HUDSON ADVISOR SERVICES, INC

OUR VIEW OF THE MARKET

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We are always optimists at Hudson Advisor Services. But we are also realistic. Three months ago we said in this newsletter: "We are not in Barbie Land." We predicted the stock market would struggle in 2024 to repeat its stellar performance in 2023.

Our premise was challenged in the first quarter. Investors were cheered on multiple fronts: a resilient economy, excitement about artificial intelligence, and expectation of interest rate cuts. The stock market surged to record levels in the three- month period.

But now that realism thing has kicked in strongly. The March data on the Consumer Price Index hovered at 3.8% on an annual basis. It has lingered at just under 4% since last December. The expectation for the Federal Reserve to do three interest rate cuts in 2024 now seems unlikely. This New York Times headline captured the dilemma: "Soft Landing or No Landing? The Fed's Economic Picture Gets Complicated."

So, indeed, the outlook is complicated, and we are not in Barbie Land. The market has paused and dipped on the news of highly stubborn inflation. At Hudson Advisors, we anticipate the market to move sideways in the months ahead. We will not be surprised to see a correction from the 2023 and 1Q 2024 gains. We also have the ongoing concerns about the numerous geopolitical uncertainties both domestically and internationally. We will manage client portfolios cautiously and defensively in the period ahead.

MARKET TRENDS

The accompanying chart summarizes stock and bond market trends in the first quarter of 2024. The stock market was strongly positive. The bond market was more unsettled.

Equity Market: Stocks had their best first quarter performance since 2019. After some uncertainty in January, the S&P 500 moved steadily higher and broke through record levels on 22 days. It ended the quarter at an all-time high of 5254. Unlike 2023, which was dominated by technology, the rally was more broad-based with diversified mutual funds posting strong returns. Sectors like consumer discretionary, energy, and basic materials competed with technology as top performers.

The broadest index, the S&P 500, was ahead 10.56% for the quarter. The Nasdaq Composite was ahead 9.31%. The Dow Jones Industrial Average gained 6.14%. The laggard was the Russell 2000 with a gain of 5.18%, as the small business sector attracted less investor interest. All of these indexes have lost ground in early April as the reality of stubborn inflation takes hold.

Fixed Income Market: The bond market was more uncertain than the stock market. The yield on the benchmark 10-year Treasury note (which moves inversely to prices) ended 2023 at 3.88%. It fluctuated during the quarter and ended at 4.19%. Most bond funds eked out gains, but barely. In early April the yield moved still higher in reaction to the inflation news.

MAJOR MARKET INDEXES

	2023 Return	YTD Return
Dow Jones Industrial Average TR	16.18	6.14
S&P 500 Index TR	26.29	10.56
Russell 2000 Index TR	16.93	5.18
NASDAQ Composite TR	44.64	9.31
EAFE Index NR	18.24	5.78
Bloomberg Aggregate Bond Treasury TR	4.05	-0.96

Source: Morningstar® as of March 31, 2024

THE OUTLOOK

The Economy: For all of 2023, the U.S. economy grew 2.5% -- up from 1.9% in 2022. The Federal Reserve had projected growth in GDP of about 2.1% for full year 2024. Many economists now expect higher GDP growth this year. Employers added 303,000 jobs in March. It was the 39th straight month of job growth and much larger than forecast. The unemployment rate fell to 3.8% from 3.9% in February. Business productivity and workforce participation have improved. Consumer confidence is stable despite inflation concerns.

The problem in the economy, of course, is the inflation. After reaching nearly 9% in 2022, the Consumer Price Index fell steadily in 2023 to its current level below 4%. But it now seems stuck in that range and is well above the Federal Reserve target of 2%. Financial analysts and economists are busy speculating what course of action the Fed will take in this tricky situation. Certainly, the Fed will re-evaluate its intention to make three rate cuts this year. They may just leave rates at their current level for an indefinite period. Some analysts are suggesting the Fed might even raise rates further to force a recession in order to squeeze out inflation.

The Market: Given the strength in the economy, the forecast for corporate earnings is much improved. S&P 500 earnings are expected to increase 11.1% overall in 2024 after rising a modest 3.1% last year. The pressure is on for companies to deliver results. The U.S. stock market is the most expensive it has been in around two years. Its valuation could be put to the test as companies report earnings in coming weeks. The benchmark S&P 500 index currently trades at 20.7 times its estimated earnings for the next 12 months, according to LSEG DataStream.

At Hudson Advisors, we will watch closely the impact of corporate earnings on these rich stock valuations. We obviously will follow the development of Federal Reserve policy. We will maintain our concerns for how the U.S. electoral cycle might affect the market. We hope for but do not anticipate much political clarity on how to manage the U.S. federal deficits and rising debt burden. We worry about the disruptive potential of international events. Given all these issues, we will be pleased if the stock market can hold onto the gains made in the first quarter. We will not be surprised to see a downward correction in the market.

OUR STRATEGIES

Asset Allocation: Most clients should stick to portfolio strategies previously identified. We advise against an increased allocation to equities at this time. For new clients, we recommend a 60% allocation to equities to be phased in over a 12- to -18- month period. The other 40% of assets will be short to intermediate term bonds, cash, and alternative investments.

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 with special interest:

HEALTH CARE: This sector lagged in 2023, but has comeback potential with its continuous evolution and response to global health needs.

CONSUMER DISCRETIONARY: Affluent shoppers have made the discretionary category a consistent good performer.

INDUSTRIALS: Federal government investment in infrastructure should work in favor of basic materials and construction companies. The need for military supplies is also an advantage.

FINANCIALS: The balance sheets of regional and super regional banks should be strong in the current economic and interest rate environment.

ENERGY: The cash performance of oil companies will be good as refineries work at full capacity.

PREFERRED STOCKS: We like the set schedule of dividends and tax advantages in this category and have several companies we recommend.

Other Assets: Our aversion to long-term bonds remains. But we explore various maturities through laddered investments with a mix of U.S. Government, municipal, and high- quality corporate bonds. We also like the current opportunities in money market funds.

Also, for some clients. we look at alternative investments through Broadly Syndicated Loan vehicles and Collateralized Loan Obligations which can provide investors with greater security through collateral, yields, and a hedge against inflation through floating rate structures.

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