

December 2016

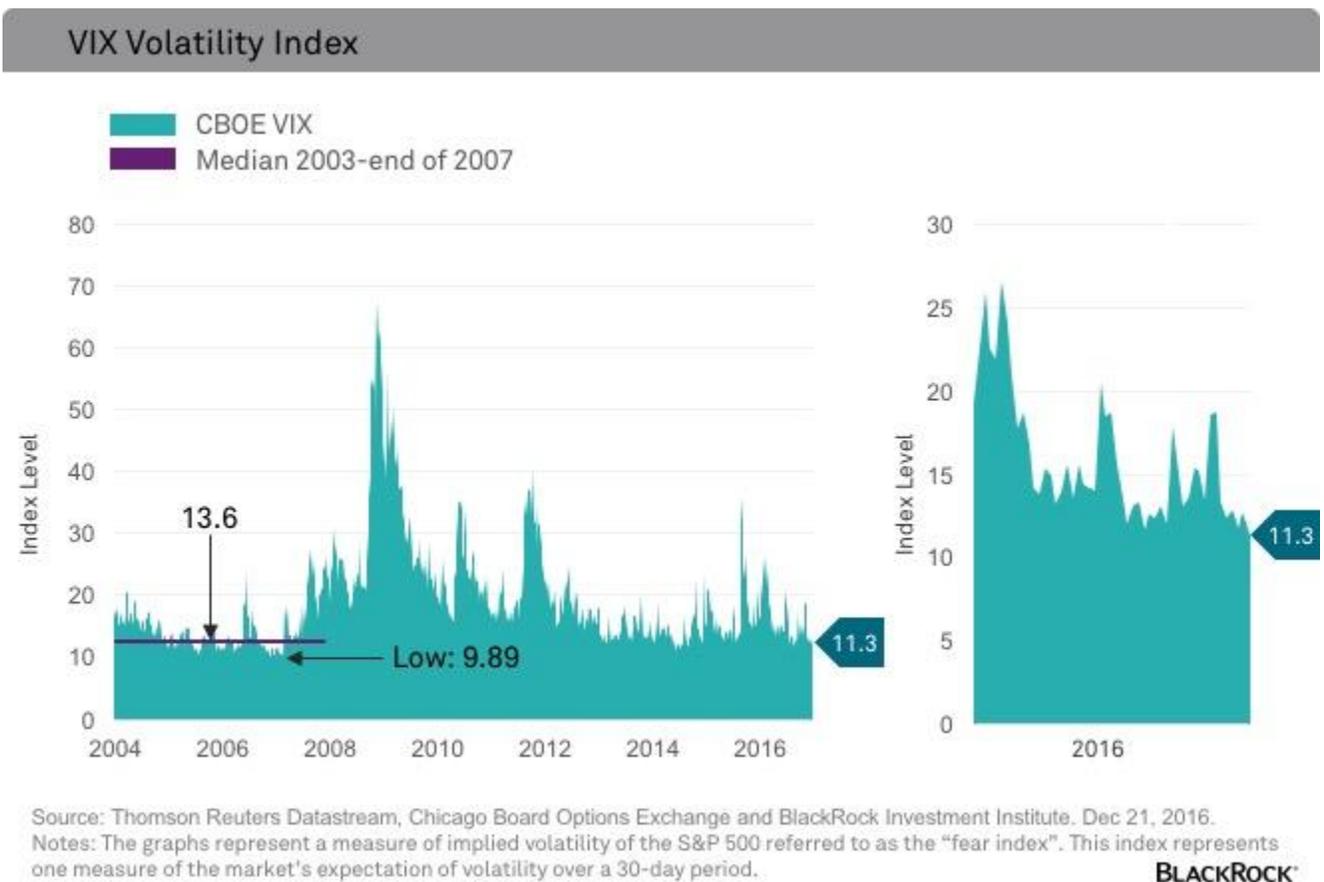
As discounted by the markets, the Fed raised the funds rate on the 14th by .25%. However, it also increased 2017's projected hikes to 3 from the 2 they were anticipating in September, which was more hawkish than the markets expected. The Trump rally faded toward the end of the month, with SentimenTrader's Medium-Term Risk Level ending the month at 6, down from 7 (on a scale of 0, lowest, to 10, highest). Both of their composite sentiment indicators continue to show excessive optimism.

Why stock market tranquility is unlikely to last

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Ideally, the holidays should be calm. Thankfully the market is obliging. Equity market volatility, as measured by the VIX Index, recently dipped below 12, close to multiyear lows. We've seen this pattern repeatedly over the past 10 years and it rarely ends well.



We've been here before, most recently last summer. In late August I described the unusually low level of volatility. By early September the VIX Index had spiked roughly 70% compared to the August low. It repeated the pattern again around the U.S. election in November (see the chart above). We may be setting up for a similar pattern in early '17. Here are three reasons volatility is unlikely to remain this low too far into 2017.

1. Equity investors are alone in their torpor.

While the VIX and other measures of equity market volatility are flirting with historic lows, volatility in other asset classes remains elevated relative to the summer levels. Currency volatility, as measured by the CVIX, remains about 20% above the fall lows. U.S. bond market volatility, measured by the MOVE Index, is off the November high but stays 30% above the October bottom. Only equity market investors are convinced that volatility will remain low in the near term.

2. Political Risk is elevated but not reflected.

Many factors, from credit market conditions to economic expectations, drive volatility. Not all are market related. Historically, equity market volatility has been correlated with general political and policy uncertainty. Using the Economic Policy Uncertainty Index as a proxy, since the mid-90s policy uncertainty has explained roughly 25% of the variation in the VIX Index. While the U.S. election is finally over, there is significant uncertainty as to the future direction of policy. The timing and form of corporate and individual tax reform, deregulation and trade policy remain in an indeterminate state. This should be adding to, not subtracting from, volatility.

3. The market is losing its safety blanket.

While prone to episodic spikes, volatility on average has been muted for some time. This is partly a function of very benign monetary conditions and a child-like faith in the ability of central banks to provide a backstop in the event of any selloff. Unfortunately, central banks are fast approaching the limits of unconventional monetary policy. While conditions in Japan and Europe are likely to remain ultra-accommodative, the Federal Reserve (Fed) has resumed its tightening cycle, a trend likely to accelerate next year. Adding to the tightening of financial conditions, the U.S. dollar has advanced roughly 10% from its August lows.

In the near term, momentum and positive seasonality will probably be enough to carry the market. But as the calendar turns, things may change. The market has many things going for it in 2017: optimism for faster growth, a more secure financial sector and the potential for corporate tax reform. Complacency, however, is not on the list.

ECPG - Held by clients focused on Capital Appreciation, we harvested the losses on 12/28 at 28.60. ECPG, a debt collector, reported a negative Earnings Surprise of 88.6% on 11/9, yet the stock was up 34.6% on Trump's election. One analyst left their estimate unchanged, while 6 lowered for the quarter ending 12/16. For the quarter ending 3/17, 1 held and 4 lowered their Earnings Estimates. One of 8 analysts lowered their recommendation to a Hold, while 1 raised, 2 held and 4 lowered their Target Price.



EPD for **KMI** (green line) in taxable accounts. EPD, rated 4* by Morningstar, is the country's largest pipeline MLP, yields 5.9% and has heavy Insider Buying, while the 3* rated KMI, a former MLP, yields 2.4%.



Insider Buying:

02/12/2016	2	MCAHEN CHARLES E, B...	15,000	20.6000
02/11/2016	1	MONTGOMERY WILLIAM C	10,000	19.7900

From Capitalist Times' December 23, 2016 issue:

Enterprise Products Partners LP (NYSE: EPD) is a classic 5-plus-5 stock that yields more than 5 percent (6.2 percent) and grows its payout by at least 5 percent annually (5.2 percent over the trailing 12 months).

As a master limited partnership (MLP), Enterprise Products Partners' quarterly payout is partially tax advantaged. The pipeline owner has been a model of consistency, increasing its payout for the 49th consecutive quarter in October. The fuel for such reliable growth is a portfolio of top-line midstream assets that operate under fee-based contracts with America's strongest energy companies.

That's the legacy of management's decision to focus on quality control during the boom times, rather than pursue growth for growth's sake. Enterprise Products Partners has \$5.6 billion worth of high-quality projects under construction that will drive future cash flow growth.

The stock has generated a total return of less than 8 percent this year, despite constituting almost 19 percent of the Alerian MLP Index. This underperformance reflects a rotation into riskier assets in the energy sector, not a deterioration in the stock's underlying growth prospects.

Trading at an attractive valuation, Enterprise Products Partners LP joins the Lifelong Income Portfolio's conservative sleeve as a buy up to \$28 per unit. The MLP should continue to grow its distribution at a steady clip, and the stock should hold its value reasonably well if the macro environment weakens.

MNK was down 9.1% on 11/29's Earnings release. While it was a 3.6% positive Surprise, the company lowered guidance. As a result, 4 analysts raised, 1 held and 11 lowered their Estimates for the quarter ending 12/16, while 4 raised and 12 lowered for 3/17. One analyst raised, 4 held and 7 lowered their Target Price. All positions, which were held in Capital Appreciation accounts, were sold on 12/21 for 53.03.



RAS - Harvested the losses for all accounts at 3.33 on 12/21. On that date 1 analyst rated RAS a Buy, while 3 rated it a Hold. Their average Target Price was 2.92, 12% below its current price.

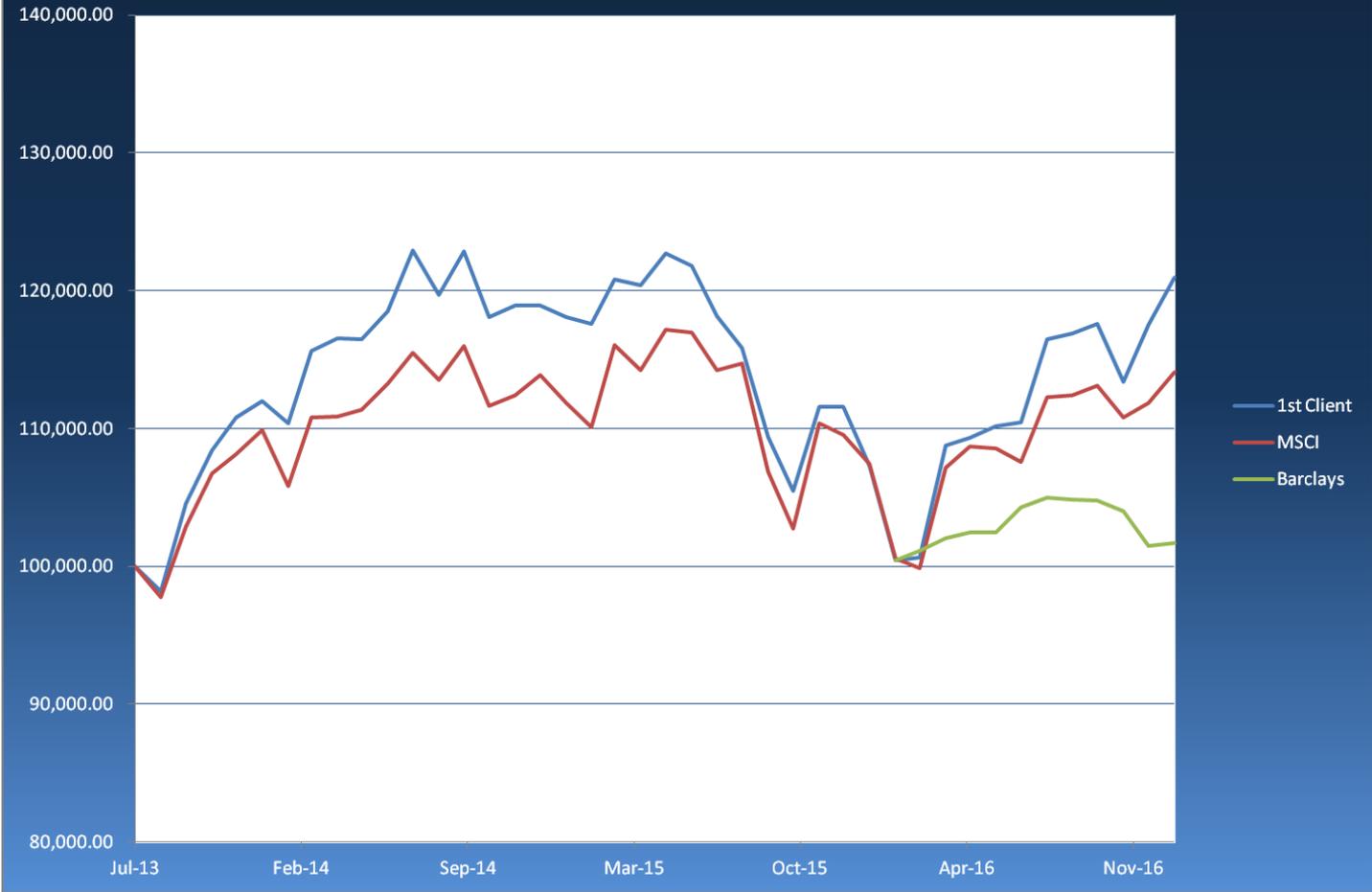


HCM's 1st Client

Hughes Capital Management's first client, whose objective was initially Capital Appreciation, came on board 7/31/13. She was +3.0% for December 2016 vs. 2.0% for our benchmark, the Morgan Stanley Capital International All Country World Index All Cap (MSCI ACWI AC). She began the transition to Capital Preservation/Income on 2/1/16, so Barclays U.S. Aggregate Bond Index is provided from that date. The graph below shows how her HCM portfolio (+21.0%) has performed vs. benchmark (+14.1% MSCI, +1.2% Barclays).

Her account was initially invested in 3 Open-End Funds (DDDIX, GPIIX, TFSSX), a Closed-End Fund (BGR), and an Exchange Traded Fund (NFO). Quest Opportunity Fund's early investment in and relationship with Grandeur Peak and the 13D Activist Fund made it possible for us to get her into GPIIX, which was soft closed at the time and is now hard closed (although we have been granted a waiver), and DDDIX, the institutional shares of the 13D Activist Fund, with its lower management fee and no load, without their \$1,000,000.00 minimum investment. With the proliferation of Smart Beta Funds over the last several years, the roster of Funds we are currently using has changed. As opportunities for investment in individual stocks trading in the US arose, the positions in Transitional Funds (BGR, NFO, TFSSX) were reduced and eventually eliminated. This is part of the reason we emphasize at least a 5 year commitment.

Hughes Capital Management



Past performance is no guarantee of future results