

Hughes Investment Advisory Service LLC

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Dear Clients and Investors,

Happy New Year to everyone!

In the fourth quarter asset classes were mixed. Here is how major asset classes did for the full year 2025:

AOM - S&P Target Risk Moderate Index (Stock/Bond mix):	+ 10.1%
IVV - S&P 500 Equity Index:	+ 17%
RSP - S&P 500 Equal Market Cap Weight Index:	+ 17%
EFA - Europe, Australasian and Far Eastern Equity markets:	+ 31%
AGG - I-Shares US Investment Grade Bond Index:	+ 7%
GLD - Gold:	+ 64%
FBTC - Fidelity Bitcoin Index ETF:	- 7%

Looking back at last year's 2025 predictions and what I expect in 2026:

	Predicted '25	Actual '25	Predicted '26
GDP Growth	2.7%	2.9%	3.5%
S&P 500 Earnings	\$245	\$268	\$310
Core PCE Inflation	2.8%	2.8%	3.2%
S&P 500 Return	10%	17%	12%
Federal Funds Rate	4.75%	3.5%	2.5%

So where do we stand as we head into 2026? As I wrote one year ago 2025 was, and I expect 2026 to be, one of the more interesting and challenging periods in my 40 plus years of investing and managing assets. The Trump Presidency has been a whirlwind of action, on all fronts, economically and Geo-politically with the Maduro arrest several days ago being just the most recent example. As I said 12 months ago – unlike common belief - the Trump Administration is an anomaly and represents change like we haven't seen in a very long time. Anticipating this change has been and remains the most important job for me as we begin the new year. Staying focused on key economic metrics especially corporate earnings, interest rates and inflation while evaluating new executive orders, legislation and geo-political developments will shape 2026 as it did in 2025. As always, it remains

important to have an investment plan while staying flexible to potential Black-Swan and mini-Black Swan events that could occur. What is a Black Swan event? A Black-Swan event is a rare, unpredictable event with major impact that is retrospectively explainable but not foreseeable.

Let's attempt to tie all this together! Trump's policies are truly an America first approach. What does this mean as it pertains to investing? We are seeing military power being used in a way that it hasn't been in decades. We are seeing the US Government utilize a form of State Capitalism similar in some ways to what China, Russia and other non-democratic countries have been doing the last 25 years. China being the prime example via their Belt and Road initiatives and pure state-run companies. As a true believer in Free Market capitalism, this is difficult for me to swallow and accept as a necessary tool. One year into this Administration and having watched what China has done the last 25 years I can't argue that some form of State Capitalism is in fact necessary to strengthen our position versus China and Russia in particular. AI, energy, semiconductor chips and rare earth minerals being the more prominent examples.

State capitalism – The government takes ownership stakes, provides capital, and uses policy tools to guide private companies toward strategic national goals (e.g., industrial policy, technology leadership, energy security). For example, the US Gov't new equity stakes in Intel (semi-conductors) and MP Materials (Rare Earths)

After 25 years of offshoring US manufacturing to China and other emerging economies it is now common knowledge and a bi-partisan belief that the US must re-shore many of these industries that went offshore. This re-shoring is critically important for many reasons however I will focus on the investment implications.

Off-Shoring kept inflation low. Prices dropped for every product that was offshored. Re-shoring will have the opposite effect – prices will rise faster than the Fed's 2% target. My belief is closer to +3%. This doesn't mean that all prices will rise across the board but there will be this underlying inflation pressure on most re-shored goods and contributing to an overall inflation rate that is well above the 2% target.

AI, lower energy prices and overall improvements in productivity will help defray the above-mentioned inflation pressures. I will be watching this push-pull and continue to focus on companies that benefit from these developments. Some industries will suffer while others prosper.

Why is the inflation number so critically important? Normally, the Federal Reserve would hold or raise interest rates under the current circumstances. However, due to the enormous US debt, which is +/- \$40 trillion, interest costs are equaling 25% of the annual budget expenditures, which is \$1 trillion annually. There's only one policy answer available to address this problem which I have written about here throughout 2025 - ***Financial Repression***.

What is financial repression? Where the Federal Reserve and Executive branch work together to artificially hold short term rates lower than the inflation rate would normally dictate. The Administration has not used these words, financial repression, however their actions and President Trump's open attempts at persuading the Federal Reserve to lower interest rates has not gone unnoticed. I expect lower short-term rates to become policy once a new Chairman is nominated to replace current Chair Jerome Powell.

I have not personally been through a period of financial repression but studying history we can easily see that financial repression is precisely what occurred after WW2 when the Federal debt situation was similarly problematic. So artificially low short-term rates (to control interest costs on short term bills), higher inflation, stronger GDP growth and associated increased Federal tax revenues is the current plan based on comments made by Treasury Secretary Bessent and other members of the current White House economic team. All of this has implications for the dollar as well, which I expect to be weaker generally in 2026, and commodity prices which I expect to be stronger as the US economy goes from the old financial focused regime to the new manufacturing regime. All of these could and should reduce the \$40T in debt and associated interest expense. A disruption to any of these could be the Black Swan or Mini Black Swan events to be watching for in 2026.

To review: Some features of Financial Repression are:

- Caps on short term interest rates - to keep gov't borrowing costs low.
- Capital controls - limits on moving money across borders.
- Forced lending - banks may be required to hold gov't bonds via stable coins perhaps.

Heavy Regulation - of banks and financial institutions.
Inflation – which erodes the real value of the 40Trillion in current debt.

Why use Financial Repression?

It makes it easier for the government to repay high levels of debt.
It can stimulate economic growth by keeping borrowing cheap.
It's an alternative to more painful measures like raising taxes and cutting spending.

Reasons for optimism in Q1 and 2026 include:

Progress on Treasury Secretary Bessant's "three arrows" plan 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. Already GDP growth has approached or reached 3%. The expected budget deficit to GDP for 2025 has gone from 6% to 5.8% and is expected to track at 5.5% in FY 2026 – progress but not nearly enough to get to 3%. Lastly, domestic oil production remains stable but is not increasing anywhere close to what's necessary to reach a 3 million increase a day. My research shows that US shale oil production has peaked and any increase may need to come from regional suppliers like Canada, Mexico and maybe Venezuela.

Other positives include record high S&P 500 profits, lower short-term interest rates, lower corporate and personal income taxes, streamlined and less regulation for business regulation and development especially in AI Data centers, energy production/infrastructure. Lower energy prices and less tariff confusion.

What asset classes do well under this scenario? Equities! Companies whose profits outpace inflation and benefit from cheap borrowing costs, hard assets, commodities and potentially real estate.

- US and Foreign equities.
- Strong corporate earnings and cash flows enhancing investments and shareholder returns via dividend increases and stock buybacks.
- Onshoring with increased factory construction, jobs, and foreign direct investment coming into the US.
- Productivity enhancement because of AI and its growing dominance in the technology space by US firms.
- Record US energy production.

- Record liquified natural gas and oil exports to our allies overseas.
- A nuclear and gas power renaissance plus re-building the US power grid.
- The Utility Industry will benefit from increased energy demand and infrastructure buildout.
- Gold and other hard assets.
- US Defense firms.
- Pharma and medical technology.

Overall, we 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 strongly 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. We will remain vigilant, assume little, and continue to follow the investment guidelines that we know, through experience, work in the medium to long-term. Producing consistent returns with less risk than the typical 60/40 portfolio. Please do not hesitate to give me a call to discuss the above analysis.

Sincerely,
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