HUGHES | FINANCIAL SERVICES, LLC

3RD QUARTER | 2018

Economic update

RUNNING WITH THE BULLS

U.S. Stocks Reach One of Longest Runs in Modern Market History

For the third quarter of 2018, the bull market seemed unstoppable. Regardless of the quarter's concerning short-term events, investors quickly looked beyond those risks and pushed stock prices higher. Back in February of this year, the markets dipped roughly 10% because of concerns, but this quarter was strong and many major equity indexes moved to all-time highs.

The Dow Jones Industrial Average set an all-time high in September, ending the quarter with an increase of over 9%. The S&P 500 index also reached an all-time high in September and finished the quarter with a gain of over 7%.

After recovering from the correction seen in February and March as well as experiencing a period that included major fears of a trade war, the S&P 500 posted a six-month winning streak between April and September. This is the sixth time since 1928 that such a streak took place between April and September, according to Bespoke Investment Group. Robust economic growth and strong corporate earnings have contributed to these new highs in the indexes. Equity markets have offset concerns of tighter U.S. monetary policy and fears of a global trade war. This current six-month winning streak within the annual calendar is the 27th overall dating to 1928!

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From Wall Street to Main Street

WHAT'S HAPPENED? WHAT'S NEXT? A MARKET REVIEW FOR INVESTORS

A HFS EDUCATIONAL LUNCH AND LEARN WORKSHOP

WEDNESDAY, NOVEMBER 7TH, 11:45 AM - 1:00 PM

Maggiano's Tysons Galleria | 2001 International Drive, McLean

Register at (703) 669-3660 or at www.h4fs.com/events.htm

You're invited to bring friends or family members as your guests

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Please join Hughes Financial Services for an educational review of:

- How the changing global economic, political and cultural arenas shaping the markets today can impact your financial strategy
- Challenges and opportunities you should plan for in 2019
- Which Tax Cuts & Jobs Act laws may affect your tax planning for next year
- Investment strategies to use for growth and income
- How the midterm elections may impact your investment results

WORKSHOP SPEAKERS

Paul Hughes, ChFEBCsm ▪ Scott Hughes, CFP®, MBA ▪ Patrick Hughes, CFP®

Although equities are high and much of the economic data for the quarter seems reasonable, investors should be cautious. On September 28th, the Department of Commerce reported that U.S. consumer spending increased steadily in August at 0.3%, in line with the consensus estimate. Personal income rose 0.3% in August, narrowly missing the consensus estimate of 0.4%. The average wage rate increased by 0.5% in August, the fastest pace since January, leading wage growth to its highest level since 2009. Retail sales also showed growth of over 7% year-on-year, and the Personal Consumption Expenditure (PCE) index grew 0.2% in August. Thanks to that result, the 12-month increase in PCE index is now 2.2%. The core PCE index (excluding food and energy) is the Fed's preferred gauge of inflation measure and it remained steady at 2%, which is a number they like.

In September, U.S. consumer confidence hit its highest level since 2000. The National Unemployment Rate stood at 3.9% through August 2018 and, according to the Bureau of Labor Statistics, approximately 201,000 jobs were created in August. Currently, the monthly average of initial jobless claims is at its lowest level since 1969. A National Federation of Independent Business survey showed that small businesses were the most optimistic they've been since the survey began in 1974. Against this remarkably strong growth backdrop, it's not surprising that U.S. equities have delivered attractive returns.

Our main goal, as always, is to continually understand our client's goals and to match those goals with the best financial planning solutions

Zach's Research reported that equity markets were fueled by a robust performance by U.S. corporations in the second quarter of 2018. Impressive fundamentals of the U.S. economy, a strong labor market, and the government's deregulation measures have enabled equity markets to advance, even with trade-related concerns, geopolitical conflicts and inflationary expectations.

The Federal Reserve's interest-rate hike in late September was the 8th increase since the end of 2015. Over nearly three years, the fed-funds rate has risen from 0.25% to its current range of 2.00% - 2.25%. During this same timeframe, the 10-year Treasury yield has more than doubled to over 3%.

From a broad perspective, the bull market that began in 2009 is now approaching 10 years (the second longest bull market ever). This year, investors have seen a correction, but market historians maintain that age does not kill a bull market. Today, equities are not cheap and even the savviest of investors need to have a watchful eye on risk. As financial professionals, we try to make our best forecasts and look for a probability of success understanding that we face an uncertain future. Remember, short-term interest rates have risen, and cash equivalent yields are still historically low.

MONEY RATES
(as posted in Barron's 10/1/2018)

	LATEST WEEK	YR AGO
Fed Funds Rate (Avg. weekly auction -c)	1.92%	1.16%
Bank Money Market -z	0.20%	0.12%
12-month Cert -z	0.76%	0.40%

c- Annualized yields, adjusted for constant maturity, reported by the Fed Reserve on a weekly average basis. z – Bankrate.com (Source: Barron's; bankrate.com)

IN THE SPOTLIGHT: INTEREST RATES

In late September, the Federal Reserve raised interest rates for the third time this year and signaled it will raise rates again in December.

After the end of their September two-day meeting, the Fed increased its target for its benchmark lending rate to a range of 2% to 2.25%. The Fed had kept the Federal Funds rate near zero from late 2008 until December 2015. Rates are now at their highest level since the fall of 2008.

At the end of their deliberations, senior Fed officials dropped long-standing language saying its stance on interest rates "remains accommodative." The unexpected removal of this language would appear to give the Fed more flexibility on how rapidly it may plan to raise interest rates next year.

"This rate hike is no surprise, but the removal of the signal that policy is still accommodative will raise a few eyebrows," said James McCann, Senior Global Economist at Aberdeen Standard Investments.

The Fed's primary goal is to nudge up short-term interest rates to what it considers a "neutral" level that would neither support nor restrict economic growth.

As reported in *MarketWatch.com*, "The United States economy is currently running hot: gross domestic product expanded at a robust 4.2% pace in the second quarter, core inflation is near the Fed's 2% target, and an ever-tightening labor market is forcing firms to boost pay and benefits."

Based on that economic backdrop, the Fed is prepared to raise rates again before the end of the year. Their meeting notes showed that 12 officials now expect another quarter-point rate hike in December, up from eight officials in their June projections. Only four officials now pencil in a pause.

The Fed continues to project three rate increases next year and one more in 2020. This would bring rates into what is considered restrictive territory — more than enough to slow the economy.

As such, the bond market has been behaving as if more rate hikes are coming. Recently, the yield on 10-year Treasury notes have risen slowly but steadily.

The Fed also released a new economic forecast that showed the unemployment rate would rise in 2021 as the bite of its restrictive policy starts to be felt. In their forecast, economic growth will gradually decline over the next three years from this year's 3.1% annual rate to a 1.8% rate in 2020 and 2021.

Impact of Rising Interest Rates on the Private Sector

Rising mortgage rates and higher payments reduce home affordability and hurt home turnover and re-financings

Slowing home sales and reduced re-financings hurt spending on renovations and remodeling

Given record-high auto prices and the difficulty in further lengthening out already long auto loan maturities, rising interest rates will hurt auto sales by raising monthly payments

Consumer, mortgage and corporate loans that are variable rated are hurt by climbing interest rates

Credit markets fall when interest rates rise, having a negative wealth effect on consumers/corporations that own bonds

Corporate capital spending depends partially on borrowings; higher borrowing costs could lead to lower capital spending

Rising interest rates impede corporate profit margins, overall profits and earnings per share

Debt is often issued by corporations to buy back stock and pay dividends; advancing rates reduce a company's return on investment on those buybacks

For now, higher short-term interest rates seem likely, so investors still need to keep a watchful eye on the interest rate environment.

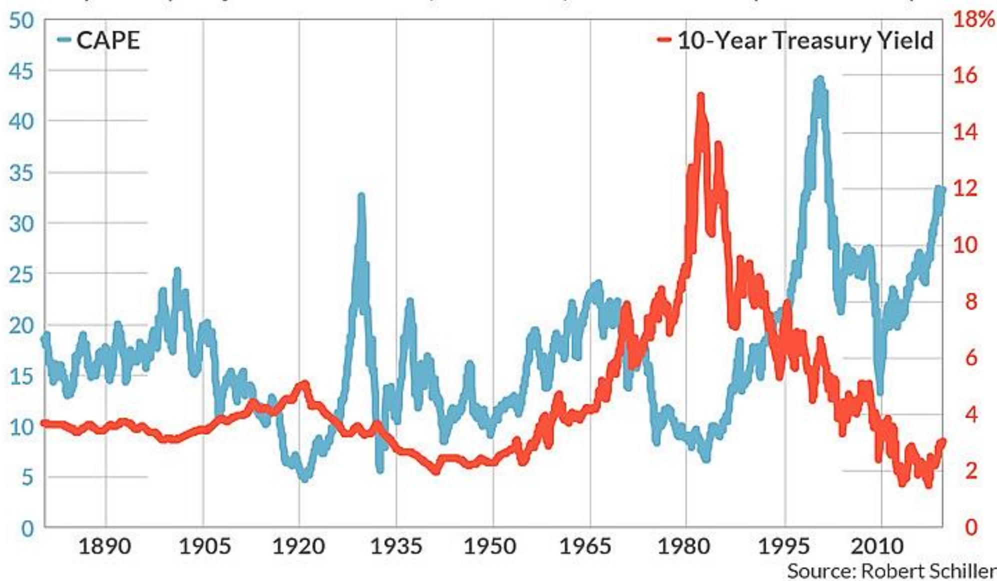
INTEREST RATES & P/E RATIOS

According to some analysts and advisers, higher than historical Price Earnings (P/E) ratios were once justified by low interest rates. When the Federal Reserve began its current round of rate hikes back in December 2015, the P/E ratio stood at 16 (according to FactSet, when calculated on earnings estimates over the subsequent 12 months). Today, the comparable P/E stands at 17.5.

On September 25th, Nobel Prize winner and legendary Yale Professor Robert Shiller stated on CNBC that, “earnings are volatile.” He also cautioned that a bear market could come without warning. "The market could go up for years. I'm not very able to predict turning points. I do think it’s risky now. This is a risky time, especially investing in the U.S. – the most expensive country in the world.”

Should P/E ratios fall when interest rates rise?

The Cyclically-Adjusted P/E Ratio (Schiller PE) versus the 10-year Treasury



An interesting conundrum for investors is: if low interest rates justified higher P/E ratios, as the bulls have argued for much of the last decade, consistency would require them to argue that with interest rates rising, P/Es should now be lower. A landmark finding in an older issue of the Journal of Portfolio Management states the “obvious” conclusion to draw is that “when P/Es are high (low), forecasted 10+ year real stock returns are low (high), regardless of starting interest rates.”

As interest rates continue to move, we will need to carefully watch the response of corporate earnings.

HIGHLIGHTS

- 2018 equity markets reached new highs
- Bull market is almost 10 years old
- Fed raised rates to 2.0 – 2.25% in September, with one more hike projected for 2018
- Based on historic Price/Earnings (P/E) ratios, equities look expensive
- Market volatility is back, and investors need to continue to be cautious and watchful but not emotional
- Focus on your personal goals and always call us with any concerns

Note: The views stated in this report are not necessarily the opinion of Hughes Financial Services, LLC, and should not be construed, directly or indirectly, as an offer to buy or sell any securities mentioned herein. Investors should be aware that there are risks inherent in all investments, such as fluctuations in investment principal. With any investment vehicle, past performance is not a guarantee of future results. Material discussed herewith is meant for general illustration and/or informational purposes only, please note that individual situations can vary. Therefore, the information should be relied upon when coordinated with individual professional advice. This material contains forward-looking statements and projections. There are no guarantees that these results will be achieved. All indices referenced are unmanaged and cannot be invested into directly. Unmanaged index returns do not reflect fees, expenses, or sales charges. Index performance is not indicative of the performance of any investment. The S&P 500 is an unmanaged index of 500 widely held stocks that is general considered representative of the U.S. Stock market. Dow Jones Industrial Average (DJIA), commonly known as “The Dow” is an index representing 30 stocks of companies maintained and reviewed by the editors of the Wall Street Journal. NASDAQ composite is an unmanaged index of securities traded on the NASDAQ system. Past performance is no guarantee of future results. Due to volatility within the markets mentioned, opinions are subject to change without notice. Information is based on sources believed to be reliable; however, their accuracy or completeness cannot be guaranteed. **Sources:** Barron’s; FactSet; JP Morgan (10/1/2018); Nerdwallet.com (9/28/2018); NASDAQ.com (10/1/2018); CNBC.com (10/2018); The Wall Street Journal; Academy of Preferred Financial Advisors, Inc.©2018

&TARIFFS TRADE WARS

A big and obvious near-term risk to the global economy is the potential for a further escalation in trade tariffs emanating from the U.S. and the subsequent retaliation from other countries.

As of the quarter's end, the U.S. is imposing tariffs on about $250 billion of imports from China, and China has retaliated with tariffs on about $110 billion of U.S. exports to China. The current tariff rate on all of China's exports to the U.S. is scheduled to increase in January if a deal cannot be reached.

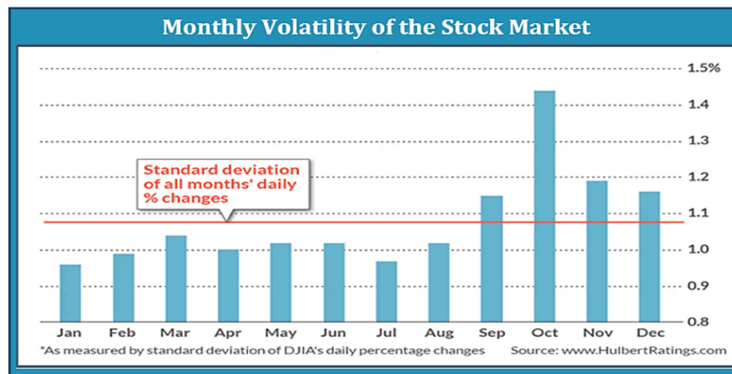
Trade negotiations also had good news this quarter. A new deal to replace the North American Free Trade Agreement (NAFTA) was signed by the U.S., Mexico and Canada.

Tariffs and trade issues could affect equities, so we will continue to monitor them.

A MIXED YEAR-END OUTLOOK

The mere mention of October is sometimes enough to frighten some investors. Newer investors may wonder, "What's the big deal?" It all comes down to perspective. Five of the stock market's worst 10 days ever in its history happened in October, including 1987's more than 20% single day drop. Overall, October is an average month for the market, but one with a higher incidence of volatility. Market volatility is typical in the investment world and experienced investors understand that while volatility is sometimes a sign of heightened risk, it most likely is a normal part of investing. They also understand that more important than the volatility is an investor's response to that volatility. Market volatility is possibly one of the most misunderstood concepts in investing. Simply put, market volatility is a statistical measure of when the equity markets rise or fall sharper than usual within a short period of time.

In their *Market Review and Outlook for September 2018*, NASDAQ.com sites that despite, "warning signs, the economic and corporate outlook in the U.S. remains constructive and equities are in a bull market. The fiscal stimulus, deregulation, and generational tax reform are fueling the U.S. economy and driving global outperformance. Concerns exist with persistent Fed tightening, a flat curve, a strengthening dollar, trade with China, and an overseas slowdown which may come home to roost at some time, but for now the U.S. is performing and consumers are spending." In their report they suggest that, "Advice from a securities professional is strongly advised."



According to market analysts, the outlook for year-end remains mixed. Some professionals on Wall Street forecast the S&P 500 will end the year slightly higher than its current level — up 1.7% to be precise, according to the average forecast of strategists surveyed by CNBC. On the flip side, among other prognosticators who are very concerned, there's near-daily talk of an imminent market crash.

As our graph of volatility shows, since the Dow Jones Industrial Average was first created in 1896, the market's volatility is higher in October than in other months (this is true even if 1987 and 2008 were excluded). This quarter may bring a volatile investment environment, so we thought it would help to continue our theme of sharing strategies to think about during volatile times.

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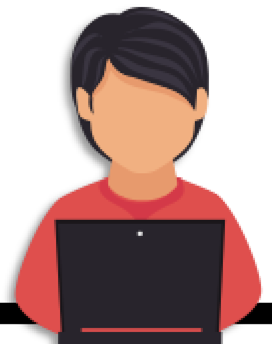

THINGS TO CONSIDER DURING TIMES OF MARKET VOLATILITY

Revisit your financial goals and objectives

Investors should always put their primary focus on their own personal goals and objectives. When equity markets become volatile sometimes even the best investors become not just concerned, but unnerved. It's important to keep perspective when markets are on the volatility roller coaster. It is very important that you understand your situation and your financial plan. Letting your emotions drive your decisions can be costly and work against your financial plan. Here are strategies that money management professionals consider when making decisions:

- Always allocate your investments to match your risk tolerance
- If possible, add money to your investments regularly and try to increase your additions during downfalls.
- It's nearly impossible to time the market right (sell when you think the markets at its peak), so have a strategy
- Accept that volatility is inherent to investing, but not something to stress about for long-term investors
- Consider avoiding or ignoring nightly financial news
- Always try not to make any emotional decisions
- *If you are concerned with your investments or goals, you've experienced a change in life circumstance, or your risk tolerance levels have changed, call us before making any decisions*

While CDs and money market funds offer the highest level of safety, they still are offering low returns. Today's traditional fixed rates might not help many investors achieve their desired financial goals, yet exposing yourself to full market risk is not appropriate for most investors either. A plan built on including risk awareness can often lead to safer but lower returns. Traditionally, bonds have been used as a hedge against market risk, but with interest rates projected to rise, investors should be extremely cautious.

Focus on your goals and strategies

During confusing times, it's always wise to have realistic time horizons and return expectations for your own personal situation and to adjust your investments accordingly.

Check your comfort levels

Equity markets will continue to move up and down. Even if your time horizons are long, you could see short-term downward movements in your portfolios. Each type of investment poses a certain level of risk and offers a level of potential reward. It's always a good idea to regularly re-evaluate your portfolio and your level of risk exposure. Peaks and valleys have always been a part of financial markets and it's highly likely that trend will continue.

Discuss any concerns with us

Our advice is not one-size-fits-all. We will always consider your feelings about risk and the markets and review your unique financial situation when making recommendations. If you would like to revisit your specific holdings or risk tolerance, please call our office or bring it up at our next scheduled meeting.

RISING OIL & GAS PRICES!

U.S. Energy Information Administration pricing data shows just how wide the swings can be:

October 1, 2018: $2.87 / gallon -- An increase of almost 40 ¢ from a year ago

21st CENTURY HIGHS AND LOWS

July 7, 2008: $4.16 / gallon
December 12, 2001: $1.10 / gallon

Prices based on U.S. averages including taxes

HUGHES FINANCIAL SERVICES, LLC

A good financial adviser should help make your financial planning journey easier. Our goal at HFS is to understand your specific goals and dreams and then offer direction and strategies to help get you there. While we cannot control financial markets or interest rates, we do keep a watchful eye on economic, tax and investment issues, continually monitoring your portfolio, and consistently communicating with you in a way that's simple, streamlined and easy to understand. One of our primary objectives is to take the emotions out of investing for clients. We can discuss your specific situation at your next review meeting or you can call to schedule an appointment anytime.

As always, we appreciate the opportunity to work with you in addressing your financial matters.

Hughes Financial Services, LLC, is an independent Registered Investment Adviser (RIA) working closely with individuals and families to provide direction and strategies on how to financially achieve their specific goals and dreams.

We are a fee-based firm that seeks to adhere to the highest fiduciary standards and provide clients with advice that is truly unbiased and has only our clients' best interests in mind.

We offer our clients a wealth of comprehensive financial planning expertise in the following areas:

- retirement planning
- estate planning
- investment management
- risk management
- insurance
- education planning

The financial advisers at Hughes Financial Services hold a variety of professional designations and certifications and are well-versed in a number of financial disciplines. We proudly specialize in helping employees and retirees of local government and school systems with their retirement options. Our combined education and experience allows us to offer you independent financial advice and solutions that we are proud to provide for you.

Hughes Financial Services, LLC, is located in Herndon, Virginia (Fairfax County).

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