Hughes Investment Advisory Service LLC

July 1, 2024

Dear Clients and Investors,

The US stock market performed well during Q2 with the S&P 500 up 3.9%. The bond market was slightly weaker with the AGG down 1.27% during Q2.

Key 2024 economic data points:

- 2024 Q2 Atlanta Fed Estimated Real GDP growth: 2.2%
- 2024 CPI Inflation: +3.3%
- 2024 S&P 500 YRI Estimated Earnings: $250

The above numbers continue to show an economy with moderate growth, a nagging inflation problem, and strong earnings growth. As I expected, US corporations with the ability to pass on higher costs have been an excellent place to be invested during this 2-year period of strong growth and high inflation.

So where do we stand as we head into Q3 2024? Wall Street is correctly obsessed with the question of inflation. Is inflation still dropping, has it leveled off or is it rising again? I believe that the Fed has now mostly won the battle with inflation. Some sectors of the economy are still inflationary but most and soon all will change gears. At the start of 2024, Wall Street was projecting 6 interest rate cuts by the Fed, today the consensus is for 1 or 2 cuts. My January forecast was for 2 quarter point cuts before year-end which is where I currently stand as well. I believe that we are now in a rolling recession that may or may not become a full recession later this year, depending upon the timing of the anticipated cuts by the Fed. What is a rolling recession? It means some sectors of the economy are in a recession while others are not – some sectors may exit while others join etc.

What areas of the economy are not in a recession? AI, or artificial intelligence, has been the fuel propelling stocks since late 2022, and Q2 of 2024 was no different. Within the S&P 500, companies related to the AI theme gained 14.7% in this latest quarter, whereas the rest lost 1.2%. Nvidia, once solely a gaming chip maker, briefly became the worlds most valuable company. I don't believe that these are purely speculative moves. Massive spending on AI has boosted leading AI company's earnings at a rapid pace.

Comparisons are rightly being made to the 1999 dot-com bubble era when tech stocks last ran up in a similar fashion. Is this comparison warranted? I don't believe the two periods are the same, AI companies are for real, with real earnings growth unlike most "internet" stocks back in 1999. This does not mean that we can ignore valuations and just assume that these great AI companies share prices can't become fundamentally overvalued. Hype on Wall Street can drive any stock too high, regardless of the circumstances! With that in mind, I will be monitoring our positions, buy and sell entry points etc.

Currently I believe that some tech companies are overvalued while other tech and non-tech related companies look inexpensive by the metrics that I follow. Within the S&P 500 the select sectors that have done well outside Tech includes Utilities, which have become an AI play due to correct expectations that new data centers will stoke electricity demand. Conversely 6 out of the 11 sectors in the S&P lost market value during Q2. Bottom line – there is a lot going on inside the S&P 500 that's not clearly reflected by a single return number.

Despite my concerns about a rolling recession and possibly a full recession on the horizon, how can I remain bullish on certain areas of the market? What would potentially drive markets higher? In a nutshell, it is the expectation that AI and technology in general will create rising productivity growth, due to widespread adoption of new technologies in response to the shortage of skilled labor which will support robust growth in GDP and profits, while keeping a lid on inflation. These are after all, the ingredients which drive stock prices higher.

What else gets me excited about the US economy and markets looking into the second half of 2024 and beyond? Many are areas that I have discussed in previous market letters: A nuclear power renaissance supplemented by natural gas, wind, and solar. A re-building of the US power grid will be needed along with these energy growth efforts which should spur the entire energy industry. The Utility industry will benefit from increased energy demand and infrastructure buildout. Industrial re-shoring. Space, aviation, and the defense sector all look primed for innovation and growth. Pharma and Med Tech should have renewed growth and interest as AI is integrated into their operations. Some of our pharma stocks have been huge winners already thanks to drug discoveries in cancer, weight loss, Alzheimer's, and soon hopefully non-opioid pain relief. Higher rates are giving us opportunities to re-establish positions in the bond market. The long treasury could be a surprise winner once the Fed initiates a series of rate cuts.

Overall, I continue to favor large-cap, dividend paying, mostly US based multi-national companies with strong balance sheets. We love businesses with irreplaceable brand names, wide moats, high margins, grow their dividends, and have modest debt. Risk/reward now seems equal between equities and fixed income – the 60/40 portfolio now works! Focused REIT's, MLP's and specialized bond/income funds look good as income producers once again. I believe that our portfolios are well positioned to produce consistently attractive long-term risk adjusted returns while preserving capital. Given all the above, I will remain vigilant, assume little, and continue to follow the investing tenants that we know, through experience, work in the medium to long-term.

Please do not hesitate to give me a call to discuss the above analysis.

Sincerely,

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