

HUDSON ADVISOR SERVICES, INC

OUR VIEW OF THE MARKET

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

One market analyst recently offered this comment: “We all underappreciated the globalization that has occurred and how much greater dependent we are on each other than in the past.”

Yes, correct indeed. The stock market setbacks in recent months are international in origin: China’s slowdown, weakness in other developing markets, tepid growth in Europe and Japan. Sluggish global demand cuts into U.S. exports and into the sales of U.S. companies with substantial operations abroad.

We started 2015 cautious on the market outlook after the stellar growth in 2014. By July we predicted the market performance would be flat for the year. We did not foresee the extent of the third quarter decline. Like most market professionals, we are learning to look at fundamentals differently in an environment with so many global forces at play.

But we are certain on one point. This current problem is not like the fiscal meltdown of 2008. The good news is that the U.S. economy is relatively healthy. We do not expect another recession. We do not expect the collapse of major financial institutions.

That said, we are not certain on how the stock market will play out in the months ahead. The key is the upcoming reports on corporate earnings in the third quarter. If earnings disappoint, market indexes could decline further. In contrast, positive reports with better than expected earnings may allow the market to recover its recent losses and at least end the year where it began.

As always, we will manage client monies carefully in this environment and be scouting for the companies with potential for long-term gain.

MARKET TRENDS

The accompanying chart summarizes stock and bond market prices in the first three quarters of 2015. Confronted with the weakened global outlook, the stock market had its worst quarter in four years meanwhile, the U.S. Treasury market once again gained from the perception of its safe haven status.

Volume 65

October 2015

Equity Market: Stock prices were steady in July – but got hammered in August and September over concerns about the global economy. Nervousness about the future actions of the Federal Reserve Board were also a factor. The declines occurred in all major indexes. The Dow Jones Industrial Average fell 6.98% for the third quarter and was down 6.95 % for the year. The S&P 500 Index declined 6.44% for the quarter and was negative 5.29% for the year. The Nasdaq Composite Index – which had done well earlier in the year – also got slammed. The index lost 4.91% for the quarter and was down 1.3% for the year. Small cap stocks were hit the hardest. The Russell 2000 index was down 11.92% for the quarter and 7.73% for the year.

Fixed Income Market: Bond prices bounced back after retreating in the second quarter. This trend seemed driven by the perception of U.S. Treasuries as a “safe haven” from the volatile equity markets and by signs that inflation is well subdued. The Federal Reserve also decided again to postpone any increases in interest rates. The yield on the 10-year Treasury note – which moves inversely to prices – settled at 2.061% at the end of September down from 2.335% at the end of June. Treasury debt overall handed investors a total return – which includes price gains and interest payments – of 1.82% in the quarter. Part of the same phenomenon was seen in Treasury inflation-protected securities, or TIPS, which are structured as a hedge against inflation. In contrast to the Treasury market overall, TIPS declined 1.2% in the quarter.

MAJOR MARKET INDEXES

| | 3Q Total Return | YTD Total Return |
|-------------------------------|-----------------|------------------|
| Dow Jones Industrials | -6.98 | -6.95 |
| S&P 500 Index | -6.44 | -5.29 |
| Russell 2000 Index | -11.92 | -7.73 |
| NASDAQ Index | -4.91 | -1.30 |
| EAFE Index NR | -10.23 | -5.28 |
| Barclays Aggregate Bond Index | 1.76 | 1.80 |

*Total Return Includes Reinvested Dividends.

THE OUTLOOK

The Economy: We are consoled by the performance of the U.S. economy. The GNP is forecast to expand this year at a moderate but healthy rate of 2.5%. Unemployment is at its lowest level since early 2008. Consumer confidence seems good. The housing market is lively.

Of course, the question is how well the U.S. economy can hold up in the midst of the international turmoil. Despite the increased global connectivity, we are fortunate that large parts of the U.S. economy are domestically based. For instance, the consumer discretionary sector – which includes retail – is largely centered at home. The contrast would be the consumer staples sector where companies have major global exposure. So, while the stock market may get nervous, the U.S. economy still has huge resilience.

The other big question is when the Federal Reserve will move finally to raise interest rates. We think an increase of 25 basis points is likely by year-end. As stated last quarter, however, we are not obsessed with this issue like many market analysts. We think the Fed will act with measured restraint and rates will remain historically low. The economic impact will be modest.

The Market: The S&P 500 now trades at 16.7 times the prior 12 months of earnings – compared to the 10-year average P/E for the index of 15.7. So, even though prices have declined in recent months, many analysts do not see stocks as a good buy right now.

Only strong corporate earnings can change that attitude. The outlook here is mixed. The forecast is that third quarter earnings in the S&P 500 will decline 4.5% from a year ago. Strip out the beleaguered energy sector, and the other companies are expected to gain just 3.4%, growth will be strongest in companies whose business concentration is domestic.

If earnings fall short of those forecasts, we expect the major stock indexes to see further decline. Our hope is that

domestic consumer demand will push average earnings above those forecasts. In that case, we see the potential that markets might recover to where they began the year. We do not have much hope to end the year in positive territory.

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 maturities under two years, 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 attractive value.
- **TECHNOLOGY:** Some technology companies have room for further growth – especially those with innovative consumer products.
- **HEALTH CARE:** We are attracted to some pharmaceutical companies because of new products coming to market.
- **ENERGY:** Despite the dismal recent performance, we think the worst of the oil bears may be in the past. There is selective buying opportunity in integrated energy companies.

Fixed Income: When the Fed does finally raise interest rates – even if the macro economic impact is limited – the effect on long maturity bond portfolios will be sharp and adverse. That is our long-held viewpoint -- and we are sticking with it despite the renewed attraction to 10-year Treasuries.

Dow Jones U.S. Sectors (Percent Change for YTD, Ending September 30, 2015)

| | | | |
|------------------------|---------------|---------------------------|--------------|
| Oil & Gas | -21.59 | Consumer Services | 1.06 |
| Basic Materials | -20.27 | Telecommunications | -3.28 |
| Industrials | -8.32 | Utilities | -6.19 |
| Consumer Goods | -0.23 | Financials | -5.34 |
| Health Care | -1.83 | Technology | -4.11 |

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Top 15% Performance YTD US listed Market Cap greater than \$1 Billion **Worst 15% Performance YTD US Listed Market Greater than \$1 Billion**

| Ticker | Company Name | Market Capitalization (USD, Millions) | Total Return, YTD | Ticker | Company Name | Market Capitalization (USD, Millions) | Total Return, YTD |
|---------|------------------------------------|---------------------------------------|-------------------|---------|----------------------------------|---------------------------------------|-------------------|
| TYMI.PK | Tyme Technologies Inc | 731.11 | 91971.06% | TROX.N | Tronox Ltd | 509.88 | -80.69% |
| KYNC.PK | KYN Capital Group Inc | 19,004.68 | 4900.00% | HLX.N | Helix Energy Solutions Group Inc | 507.55 | -77.93% |
| CLLY.PK | CNL Lifestyle Properties Inc | 1,430.81 | 4300.00% | CNX.N | CONSOL Energy Inc | 2,244.24 | -70.88% |
| ROGP.PK | Royale Globe Holding Inc | 4,834.46 | 733.33% | VHI.N | Valhi Inc | 640.98 | -70.08% |
| EGRX.OQ | Eagle Pharmaceuticals Inc | 1,154.12 | 377.61% | LINE.OQ | Linn Energy LLC | 955.50 | -69.87% |
| EXEL.OQ | Exelixis Inc | 1,264.67 | 289.58% | DNR.N | Denbury Resources Inc | 867.30 | -68.99% |
| ANAC.OQ | Anacor Pharmaceuticals Inc | 5,181.99 | 264.99% | SSYS.OQ | STRATASYS LTD | 1,378.25 | -68.13% |
| COFI.PK | Credit One Financial Inc | 978.47 | 172.73% | APOL.OQ | Apollo Education Group Inc | 1,191.32 | -67.58% |
| QRVO.OQ | Qorvo Inc | 6,736.37 | 171.55% | JOY.N | Joy Global Inc | 1,455.30 | -67.30% |
| ABMD.OQ | Abiomed Inc | 3,900.94 | 143.72% | UNT.N | Unit Corp | 567.67 | -66.98% |
| SKX.N | Skechers USA Inc | 6,833.60 | 142.68% | SPNC.OQ | Spectranetics Corp | 501.05 | -65.91% |
| HRTX.OQ | Heron Therapeutics Inc | 870.73 | 142.54% | FELP.N | Foresight Energy LP | 693.40 | -65.18% |
| ITCI.OQ | Intra-Cellular Therapies Inc | 1,679.35 | 126.86% | DDD.N | 3D Systems Corp | 1,293.58 | -64.86% |
| SRPT.OQ | Sarepta Therapeutics Inc | 1,333.01 | 121.91% | AVP.N | Avon Products Inc | 1,414.66 | -64.50% |
| COKE.OQ | Coca Cola Bottling Co Consolidated | 1,796.93 | 120.53% | WYNN.OQ | Wynn Resorts Ltd | 5,393.63 | -63.60% |
| HILL.OQ | Dot Hill Systems Corp | 606.50 | 120.14% | SUNE.N | Sunedison Inc | 2,262.08 | -63.20% |
| RARE.OQ | Ultragenyx Pharmaceutical Inc | 3,725.44 | 119.48% | CSTM.N | Constellium NV | 635.02 | -63.12% |
| PRTA.OQ | Prothena Corporation PLC | 1,422.77 | 118.40% | I.N | Intelsat SA | 689.94 | -62.96% |
| KYTH.OQ | KYTHERA Biopharmaceuticals Inc | 1,969.96 | 116.21% | AXLL.N | Axiall Corp | 1,107.28 | -62.47% |
| ADPT.N | Adeptus Health Inc | 1,674.37 | 115.94% | CZR.OQ | Caesars Entertainment Corp | 854.06 | -62.46% |
| NFLX.OQ | Netflix Inc | 43,989.26 | 111.59% | CHK.N | Chesapeake Energy Corp | 4,877.14 | -62.14% |
| ISLE.OQ | Isle of Capri Casinos Inc | 709.64 | 108.36% | CZZ.N | Cosan Limited | 773.42 | -62.04% |
| DY.N | Dycom Industries Inc | 2,404.99 | 106.21% | NAV.N | Navistar International Corp | 1,036.96 | -62.01% |
| ELRE.PK | Yinfu Gold Corp | 694.24 | 100.00% | CNV.OQ | Cnova NV | 1,329.69 | -61.82% |
| ALDW.N | Alon USA Partners LP | 1,457.11 | 99.54% | X.N | United States Steel Corp | 1,523.92 | -60.79% |

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 | | | |