0606061	Pharmaceuticals
NPSNY	Naspers Limited ADR Sponsored	\$ 57.56	18137.156	284.6308052	Media
EXAS	EXACT Sciences Corp	\$ 51.75	6195.4496	240.8761528	Biotechnology
SAGE	Sage Therapeutics, Inc.	\$ 164.76	6184.704038	209.6410449	Biotechnology
ALNY	Alnylam Pharmaceuticals	\$ 127.22	11796.75025	207.6541717	Biotechnology
SHCAY	Sharp Corporation	\$ 8.49	9343.0752	202.1352313	
AAAP	Advanced Accelerator App ADR	\$ 81.63	7142.625	198.246255	Biotechnology
HTHT	China Lodging Group, Ltd ADS	\$ 146.91	10270.14755	198.4762292	Hotels Restaurant & Leisure
OLED	Universal Display Corp	\$ 173.35	8154.488357	192.3271501	Electronic Equipment & Instruments
YY	YY Inc. ADS	\$ 114.75	6886.215003	184.1161179	Internet Software & Services
DLAKY	Deutsche Lufthansa	\$ 36.24	16834.88238	167.948244	
GOL	Gol Linhas Aereas Intelgentes	\$ 9.14	15867.04	183.4987593	Airlines
GDS	GDS Holdings Limited ADS	\$ 22.96	17489.50448	170.1176471	Diversified Telecommunication Services
BLUE	bluebird bio, Inc.	\$ 177.55	8137.283752	163.037037	Biotechnology
WUBA	58.com Inc.	\$ 74.59	10815.28894	148.8822155	Internet Software & Services
ATHM	Autohome Inc.	\$ 64.67	7552.430334	137.2340426	Catalog Retail
ALGN	Align Technology Inc	\$ 221.34	17746.533	133.4317655	Health Care Equipment & Supplies
ANET	Arista Networks	\$ 235.19	17192.72321	130.716598	Communications Equipment
GGAL	Grupo Financiaro Galicia SA	\$ 66.00	8581.749	131.092437	Commercial Banks
WB	Weibo Corporation ADS	\$ 104.84	23191.2842	133.2777036	Internet Software & Services
CC	Chemours Company	\$ 50.33	9318.868169	130.0178245	Chemicals
JUNO	Juno Therapeutics, Inc.	\$ 45.56	5201.146323	126.641791	Biotechnology
IPGP	IPG Photonics Corporation	\$ 214.30	11489.88137	123.4386404	Electronic Equipment & Instruments
TTWO	Take-Two Interactive Software	\$ 110.15	12562.93503	123.1561994	Software
W	Wayfair Inc Class A	\$ 80.25	7048.475147	115.8999193	Catalog Retail

**Bottom 25 Performing Stocks YTD 12/31/17 - US Listed companies with a market cap above \$5 Billion. Per Telemet.**

Issue	Name	Last	Mkt Cap	Net Pct Q	Industry Group
CPFH	Capital Financial Holdings	\$ 1,000.00	20819.02	-57.44680851	Capital Markets
UAA	Under Armour, Inc. Cl A	\$ 14.60	6446.580208	-51.81578079	Textiles & Apparel
BHGE	Baker Hughes, a GE Co. Cl A	\$ 31.73	13748.609	-50.69153069	Energy Equipment & Services
TEVA	Teva Pharmaceutical	\$ 18.75	19068.75	-50.60590095	Pharmaceuticals
MAT	Mattel Inc.	\$ 15.54	5341.557207	-49.77375566	Leisure Equipment & Products
SCG	Scana Corporation	\$ 39.63	5651.596914	-45.26519337	Multi-Utilities
GE	General Electric Company	\$ 17.54	152097.0972	-44.35691624	Industrial Conglomerates
AAP	Advance Auto Parts Inc	\$ 101.50	7500.281874	-40.95008145	Specialty Retail
CVE	Cenovus Energy Inc.	\$ 9.22	6992.448	-39.73856209	Oil Gas & Consumable Fuels
MKTAY	Makita Corporation	\$ 41.49	5631.550636	-39.04803878	Machinery
PAA	Plains All American Pipeline	\$ 20.86	15127.44542	-36.88350983	Oil Gas & Consumable Fuels
FMCC	Freddie Mac	\$ 2.52	8133.51	-34.50520833	Thriffs and Mortgage Finance
FL	Foot Locker Inc	\$ 47.46	5752.417254	-33.8720914	Specialty Retail
FNMA	Fannie Mae	\$ 2.64	15127.2	-33.50125945	Thriffs and Mortgage Finance
CTL	CenturyLink, Inc.	\$ 16.97	9197.11211	-33.45098039	Diversified Telecommunication Services
NWL	Newell Brands Inc	\$ 31.17	15277.8873	-33.21979434	Household Durables
APA	Apache Corporation	\$ 42.63	16237.67956	-32.60869565	Oil Gas & Consumable Fuels
S	Sprint Corp.	\$ 5.93	23722.04943	-32.38312429	Wireless Telecommunication Services
KIM	Kimco Realty Corp.	\$ 18.25	7768.174714	-29.99616417	Equity Real Estate Investment Trusts (REITs)
BPL	Buckeye Partners LP	\$ 49.65	7280.872366	-26.47712128	Oil Gas & Consumable Fuels
ETP	Energy Transfer Partners, L.P.	\$ 18.10	20914.43278	-26.27291242	Oil Gas & Consumable Fuels
NFX	Newfield Exploration Co.	\$ 31.81	6349.872597	-25.98883201	Oil Gas & Consumable Fuels
BRX	Brixmor Property Group Inc.	\$ 18.73	5711.472707	-25.93910637	Equity Real Estate Investment Trusts (REITs)
CMG	Chipotle Mexican Grill	\$ 290.50	8201.607666	-25.87256628	Hotels Restaurant & Leisure
TLSYY	Telstra Corp Ltd ADS	\$ 14.21	35363.21915	-25.83507307	Diversified Telecommunication Services
AYI	Acuity Brands, Inc.	\$ 178.63	7516.898127	-25.15607324	Electrical equipment