Hughes Investment Advisory Service LLC

January 1, 2025

Dear Clients and Investors,

Happy New Year! By late December, the S&P 500 is heading towards a 22% gain in 2024, capping the strongest back-to-back years since the dot-com bubble of the late 1990s. As has been the case in recent years, most of the gains have been in a select few large cap tech stocks specifically the "Magnificent 7." These are heavily weighted market capitalization technology stocks that have an outsized effect on the S&P 500 index overall performance. For comparison and perspective here are some of the other major indexes that should also be used in measuring how the markets performed in 2024:

DJIA - Dow Jones Industrial Average:	+13.0%
RSP - S&P 500 Equal Market Cap Weight Index:	+11.0%
EFA - Europe, Australasian and Far Eastern Equity markets:	+ 0.5%
AOM - S&P Target Risk Moderate Index (Stock/Bond mix):	+ 4.8%
AGG - I-Shares US Investment Grade Bond Index:	- 2.2%
GLD – Gold:	+26.00%
FBTC - Fidelity Bitcoin Index ETF:	+73.00%

Looking back at last year's 2024 predictions:

	Predicted '24	Actual '24	Predicted '25
GDP Growth	2.2%	2.7%	2.8%
S&P 500 Earnings	$245	$240	$280
Core PCE Inflation	2.8%	2.9%	2.8%
S&P 500 Return	10%	22%	8%
Federal Funds Rate	4.75%	4.5%	4.5%

So where do we stand as we head into 2025? With 40 plus years of investing experience in the markets and my strong professional and personal interest in US and Global politics, this may be the most interesting and possibly challenging period that I can re-call. We have had a Presidential election with Donald Trump as the winner. Some investors believe that who controls Washington matters little overall to the markets. I know that sometimes this proves to be true however the re-election of Donald Trump, his campaign promises, and his history from his first term in office tells me that the next four years will be anything but smooth.

Plotting a course to navigate the next four years will not be simple from an investment standpoint. With the new Trump Administration in the White House, a case can be made for an overall investor friendly environment (i.e., fiscal responsibility, lower taxes, less regulation). On the other hand, some of Trump's other policy proposals, though necessary, are "experimental" such as "DOGE", higher tariffs, and immigration reform. We don't yet know what will pass Congress, the speed of implementation, and the net effects of these policy shifts.

The steady upward climb of the S&P 500 over the last two years may be over. Long-only passive index investors, who have fared extraordinarily well in the market's steady advance from the lower left to the upper right on price charts may face a painful reversal. More volatility with continued select advances in certain market sectors should prevail in this new market environment ahead.

There are increasing concerns about the annual Federal Budget deficit and accumulated Federal Debt, which is 37 trillion and growing rapidly. I believe that Wall Street in general, the "Bond Vigilantes" and the incoming Administration understand the importance of this issue. The 10-year Treasury note yield is **up** 100 Basis Points since the Fed started **lowering** rates on Sept 18, 2024. There are only two reasons why this would occur and they're not good ones. Bond buyers are either concerned about higher inflation or they're concerned about Washingtons ability to pay back their financial obligations or both! Higher rates means that the government needs to spend even more to service the interest on the debt. This interest is already larger than the defense budget and is eating more and more of the available funds to run the nation. This situation can't persist without dire consequences and a debt doom loop.

The new Treasury Secretary and incoming Administration plan to deal head on with this debt and spending problem for the first time since Newt Gingrich and Bill Clinton tackled a similar but lesser problem in the late 90's. Treasury Secretary elect Scott Bessant took the job because he believes in the view, as do I, that time is running out for the US economy to grow its way out of the excessive budget deficits and total indebtedness. Bessant believes that a "Global Economic Reordering" is coming, and he wants the US to be leading the way.

So, there are 2 major factors at play here to get the US indebtedness under control. First, increase GDP growth at least 50% resulting in 3% plus future GDP growth. Faster GDP growth will deliver higher revenues/taxes to Washington allowing for Trump's promised tax cuts. The new Administration will significantly reduce excessive and redundant regulation with the intent to speed up new growth initiatives across the economy. Lower energy prices will also spur GDP growth across all areas of the economy. While some may disagree philosophically with this approach, from an investors standpoint this is "free market capitalism" on steroids and is market friendly.

Second is the spending side. Elon Musk and Vivek Ramaswamy plan to cut annual spending significantly using technology, AI and common sense to reduce and improve how the federal government delivers services to the country. As investors, we believe and invest in the companies that are producing such improvements in the private sector, so why wouldn't we be excited about what could be achieved on the Federal Government level? Enacting tariffs and cutting spending will be a focus along with "maintaining the status of the dollar as the worlds reserve currency" according to Bessant.

The above initiatives are bold and enacting them with narrow majorities in Congress will prove difficult. As investors we need to monitor these policy initiatives and act accordingly as they should prove to be very bullish for US companies, their earnings, and their stock prices. As a nation, we all need to hope that these initiatives prove fruitful as it will benefit everyone especially those who depend upon the government for the big 4 spending categories: Affordable Care Act, Medicaid, Medicare, and Social Security, which together consume over 50% of annual federal spending.

Bessant's other responsibilities include the sale of trillions of dollars of US Government bonds, advising on fiscal policy, handling tax collection, enforcing sanctions, the currency, and more. Like me, Bessant has long been worried about the US's heavy debt and thinks that the main way it can be reduced is by boosting growth, which increases overall tax revenues. Bessant also believes in what's known as "three arrows" which means cutting the budget deficit to 3% of GDP by 2028 from 6% in 2024, grow the economy at 3%, produce an additional 3 million barrels of oil daily.

None of the above will prove easy and January could start the year off with volatility in the bond and stock markets. There are lots of fundamental and technical crosscurrents and a few possible riptides. The Q4 earnings reporting season during January should show a solid increase in S&P 500 operating earnings per share of at least 8.5% and the outlook for earnings in 2025 remains strong. Earnings drive stock prices.

Potential headwinds could include (1) *Portfolio Rebalancing*. Investors have huge capital gains in the Magnificent-7. They might have held off rebalancing their portfolios in 2024 until the start of the new tax year in 2025. Such selling might feed on itself. Individual investors might also rebalance out of stocks and into cash, bonds, and other assets. US households have a record 43.4% of their financial assets in equities.

(2) *Fed fight*. We all know the adage: "Don't fight the Fed." In January, Fed officials might reveal that there's a fight within the Fed about the course of monetary policy. There is lots of disagreement among the participants of the Federal Open Market Committee (FOMC) about the neutral interest rate. The median estimate is 3.0%, but the range is 2.4% to 3.9%. The next meeting of the FOMC will be held January 31. The committee is very unlikely to cut the federal funds rate again at this meeting.

(3) *Trump 2.0*. Donald Trump will be inaugurated on Monday, January 20. He will undoubtedly quickly issue several executives orders (EOs) regarding raising tariffs, deporting illegal immigrants, and reducing regulations. The EOs are likely to be mostly controversial, creating lots of uncertainty about their economic impact.
(4) *Bond Vigilantes*. As discussed above the 10-year Treasury bond yield is rising. Generally, markets prefer lower yields. The yield might revisit last year's record high of 5.00% if the Bond Vigilantes fret that Trump 2.0 might not do much to reduce the deficit and could increase inflation due to faster GDP growth.
(5) *Geopolitics*. Israel has spent the last few months of 2024 crushing Iran's proxies in the Middle East, the Houthi's, Hezbollah, and Hamas, as well as taking out Iran's air defense systems. According to some defense analysts, "Iran is essentially naked." A successful attack by Israel on Iran's nuclear or oil facilities early next year would probably be greeted favorably by financial markets. Russia keeps testing NATO in Ukraine and the North Sea by cutting communication and energy infrastructure lines. Syria's dictatorship has fallen.
Where am I optimistic and see opportunities in 2025 and beyond?

- US Markets – equity and bond.
- Higher rates are giving us opportunities to re-establish positions in the bond market.
- Strong consumer purchasing power thanks to continued strong GDP growth, job creation, and wage growth.
- Record Household net worth. Total American household net worth stands at a record-high 169 trillion.
- Onshoring with increased factory construction, jobs and foreign direct investment coming into the US.
- Strong corporate earnings and cash flows enhancing investments and shareholder returns via dividend increases and stock buybacks.
- Productivity enhancement because of AI and its growing dominance in the technology space by US firms. We seem to have entered a new era of technological advancement and productivity growth resulting in a new technology productivity boom mostly dominated by US corporations.
- Record US energy production. Record liquified natural gas and oil exports to our allies overseas.
- A nuclear power renaissance and re-building the US power grid.
- The Utility Industry will benefit from increased energy demand and infrastructure buildout.
- American exceptionalism and dollar dominance should prevail. Economically the world is not doing well outside the US. Europe and China are stagnating. Russia and Iran's economies are crumbling.
- Gold as an inflation hedge

Overall, I continue to favor high-quality, large-cap, dividend paying, 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 favors equities over fixed income. T-Bills, select REIT's,

MLP's, and specialized bond/income funds look good as income producers. I believe that our portfolios are well positioned to produce consistently attractive long-term risk adjusted returns while preserving capital. I will remain vigilant, assume little, and continue to follow the investment guidelines 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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