HUDSON ADVISOR SERVICES, INC

OUR VIEW OF THE MARKET

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We enjoy following the buzzwords that analysts and journalists use to describe the behavior of the stock market. One popular word in the last year has been "overdrive" to portray the market's stunning recovery from its pandemic depths. Right now, however, we frequently see the word "pause" to suggest the market needs to take a breather to assess all that has occurred and the likely future trends.

Indeed, to watch the market in the last year has been a bit dizzying. The market declined 35% after the onset of the pandemic last February – reaching a low point on March 23, 2020. Since then, the market has gained over 80% driven by aggressive monetary and fiscal policy that promised healthy economic recovery. Development and administration of vaccines has assisted confidence. On April 1, the S&P 500 broke through the symbolic 4,000 level.

At Hudson Advisors, we agree that a "pause" is in store during the months ahead. Stock prices are now extremely rich by any standard measure. The market has priced in a full economic recovery which is a year or more away and is threatened by the possibility of a prolonged end to the pandemic. We do not use the word "bubble" to describe the market. But we recognize that some parts of the market are in speculative territory.

As always, we look to protect our clients and also to find opportunity. We are not recommending an increase in equity allocation at this time. We will look for a classic stock picker strategy to find equities with reasonable value and to avoid those, to use another popular word, that may have become too "frothy."

MARKET TRENDS

The accompanying chart summarizes stock and bond market returns for the first quarter of the year. The stock market was volatile and choppy but ended up with gains that built upon the momentum coming out of 2020. Meanwhile, the bond market showed concern about the future possibility of inflation.

Equity Market: The first quarter was not a smooth ride. The market dipped in January and again in late February as the specter of a stubborn and sustained pandemic clouded the economic recovery. Investors also reassessed the high-flying tech stocks that enjoyed a major bounce during the long 2020 shutdowns. Preferences seemed to shift to smaller, domestically oriented businesses and manufacturers.

The Dow Jones Composite Average gained 9.85% for the quarter. The S&P 500 was ahead 6.17%. The Russell 2000 index was the market leader with a gain of 12.7% - an appreciation that small businesses would likely do well in the period ahead. The laggard was the Nasdaq Composite index which was ahead only 2.95% for the quarter, a marked slowdown from 2020 when it grew 44% for the year.

Then we saw a remarkable market performance on April 1 when in one day the Nasdaq grew 1.81%, the S&P 500 by 1.25%, the Russell 2000 by 1.89%, and the Dow by .56%. The tech rally was an especially interesting development.

Fixed Income Market Prices of Government bonds dropped over concern that a strong rebound in the economy would spark inflation. The yield on the 10-year Treasury bond ended the quarter at 1.749% --- up from .913% at the end of December. (Yields move inversely to prices.) Our caution on bonds remains. As indicated, the price of the federal stimulus of the economy is inflation in future years. At some point the Federal Reserve will switch monetary policy to fight inflation. This situation makes long-term bonds have more risk than we are comfortable taking. We prefer direct issue municipal bonds with maturities of less than five years. As an alternative, we are using closed-end municipal funds that are trading at a discount to their net asset value for enhanced yield. Our municipal tax lien strategy offers a competitive yield as a fixed income alternative.

MAJOR MARKET INDEXES

	YTD Return
Dow Jones Composite Average TR	9.85
S&P 500 Index TR	6.17
Russell 2000 Index TR	12.7
NASDAQ Composite TR	2.95
EAFE Index NR	3.48
Barclays Aggregate Bond Treasury TR	-4.25

Source: Morningstar® as of March 31, 2021

THE OUTLOOK

The Economy: Most economists predict that GDP will grow between 5 to 7% in 2021. This forecast was supported by the March jobs report which showed a gain of over 900,000 jobs and unemployment falling to 6%. Gains were recorded across diverse sectors of the economy. Certainly, the economy is getting a boost from $5 trillion in fiscal stimulus in the past year and accommodative Federal Reserve policies.

But it may take the economy until 2022 to get back to its pre-pandemic levels. Over 8 million people are still officially out of work and the unemployment rate might be 9% if it counted people who have dropped out of the labor force. Full recovery is many months away for industries such as travel and leisure and entertainment and retail.

Then we have the questions surrounding plans by the Biden Administration to invest almost $4 trillion into physical and human capital – broadly being called "infrastructure". Without doubt, much of the proposed spending will boost the economy and create jobs. But the taxes on corporations and wealthy individuals to pay for these plans have uncertain impact on the economy and may put a drag on private sector earnings and investment. The details will be hotly debated in Washington before anything is enacted.

The Market: The dominant factor in the market right now is the rich price of stocks. The price/earnings ratio is a classic measure of any security's value, indicating how many years of profits (at the current rate) it takes to recoup an investment in the stock. The current S&P 500 10-year P/E Ratio is now 35.92. This is 82% above the modern-era market average of 19.6 and suggests that the market is Strongly Overvalued. With the economic rebound, corporate earnings are expected to rise about 25 % in 2021 after declining 15% in 2020. But those higher earnings will still leave stocks richly priced.

One new force in the market is small individual investors who now comprise 25% of trading activity versus 10% in 2019. Much of their activity is speculative and fickle. Thus, we expect the months ahead to be fairly volatile.

We hope the market can record modest gains in the period upcoming. But we also will advise clients that a downturn in the market is possible and that our portfolio management must include defensive strategies.

OUR STRATEGIES

Asset Allocation: Most clients should stick to portfolio strategies previously identified. As mentioned, we advise against an increased allocation to equities at this time.

Preferred Equities: As always, despite market conditions, we look for long-term equity opportunities. Our focus is on companies that can weather both the short-term period and flourish in a longer time frame. We want fundamentally sound companies with reasonable valuations and that pay dividends. In that context, we are looking at these sectors:

CONSUMERS: The consumer staple companies are a base in this situation. The discretionary companies have promise as more people go back to work. The estimated $1 trillion in consumer savings should spur sales.

FINANCIALS: Somewhat higher interest rates may benefit the financial sector – and regional banks are interesting.

INDUSTRIALS/MATERIALS: President Biden's plans for infrastructure investment should create opportunity for many companies in this sector.

TECHNOLOGY: We are holding but not expanding our allocation to the FANG stocks. The early April boom in big tech suggests these companies may do well in the Biden era.

SMALL BUSINESS: This sector will see good growth as the economy reopens and we invest in funds that give us broad exposure.

Other Assets: We are not overly concerned about any period of sustained inflation. But our aversion to long-term bonds remains. We like maturities under two years and cash and alternative investments such as municipal tax liens and REITs.

Dow Jones U.S. Sectors Total Return
(Percent Change for YTD, Ending March 31, 2021)
Source: Morningstar®

Oil & Gas	**30.18**	**Consumer Services**	**3.76**
Basic Materials	**11.09**	**Telecommunications**	**1.73**
Industrials	**8.99**	**Utilities**	**3.12**
Consumer Goods	**2.35**	**Financials**	**12.26**
Health Care	**2.95**	**Technology**	**3.46**

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